IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re: COSI, INC., *et al.*,[1] Debtors.	Chapter 11 Case No. 20-10417 (BLS) Jointly Administered
COSI, INC., *et al.*, Plaintiffs, v. THE U.S. SMALL BUSINESS ADMINISTRATION, AND JOVITA CORRANZA, AS ADMINISTRATOR OF THE U.S. SMALL BUSINESS ADMINISTRATION, Defendants.	Adv. Proceeding No. 20-50591 (BLS)

DEBTORS' BRIEF IN SUPPORT OF MOTION FOR TEMPORARY RESTRAINING ORDER AND/OR PRELIMINARY INJUNCTION

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[1] The Debtors in these Chapter 11 Cases are the following entities (the last four digits of each Debtor's respective federal tax identification number, if any, follow in parentheses): Cosi, Inc. (3745); Xando Cosi Maryland, Inc. (2196); Cosi Sandwich Bar, Inc. (0910); Hearthstone Associates, LLC (6267); Hearthstone Partners, LLC (9433); Cosi Franchise Holdings LLC (6984); and Cosi Restaurant Holdings LLC (3461). The Debtors' corporate headquarters are located at 500 Rutherford Avenue, Suite 130, Charlestown, MA 02129.

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INTRODUCTION

The Debtors are in the restaurant and catering business, which is among the segments of our economy hardest hit by the COVID-19 pandemic. Prior to the onset, the Debtors were executing their business plan in an attempt to successfully reorganize the Company. But now, virtually overnight, their income has been reduced to a trickle, severely jeopardizing their chances of reorganizing and remaining in business if the pandemic effect continues. Since the commencement of the outbreak, the Debtors' sales are down over 80% from pre-filing projections.

Over the past month, the Debtors have been working feverishly to reduce costs, including temporary measures such as concessions from their landlords during this situation to help stave off a potential liquidation, which, among other consequences, would result in a loss of employment for the Debtors' workers.

The Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") was signed into federal law on March 27, 2020 in order to prevent precisely this outcome for struggling small businesses across the country. In a press release that same day, Ms. Corranza, acting as the administrator of the U.S. Small Business Administration (Ms. Corranza in this capacity, and the U.S Small Business Administration together, the "SBA"), stated:

> Our small businesses are the economic engines of their communities, and the SBA is ready to provide them with the support they need to remain open and keep their workers employed. With our whole-of-government approach led by the President, we are providing small businesses with the resources they need to get them through this unprecedented time.[2]

The CARES Act established the "Paycheck Protection Program (the "PPP"), which provides forgivable loans of up to $10 million to small businesses left financially distressed by

[2] CARES Act Statement from SBA Administrator Jovita Carranza, March 27, 2020.

the COVID-19 pandemic, to be used for up to eight weeks of payroll and day-to-day operating expenses. A press release from the SBA regarding the PPP stated in part:

> "These loans will bring immediate economic relief and eight weeks of financial certainty to millions of small businesses and their employees," SBA Administrator Carranza said. "We urge every struggling small business to take advantage of this unprecedented federal resource – their viability is critically important to their employees, their community, and the country."[3]

The PPP appeared to be just the lifeline that the Debtors needed to maintain their business and their employees' jobs, throughout the pandemic. However, contrary to both the Bankruptcy Code and its own governing laws and rules, the SBA, without notice of justification, has adopted a position that bankruptcy debtors are *ipso facto* ineligible to participate in the PPP. The Debtors have been told that they are ineligible solely on this basis.

The SBA's discrimination based solely on an applicant's status as a debtor is legally unsupported, arbitrary and capricious, and runs completely counter to the express mandate of the CARES Act and the PPP.

Accordingly, on April 28, 2020, the Debtors filed a Complaint [A.P. docket No. 1] (the "Complaint") against the SBA seeking a declaratory judgment, injunctive relief, a writ of mandamus, and related relief to compel the SBA to allow them to participate in the PPP. Due to the significant exigencies that they face, the Debtors now move for a temporary restraining order (a "TRO") and/or a preliminary injunction enjoining the SBA from denying the Debtors a loan under the PPP based solely on their status as debtors in bankruptcy, and related relief.

[3] SBA's Paycheck Protection Program for Small Businesses Affected by the Coronavirus Pandemic Launches, April 3, 2020.

BACKGROUND

A. COSI's business and the Chapter 11 Cases

On February 24, 2020 (the "Petition Date"), the Debtors each filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code in this Court (the "Chapter 11 Cases"). On the Petition Date, the Debtors moved for an order of joint administration pursuant to Bankruptcy Rule 1015(b). The Debtors remain in possession of their property and continue in the operation and management of their business as debtors-in-possession pursuant to sections 1107 and 1108 of the Bankruptcy Code.

The Debtors operate fast-casual restaurants and perform associated catering activities under the COSI® brand ("COSI"). COSI features flatbread made fresh throughout the day and specializes in a variety of made-to-order hot and cold sandwiches, salads, bowls, breakfast wraps, bagels, melts, soups, flatbread pizzas, snacks, desserts, and a large offering of handcrafted, coffee-based, and specialty beverages.

The events leading up to the Petition Date and the facts and circumstances supporting the relief requested in this Motion are set forth in the Declaration of Vicki Baue, Vice President & General Counsel, Chief Compliance Officer (CCO) and Secretary, in Support of Debtors' Chapter 11 Petitions and First-Day Pleadings [D.I.3] (the "First Day Declaration"), which is incorporated herein by reference.

