

How Companies Can Use Gov't Funding Amid Bankruptcy

By **Matthew McGuire and Howard Robertson** (March 15, 2023)

In response to the COVID-19 pandemic Congress enacted the Coronavirus Aid, Relief, and Economic Security Act[1] and the American Rescue Plan Act.[2]

Through the CARES Act and American Rescue Plan, Congress implemented the Paycheck Protection Program[3] and the Restaurant Revitalization Fund,[4] respectively. These programs enabled small businesses to obtain PPP loans guaranteed by the Small Business Administration or restaurants to receive RRF grants of up to \$10 million.[5]

While these programs were intended to assist distressed businesses during the pandemic, bankrupt businesses were essentially precluded from participating.

Initially, the SBA barred bankruptcy debtors outright from applying for PPP loans.[6] With the RRF grant, the SBA was not quite as drastic allowing bankruptcy debtors with an approved plan of reorganization to apply,[7] meaning a business could not participate if actively proceeding in a bankruptcy without a confirmed plan of reorganization.

The SBA later adopted the same standard for PPP loan applications.[8]

Bankruptcy debtors challenged the exclusionary rule and failed. Debtors argued that a PPP loan was an "other similar grant" under Title 11 of the U.S. Code, Section 525, therefore, the exclusionary rule violated Section 525 of the Bankruptcy Code.[9]

Courts overwhelmingly disagreed, holding that exclusion did not violate Section 525.[10]

Alternatively, bankruptcy debtors argued the exclusionary rule violated the Administrative Procedure Act. Courts again disagreed, holding that the exclusionary rule was based on a reasonable interpretation of the CARES Act.[11]

After unsuccessful challenges to the