Since the onset of the COVID-19 pandemic, the Debtors' business has virtually ground to a stand-still due to government mandated closures and stay-at-home directives in the cities and states where the Debtors' restaurants are located. Although the Debtors have obtained some temporary concessions from their landlords and are cutting costs everywhere they can, this is not a sustainable long-term strategy. The PPP is exactly the sort of intervention that the Debtors need to sustain their operations during the pandemic.

B. The CARES Act and the PPP

On March 27, 2020, the President of the United States signed into law the CARES Act, S. 3548, 116 Cong. (2020). Among other things, the CARES Act is intended to allow businesses – particularly small businesses – in the hardest hit segments of the economy to survive and continue paying their employees for the duration of the pandemic. Within the CARES Act, this policy is to be carried out through the PPP, which is set forth in Title I of the CARES Act, and which amends section 7(a) of the Small Business Act. The PPP allows lenders to provide federally guaranteed loans to small businesses to cover payroll through June 30, 2020, as well as other expenses including payments of interest on mortgages, rent, utilities, and interest on other debt.

A qualified borrower may receive a PPP loan equal to 2.5 times its average monthly payroll, up to a limit of $10 million. A borrower need not exhaust its other credit options prior to receiving a PPP loan. PPP loans have numerous benefits: (1) no collateral or personal guarantees are required to receive a PPP loan; (2) neither the SBA nor the lenders charge any fees for a PPP loan; (3) PPP loans mature in two years and carry an interest rate of just 1%; (4) payments on PPP loans are deferred for at least six months and loans may be forgiven entirely if the borrower uses the funds for payroll costs, interest on mortgages, rent, or utilities, and meets certain other conditions set forth in the CARES Act; and, (5) no prepayment penalties.

Importantly, neither the CARES Act, the Small Business Act, nor any other applicable law or regulation prohibits the granting of PPP Loans to bankruptcy debtors.

Congress initially authorized up to $349 billion in total for the PPP. Loan applications were reviewed and loans granted on a “first come first served” basis; however, due to overwhelming demand, the full $349 billion in funding was soon depleted and new loans ceased.

Congress has now allocated additional funds, and PPP loans are once again being granted on a "first come first served" basis. However, based on how quickly the prior funding was depleted, and from numerous news reports and statements by industry personnel, new borrowers will need to move very quickly to receive PPP loans. See, e.g., Trish Turner, Billions more for small business not available immediately, will likely run out quickly: Lender, abcnews.go.com, April 23, 2020. A copy of this article is attached as Exhibit "A" to the Declaration of Vicki Baue (the "Baue Declaration"), which accompanies this Brief.

C. Disqualification of Debtors from Participating in the PPP

To receive a PPP loan, a qualified business must apply with any federally insured participating lender, using an application form created by the SBA.

On or about April 2, 2020, the SBA released Official SBA Form 2483, titled "Paycheck Protection Program Borrower Application Form," which is the SBA's official form of application for a PPP loan (the "Borrower PPP Application"). A copy of the Borrower PPP Application is attached to the Baue Declaration Exhibit "B."

Question No. 1 of the Borrower PPP Application asks, "Is the Applicant or any owner of the Applicant . . . presently involved in any bankruptcy?" Despite the fact that no law or regulation exists disqualifying bankruptcy debtors from the PPP, the Borrower PPP Application inexplicably states that if the applicant answers "yes" to question No. 1, "the loan will not be approved."

In addition, the SBA has released Official SBA Form 2484, titled "Lender Application Form – Paycheck Protection Program Loan Guaranty," which is the SBA's official form that lenders must submit to the SBA in connection with a PPP loan request (the "Lender PPP

Application" and, together with the Borrower PPP Application, the "PPP Applications"). A copy of the Lender PPP Application is attached as Exhibit "C" to the Baue Declaration.

The Lender PPP Application asks the lender whether "[t]he Applicant has certified to the Lender that neither the Applicant nor any owner (as defined in the Applicant's SBA Form 2483) is . . . presently involved in any bankruptcy." Lender PPP Application at §I. The Lender PPP Application states that if the lender answers "no" to this question, "the loan cannot be approved." Id. The Debtors otherwise meet the criteria for eligibility to participate in the PPP.

The Debtors have reached out to two potential lenders regarding PPP loans, Bank of America and JP Morgan Chase, each of whom stated that they would reject the Debtors for a PPP loan based on the fact that the Debtors' response to question No. 1 on the Borrower PPP Application is "yes," regardless of any other criteria. A screen shot of the application portal from Bank of America informing the Debtors that they are ineligible to participate in the PPP is attached as Exhibit "D" to the Baue Declaration.

The Debtors are precisely the sort of business the PPP was enacted to protect and assist – they are a small business (as defined by the SBA) in one of the industries hardest hit by the pandemic and are desperately trying to obtain funding to meet payroll for their employees. A PPP loan would allow the Debtors to endure the pandemic without having to make further workforce reductions.

However, due to what appears to be a completely arbitrary, baseless, and discriminatory requirement imposed by the SBA, the Debtors are ineligible to participate based solely on their status as a debtor under title 11 of the United States Code.

D. Other Debtors' Efforts to Obtain PPP Loans

Thus far, several chapter 11 debtors in various courts around the country have commenced adversary proceedings and moved for TROs or preliminary injunctions challenging the SBA's discriminatory policy. One of these courts has already ruled. On April 24, 2020, in In re Hidalgo County Emergency Service Foundation, AP No. 20-02006 (Bankr. S.D. Tex., D. Jones, J.), ("Hidalgo County"), the court granted a TRO in the debtor's favor proving relief including allowing the debtor to submit a to any lender a Borrower PPP Application with the phrase "or presently involved in any bankruptcy" stricken, and with the box for Question No. 1 marked "no." A copy of the court's order and the transcript of the TRO hearing in Hidalgo County is attached to the Baue Declaration Exhibit "E."

In addition, the Debtors have learned of other debtors in bankruptcy who have managed to obtain PPP loans in ways that highlight the absurdity, arbitrariness, and unenforceability of the SBA's policy. For example, Longview Power, LLC filed a pre-packaged bankruptcy case in this Court on April 14, 2020, two business days after having successfully applied for a PPP loan, and before it had even received the funding. In Longview Power's "first day" declaration, its CEO stated, "Longview has applied for a loan with the Small Business Administration under the Payroll [sic] Protection Program and was notified on April 10, 2020, that the loan was approved. Longview expects to receive the funds postpetition . . . ." See *Declaration of Jeffrey C. Keffer, Chief Executive Officer of Longview Power, LLC*, at ¶45 (docket No. 4, April 14, 2020) (Bankr. D. Del. No. 20-10951-BLS) ("Longview Power").

Similarly, on April 20, 2020, the first day of its bankruptcy case, another debtor Elemental Processing, LLC filed a section 364 motion in which it stated without explanation, "The Debtor has filed pre-petition an application with the Small Business Administration

through the CARE [sic] Act seeking a Payroll [sic] Protection Program loan. The Debtor has been approved for a loan of $750,000 for use toward business operations of payroll, rent, utilities, etc., and the Debtor desperately needs such funding to operate its business." See *Motion for Authority to Incur Debt for Post-Petition PPP Funds*, at ¶5 (docket No. 13, April 20, 2020) (Bankr. E.D. Ky., No. 20-50640) ("Elemental Processing").

On April 21, 2020, the Debtor in In re Mountain States Rosen, LLC, No. 20-20111(Bankr. D. Wyo.) filed a motion under section 364 of the Bankruptcy Code, for court approval of a PPP loan which the debtor, without explanation, stated had been approved. A fully executed promissory note attached to the debtor's motion confirms that the loan has been approved notwithstanding the fact that this debtor is plainly "involved in a bankruptcy." The Debtors have been unable to locate any explanation for how this particular debtor was able to obtain a PPP loan.

In In re Advanced Power Technologies, LLC, No. 20-11304 (Bankr. S.D. Fla.) ("Advanced Power"), the debtor filed an emergency motion to dismiss its own case solely for the purpose of obtaining a PPP loan. On April 24, 2020, the court in that case granted the debtor's motion and dismissed the case without prejudice. Upon information and belief, the debtor filed a PPP application that same day.

No possible justification exists for a scheme that permits a debtor to obtain PPP loan on the very eve of its bankruptcy case, while denying that same loan to a debtor subsequent to its petition date. In fact, the SBA itself would be better served in the latter scenario, as it would be deemed a post-petition lender instead of relegated to pre-petition general unsecured status. Likewise, the fact that Advanced Power had to dismiss its own bankruptcy case in order to apply for a PPP loan demonstrates the wrong-headedness of the SBA's policy.

The Hidalgo County court also recognized that a debtor-in-possession is subject to strict controls, which would help ensure that PPP loan proceeds are used for their intended purposes. In rejecting an argument made by the SBA that it would somehow have insufficient control over a debtor's use of funds, the court explained:

> They [the words "involved in any bankruptcy"] are intended to be discriminatory toward debtors for reasons offered that somehow we [i.e. the SBA] lose control of the money, again I find to be completely frivolous. I cannot imagine anything less controlling than to simply give out money with no underwriting, with no oversight, and then complain that if I have a Federal judge who makes sure that the debtor complies with the law, ensures that the debtors file monthly operating reports, ensure that copies of bank statements are filed on the docket every month, that they somehow lost control. I simply don't buy it. I find the arguments to lack any good faith.
>
> Hidalgo County, Transcript, at pp.31-32.[4]

Accordingly, the Debtors filed the Complaint against the SBA, seeking a declaratory judgment, injunctive relief, a writ of mandamus, and related relief to compel the SBA to allow them to participate in the PPP to the same extent as a similarly situated non-debtor. The Debtors now file this Motion seeking a TRO and/or a preliminary injunction granting relief on an expedited basis. Based on how quickly the additional funding allocated to the PPP is likely to be depleted, the Debtors respectfully submit that without expedited relief, they will miss out entirely on the ability to participate in the PPP, and suffer irreparable harm.

[4] The Debtors understand that on April 24, 2020, the SBA issued "guidance," stating in part, "Will I be approved for a PPP loan if my business is in bankruptcy? No. . . . The Administrator, in consultation with the Secretary, determined that providing PPP loans to debtors in bankruptcy would present an unacceptably high risk of an unauthorized use of funds or non-repayment of unforgiven loans."

As the Hidalgo County court recognized above, this rationale flies in the face of all logic, and demonstrates a fundamental misunderstanding of bankruptcy law. In reality, there is no scenario in which a recipient of PPP funds will be subject to as much transparency and oversight as where the recipient is a debtor in possession. Moreover, the SBA issued this "guidance" only after being sharply scolded by Judge Jones, and facing at least five other pending TRO motions in courts around the country. Viewed in context, the SBA's "guidance" is simply a transparent, self-serving, *ex post facto* attempt to justify an absurd policy.

SUMMARY OF REQUESTED RELIEF

The Debtors respectfully request entry of an order: granting a TRO and/or preliminary injunction: (i) declaring that the PPP Applications and their disqualification of bankruptcy debtors as eligible applicants is beyond its statutory and regulatory authority, is arbitrary and capricious, and violates section 525(a) of the Bankruptcy Code; (ii) enjoining the SBA from denying the Debtors a loan under the PPP based on the Debtors' status as debtors in bankruptcy, including without limitation by interpreting any of the questions and instructions in the PPP Applications in such a way as to disqualify the Debtors based on their status as Debtors in bankruptcy; (iii) compelling the SBA to remove from all PPP Applications its automatic disqualification of bankruptcy debtors as viable applicants; (iv) enjoining the SBA from disbursing or otherwise allocating $3,681,759.86 from the PPP and compelling them to set aside such amount for a qualified loan to the Debtors; (v) compelling the SBA to instruct all lending institutions administering PPP loans that there is no exclusion from the PPP loan program on account of an applicant's involvement in bankruptcy; and (vi) providing such further relief as the Court may deem just and proper.

By a separate motion, the Debtors will request that the Court schedule a hearing regarding this relief on an expedited basis at the Court's earliest possible convenience.

LEGAL STANDARD

In the Third Circuit, a TRO will issue when (1) the movant has shown a reasonable probability of success on the merits; (2) the movant would be irreparably injured by denial of such relief; (3) granting the TRO will not result in even greater harm to the non-moving party; and (4) granting the TRO would be in the public interest. *Inst. for Motivational Living, Inc. v. Sylvan Learning Ctr., Inc.*, 2008 WL 379654, at *2, fn. 2 (W.D. Pa. 2008). The Debtors satisfy each of these requirements.

ARGUMENT

A. The Debtors have a reasonable probability of success on the merits

(i) The SBA's Violation of 11 U.S.C. §525(a)

Section 525(a) of the Bankruptcy Code provides in relevant part that "a governmental unit may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to, condition such a grant to, [or] discriminate with respect to such a grant against . . . a person that is or has been a debtor under this title or a bankrupt or a debtor under the Bankruptcy Act, or another person with whom such bankrupt or debtor has been associated, solely because such bankrupt or debtor is or has been a debtor under this title . . . ."

Section 525(a)'s list is illustrative and not exhaustive. See, e.g., In re Stinson, 285 B.R. 239, 246 (Bankr. W.D. Va. 2002) ("The enumerations in § 525(a) are not intended to be an exhaustive list, rather the section was drafted to permit further development of prohibited discriminatory treatment. When read as a starting point, and not an exclusive and circumscribed list, the enumerations in § 525(a) can be viewed as examples of prohibited discriminatory treatment and not the only instances thereof.") (citing Collier on Bankruptcy, ¶ 525.01); H. Rep. No. 95–595, 95th Cong., 1st Sess. 366–67 (1977) ("In addition, the section is not exhaustive. The enumeration of various forms of discrimination against former bankrupts is not intended to permit other forms of discrimination.").

A governmental agency may not deny an applicant participation in a government program based on its status as a bankruptcy debtor. For example, in In re Rose, 23 B.R. 662 (Bankr. D. Conn. 1982), the court held that a state mortgage financing program could not deny a mortgage to a former debtor on that basis. The court explained, "If a state has chosen to enact a program of home financing for its citizens, §525 prohibits that state from exempting debtors or bankrupts from those benefits solely because of bankruptcy and without taking into

account present financial capability. To hold to the contrary would frustrate the Congressional policy of granting the debtor a fresh start by denying him a means open to other citizens of acquiring a home." In re Rose, 23 B.R. at 666-67. While a governmental lender may consider an applicant's bankruptcy as part of an overall inquiry into its creditworthiness, it may not deny entry into a loan program altogether on a basis that discriminates against bankruptcy debtors. See, e.g., Goldrich v. New York States Higher Ed. Servs. Corp. (In re Goldrich), 771 F.2d 28, (2d Cir. 1985) (United States v. Cleasby, 139 B.R. 897, 900 (W.D. Wis. 1992) ("Consideration of a past discharge in determining whether to provide credit to the debtor does not violate § 525(a) to the extent that the decision is part of an overall evaluation of purely economic criteria, such as future financial responsibility.").

The PPP is a government program expressly designed to provide relief to small businesses affected by COVID-19. Through the "bankruptcy disqualification" provisions of the PPP Applications, the SBA is denying the Debtors participation in the PPP program in a discriminatory fashion, solely on the basis that they are debtors in bankruptcy, in violation of section 525(a) of the Bankruptcy Code.

Importantly, the Debtors are not being denied access to the PPP as a result of a fulsome evaluation of their creditworthiness. In fact, the PPP was enacted precisely to provide relief to struggling small businesses in industries hard hit by the pandemic, such as the Debtors, without regard to their creditworthiness. In its Interim Rule published on April 20, 2020 (the "Third Interim Rule"), the SBA stated, "The Administrator recognizes that, unlike other SBA loan programs, the financial terms for PPP Loans are uniform for all borrowers, and the standard underwriting process does not apply because no creditworthiness assessment is required for PPP Loans." Third Interim Rule, 13 CFR 120, 85 FR 21747, pp. 21747-21752 (p. 14 of printed

version). A copy of the Third Interim Rule is attached to the Baue Declaration as Exhibit "F." This disavowal by the SBA of any concern for creditworthiness cuts directly against any argument it might now make that its exclusion of bankruptcy debtors is motivated by this concern.

In Hidalgo County, the SBA argued that qualification for the PPP is akin to being granted a loan, and that section 525(a) cannot be used to force the government to grant a loan to a debtor. Not only does this argument ignore the caselaw's prohibition against automatic disqualification from loan programs, but the court, in no uncertain terms, rejected the notion that the PPP is a loan program. The Court stated:

> This isn't a loan program. This is a support program. It is phrased the way it is to try and ensure that the money ends up in the right hands and used for the right purposes. It is intended to protect tax-paying citizens from the effects of government shutdowns, stay-at-home orders, and simply the public not being able to engage in ongoing commerce. To suggest that this is a program that enjoys underwriting and scrutiny in terms of who receives the money is to simply ignore the obvious. The SBA's own rules (indisc.) effectively look at the form, make the loans. You make the loans, and so long as they're used for the right purposes, there's no need to pay it back. That is not a traditional loan program. There is no collateral valuation, there is no credit worthiness test. And, again, to make that argument is simply frivolous.
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> . . . .
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> Practically speaking, this program isn't designed to be a commercial product; it is a support product. The only entity that would ever engage in this type of activity is the government because, again, it's a support for citizens. I can think of no greater example of the government performing its gatekeeping role as to who can engage in commerce and pursue certain livelihoods than this particular program; because if we didn't have this program, there would be no ambulance services, there would be no nail salons, there would be no convenience stores. Society would be in a very difficult (indisc.) so I do think the requirements of Section 525(a) are absolutely in play.

Hidalgo County, pp. at 30.

Using strong language the Hidalgo County court held that the SBA's discrimination against bankruptcy debtors violated section 525, and that any argument that the SBA was

motived by concerns over creditworthiness, or an inability to ensure that debtors would use the funds responsibly, was frivolous. The court held:

> It's entirely inappropriate that those words were added into that form in that list in that manner. And I see no authority anywhere for including those words in that form. It serves no purpose. I do find that by including the words "or presently involved in any bankruptcy," they are intended to be discriminatory. They are intended to be discriminatory toward debtors for reasons offered that somehow we lose control of the money, again I find to be completely frivolous. I cannot imagine anything less controlling than to simply give out money with no underwriting, with no oversight, and then complain that if I have a Federal judge who makes sure that the debtor complies with the law, ensures that the debtors file monthly operating reports, ensure that copies of bank statements are filed on the docket every month, that they somehow lost control. I simply don't buy it. I find the arguments to lack any good faith.

Id. at 29-32.

In holding that the SBA's policy violates section 525(a), the court concluded:

> But this [discrimination] can't be what Congress intended. This can't be the way that we are supposed to treat our fellow man in this time. It's inconceivable to me that this distinction could be drawn. The people that need the most help and who have sought protection under our laws are the people who are the targets of discrimination in a government support program; can't possibly be. So I am going to grant the TRO. . . . It is my hope that my government that I serve will realize the error that it has made and that it will act appropriately and ensure that all of our citizens have access to the support they needed.

Id. at 32.

But for their status as debtors in bankruptcy, the Debtors are otherwise qualified for a PPP loan. See, Declaration of V. Baue at ¶¶11-14. The SBA's sole basis for denying the Debtors participation in the PPP appears to be simply the Debtors' status as "bankruptcy debtors." Therefore, as Judge Jones found, the SBA, through its arbitrary and unjustifiable decision to exclude debtors in bankruptcy from the PPP, has clearly violated, and continues to violate, section 525(a) of the Bankruptcy Code by discriminating against debtors in bankruptcy.

Accordingly, the Debtors have a reasonable probability of success on the merits with respect to their cause of action against the SBA based on section 525(a) of the Bankruptcy Code.

(ii) The SBA's Violation of the Administrative Procedure Act

The CARES Act grants the SBA emergency rule making authority and charges the SBA to issue regulations to carry out certain of the programs contemplated in the CARES Act, including the PPP. See CARES Act, section 1114.

On April 2, 2020, the SBA issued an interim final rule (the "First Interim Rule") providing guidance on, *inter alia*, the eligibility requirements to receive a loan under the PPP. The First Interim Rule adopts the eligibility standards contained in section 120.110, title 13 of the Code of Federal Regulations ("CFR 120.110"), as further described in the SBA's Standard Operating Procedure 50-10, subpart B, Chapter 2 (the "SOP 50-10"). See First Interim Rule, 2(c) ("Businesses that are not eligible for PPP loans are identified in 13 CFR 120.110 and described further in SBA's Standard Operating Procedure").

The SOP 50-10 provides that in order to be eligible for a small business loan, an applicant must: "be an operating business;" "be organized for profit;" "be located in the United States (including its territories and possessions);" "be small under SBA size requirements;" and "demonstrate the need for desired credit." See SOP 50-10, pp. 91-104. The SOP-50-10 goes on to provide that the types of businesses listed as ineligible in CFR 120-110 are not eligible for an SBA loan. Bankruptcy debtors are not listed as ineligible businesses in CFR 120-110.

On April 4, 2020, the SBA issued a supplemental interim final rule (the "Second Interim Rule") providing further guidance on the PPP. Like the First, the Second Interim Rule does not state that bankruptcy debtors are ineligible for a PPP loan. On April 20, 2020, the SBA issued the Third Interim Rule. Not only does the Third Interim Rule make no mention of bankruptcy debtors, but it specifically states, "The Administrator recognizes that, unlike other SBA loan programs, the financial terms for PPP Loans are uniform for all borrowers, and the standard

underwriting process does not apply because no creditworthiness assessment is required for PPP Loans." Third Interim Rule, 13 CFR 120, 85 FR 21747, pp. 21747-21752 (p. 14 of printed version). This disavowal by the SBA of any concern for creditworthiness cuts directly against any argument it might make that its exclusion of bankruptcy debtors is motivated by this concern.

In short, no law, regulation, or rule of any kind disqualifies, or authorizes the SBA to disqualify, bankruptcy debtors from participating in the PPP. However, the SBA issued the PPP Applications, which state that a PPP loan will not be approved if the applicant is "presently involved in any bankruptcy."

The SBA may only exercise the authority conferred upon it by statute. Under the Administrative Procedure Act, 5 U.S.C. §701 *et seq.*, (the "APA"), courts must "hold unlawful and set aside agency action" that is "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right." 5 U.S.C. §706(2)(C). In addition, the APA provides that courts must "hold unlawful and set aside" agency action that is "arbitrary, capricious, [or] an abuse of discretion." 5 U.S.C. §706(2)(A).

A court's analysis of APA section 706(2)(C) "naturally begins with a delineation of the scope of the [agency's] authority and discretion" and then requires the court to determine whether the agency's action was made within the scope of that authority. Citizens to Pres. Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971).

As described above, nothing in the CARES Act, the SOP 50-10, the First or Second Interim Rule, or any other law or regulation of any kind, authorizes the SBA's blanket exclusion of bankruptcy debtors from the PPP. It is well established that "an administrative agency must adhere to its own regulations." Singh v. U.S. Dep't of Justice, 461 F.3d 290, 296 (2d Cir. 2006)

(setting aside an agency action where "[t]he [agency's] decision, and the government's defense of it, expose a clear conflict between the relevant statute and the agency's corresponding regulation, which, to date, as far as we have found, [has] not been acknowledged let alone reconciled.") In addition, while the SBA does possess emergency rule-making authority under section 1114 of the CARES Act, this authority is limited to the development of regulations that carry out the provisions of the CARES Act, and it is clear that Congress did not intend for bankruptcy debtors to be excluded from participation in the PPP, otherwise it would have expressly included such a prohibition in the PPP, as it did in section 4003 of the CARES Act.[5]

The SBA acted outside the scope of its statutory and regulatory authority when it issued the PPP Applications in a manner that automatically disqualified debtors from the PPP. Accordingly, the SBA's implementation of the PPP in this manner is "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right," in violation of the APA. 5 U.S.C. §706(2)(C).

Similarly, the SBA's implementation of the PPP in a manner that causes bankruptcy debtors to be ineligible is "arbitrary, capricious, [or] an abuse of discretion" in violation of section 7065(2)(A) of the APA. When analyzing whether an agency's action was arbitrary or capricious, courts must determine whether "the agency has complied with the APA; specifically, whether . . . it has acted consistently with its own procedures; and whether its applications of its governing law have been reasonable." Troy Corp. v. Browner, 120 F.3d 277, 281 (D.C. Cir.

[5] The only disqualifying criteria in the CARES Act that affects bankruptcy debtors appears in section 4003 of title IV, titled "Economic Stabilization and Assistance to Severely Distressed Sectors of the United States Economy." Section 4003 governs loans that are not reserved to small business, is regulated by the United States Department of Treasury, as opposed to the SBA, and does not apply to the PPP. See CARES Act at §4003(c)(3)(D)(i)(V) (requiring that "any eligible borrower applying for a direct loan under this program shall make a good faith certification that -- . . . the recipient is not a debtor in a bankruptcy proceeding."). The fact that Congress explicitly carved bankruptcy debtors from the program described in section 4003 evidence its intent for debtors to remain eligible for programs from which they are not explicitly carved out.

1997). An agency's action is arbitrary and capricious "if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983). In addition, a federal agency's interpretation of its own regulation is not entitled to deference where the agency's action "is plainly erroneous or inconsistent with the regulation." Bergamo v. Commodity Futures Trading Comm'n, 192 F.3d 78, 79-80 (2d Cir. 1999).

Here, the SBA has acted in contradiction to the CARES Act, its own eligibility requirements set forth in CFR 120.110, the First and Second Interim Rules, and the SOP 50-10 by implementing the PPP in a manner that automatically excluded bankruptcy debtors. Neither the law nor the regulations, nor any other authority, support the SBA's position that debtors should be ineligible for a government-sponsored program that is expressly designed to protect and assist distressed small businesses (of which the Debtors are a prime example). No principled distinction can be made between a chapter 11 debtor-in-possession and any other "struggling small business."[6] In fact, businesses having the same characteristics as debtors-in-possession are the intended beneficiaries of the PPP. No justification exists to exclude debtors-in-possession from the ranks of all other distressed businesses, and there is no indication that Congress intended to do so. As indicated above, Congress plainly demonstrated that it knew how to exclude businesses on the basis of bankruptcy as it did in Section 4003 of Title IV of the CARES Act.

[6] As described above, at the outset of the PPP, Ms. Corranza stated in a press release, "We urge every struggling small business to take advantage of this unprecedented federal resource – their viability is critically important to their employees, their community, and the country." See SBA's Paycheck Protection Program for Small Businesses Affected by the Coronavirus Pandemic Launches, April 3, 2020.

The examples of the Longview Power and Elemental Processing debtors drive home the absurdity of the SBA's position. On the eve of their bankruptcy filings, these two debtors successfully obtained PPP loans to help fund payroll during the pendency of their cases. At the same time, a similarly situated debtor who happens to apply for a PPP loan immediately following – instead of immediately prior – to its petition date would be denied. No possible justification exists for such a distinction. In addition, the fact that the SBA's policy rewards a debtor who is able to dismiss its bankruptcy case and then apply for a PPP loan is simply ridiculous. This perverse incentive led the Advanced Power debtor to take this drastic step just to gain the right to participate in the program.

As well as demonstrating the arbitrariness of the SBA's policy, these examples belie the SBA's professed concern for creditworthiness. The SBA, as a creditor, would be far better protected as a post-petition lender than as simply a pre-petition general unsecured creditor.

Accordingly, the SBA's implementation of the PPP in a manner that automatically excludes bankruptcy debtors is "arbitrary, capricious, [or] an abuse of discretion" in violation of section 7065(2)(A) of the APA. As described above, the SBA has also acted "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right," in violation of the APA. 5 U.S.C. §706(2)(C).

The Debtors therefor are likely to succeed on the merits of their claims against the SBA based on its violation of the APA.

(iii) Declaration Regarding Interpretation of Ambiguous Language

The PPP Applications state that any applicant "presently involved in any bankruptcy" is ineligible to participate in the PPP.

The phrase "involved in any bankruptcy" is overly broad, vague, and difficult to apply. If given its plain meaning, this phrase would disqualify any applicant who is a creditor or vendor to a debtor in a bankruptcy case, or even just a party in interest of any kind. This interpretation would be nonsensical and, therefore, should be avoided. See, e.g., In re Kaiser Aluminum Corp., 456 F.3d 328, 338 (3d Cir. 2006) ("A basic tenet of statutory construction is that courts should interpret a law to avoid absurd or bizarre results.").

Reacting to the SBA's use of the words "involved in any bankruptcy" in the PPP Application, the court in Hidalgo strongly condemned the language:

> I am bothered by the use of the words. I disagree with [counsel] that, well, of course everybody knows what that means, it's simply if you're a debtor. Couldn't be further from the truth. Congress knew how to say we don't give these loans to debtors. They did it within the CARES Act itself. And then to have a form that simply says if an owner or a business is presently involved in a bankruptcy, I have zero idea what that means. It means if you have filed a proof of claim in the General Motors bankruptcy umpteen years ago and haven't yet received a final distribution on your claim, you have to check that box "no." That's silly. It's even sillier in light of the purpose of this program.

Hidalgo County, at 30-31.

The phrase "involved in any bankruptcy" is therefore ambiguous, as its intended scope is unclear. See, e.g., In re Idleaire Technologies Corp., No. 08-10960, 2009 WL 4131117, *8 (Bankr. D. Del. Feb. 18, 2009) (stating that language can be considered ambiguous when applying plain meaning would lead to absurd result).

Where language in a statute is ambiguous, a court may look to legislative intent to determine the meaning. See, e.g., Kaiser Aluminum, 456 F.3d at 338 ("It is true that interpretations of a statute which would produce absurd results are to be avoided if alternative interpretations consistent with the legislative purpose are available.") (quoting Griffin v. Oceanic Contractors, Inc., 548 U.S. 564, 575, 102 S.Ct. 3245, 3252 (1982)).

In a press release accompanying the unveiling of the PPP, the SBA itself described the purpose of the program:

> These loans will bring immediate economic relief and eight weeks of financial certainty to millions of small businesses and their employees," SBA Administrator Carranza said. "We urge every struggling small business to take advantage of this unprecedented federal resource – their viability is critically important to their employees, their community, and the country. [7]

Making PPP loans available to "every struggling small business" is best achieved by applying as narrow an interpretation as possible to the phrase "involved in any bankruptcy." Interpreting this phrase as an across-the-board disqualification of struggling – but potentially viable – businesses such as debtors-in-possession under the Bankruptcy Code would be demonstrably at odds with the intent of the PPP as expressed by the SBA itself.

Instead, the Debtors submit that of the possible interpretations of the phrase "involved in any bankruptcy," the one most consistent with the purpose of the PPP would apply the phrase only to *chapter 7* debtors. These businesses, by definition, have already ceased operations, are in the process of liquidation, and are beyond rescue.

But no principled distinction can be made between a chapter 11 debtor-in-possession and any other "struggling small business." In fact, businesses having the characteristics of most debtors-in-possession are among the core targets of the PPP. Accordingly, the best-fit interpretation of the phrase "involved in any bankruptcy," should not disqualify chapter 11 debtors-in-possession from the PPP.

The Debtors therefore are likely to succeed on the merits of their claims based on the interpretation of the phrase "presently involved in any bankruptcy."

[7] SBA's Paycheck Protection Program for Small Businesses Affected by the Coronavirus Pandemic Launches, April 3, 2020.

B. The Debtors will suffer irreparable harm is relief is not granted

A temporary restraining order and/or a preliminary injunction is absolutely necessary to prevent the Debtors and their estates – and by extension their creditors – from suffering irreparable harm. The PPP offers applicants guaranteed loans with extremely favorable terms that are not otherwise available in the private marketplace. For a distressed business in one of the hardest his industries in the country like the Debtors, a PPP loan would be invaluable.

Congress has now allocated additional funds, and PPP loans are once again being granted on a "first come first served" basis. However, based on how quickly the prior funding disappeared, and from numerous news reports and statements by industry personnel, new applicants will need to act very quickly to receive PPP loans. Once the new funding is depleted, Congress may well turn off the spigot. The next few days are likely to be the Debtors' final window of opportunity to obtain a PPP loan. And a PPP loan will be what allows the Debtors to remain in business and reorganize if the pandemic effect continues, as opposed to liquidating, laying off their employees, and leaving their creditors with no recovery. If the latter were to come to pass, the damage would be catastrophic and irreversible.

Without a preliminary injunction, the Debtors will be unable to participate in the PPP and an invaluable opportunity to save their business, and their employees' livelihoods, will be lost.

C. The balance of harm weighs heavily in favor of granting the requested relief

The "balance of harm" weighs heavily in favor of the issuance of injunctive relief for the Debtors. In contrast to the existential harm threatening the Debtors, the SBA would suffer no hardship at all. On the contrary, the plain language and policy considerations of the CARES Act – the promotion of which is part of the SBA's mission – would all be furthered by the elimination of the disqualification provisions in the PPP Applications and the inclusion of

bankruptcy debtors into the PPP. Indeed, eliminating this disqualification would help PPP to realize its own mandate – helping to preserve "struggling small businesses" and their employees.

The SBA has not, and cannot, direct the Court to any harm that it would suffer by ceasing its discriminatory policy or any justification for maintaining it. The PPP has no creditworthiness requirement (indeed, if it had, it would entirely alienate its intended applicant pool), so any concern that the SBA might voice in this regard is disingenuous, and contrary to the SBA's own rules, which state that creditworthiness plays no role in the PPP application process. See Third Interim Rule ("The Administrator recognizes that, unlike other SBA loan programs, the financial terms for PPP Loans are uniform for all borrowers, and the standard underwriting process does not apply because no creditworthiness assessment is required for PPP Loans." Third Interim Rule, 13 CFR 120, 85 FR 21747, pp. 21747-21752 (p. 14 of printed version).

As the Hidalgo court observed, "And in fact there really isn't an underwriting function. . . . There's no evaluation of ability to repay, there's no evaluation of collateral. . . . You know, that just doesn't exist in this program. In fact, let's just be practical. The entire intent of the program is for people not to pay this back. It's a way of getting money from the government to people that are being harmed. And so long as they use it in the right way, they don't have to pay it back." Hidalgo County, pp. 22-23.

Accordingly, the "balance of harm" weighs heavily in favor granting the Debtors' requested relief.

D. Granting the requested relief is in the public interest

The CARES Act established the PPP to protect distressed small businesses during a global pandemic, which is a goal that certainly furthers the public interest. As the SBA itself announced at the unveiling of the PPP, "Our small businesses are the economic engines of their

communities," [8] and "their viability is critically important to their employees, their community, and the country."[9] The importance of small businesses to our economy cannot be understated, and the goal of the PPP to provide "every struggling small business"[10] with "immediate economic relief and eight weeks of financial certainty"[11] is undoubtedly in the public interest.

The Debtors' requested relief would directly further the public interest by making the PPP available to the very businesses who need its assistance the most. It would help to save the livelihoods of the Debtors' own employees, as well as the employees of other debtors who desperately need assistance from the PPP to survive the Covid-19 pandemic.

In addition, "There is a strong public interest in promoting a successful Chapter 11 reorganization." Rickel Home Centers, Inc. v. Baffa (In re Rickel Home Centers, Inc.), 199 B.R. 498, 501 (Bankr. D. Del. 1996). Obtaining a PPP loan would promote the Debtors' reorganization to a degree that no other assistance possibly could, and would be vitally important to the Debtors efforts in this regard.

Accordingly, the Debtors submit that this final factor weighs heavily in favor of granting their requested relief.

PRAYER FOR RELIEF

WHEREFORE, the Debtors respectfully request the entry of an order granting a TRO and/or preliminary injunction: (i) declaring that the PPP Applications and their disqualification of bankruptcy debtors as eligible applicants is beyond its statutory and regulatory authority, is

[8] CARES Act Statement from SBA Administrator Jovita Carranza, March 27, 2020.

[9] SBA's Paycheck Protection Program for Small Businesses Affected by the Coronavirus Pandemic Launches, April 3, 2020.

[10] Id.

[11] Id.

arbitrary and capricious, and violates section 525(a) of the Bankruptcy Code; (ii) enjoining the SBA from denying the Debtors a loan under the PPP based on the Debtors' status as debtors in bankruptcy, including without limitation by interpreting any of the questions and instructions in the PPP Applications in such a way as to disqualify the Debtors based on their status as Debtors in bankruptcy; (iii) compelling the SBA to remove from all PPP Applications its automatic disqualification of bankruptcy debtors as viable applicants; (iv) enjoining the SBA from disbursing or otherwise allocating $3,681,759.86 from the PPP and compelling them to set aside such amount for a qualified loan to the Debtors; (v) compelling the SBA to instruct all lending institutions administering PPP loans that there is no exclusion from the PPP loan program on account of an applicant's involvement in bankruptcy; and (vi) providing such further relief as the Court may deem just and proper.

Dated: April 28, 2020

COZEN O'CONNOR

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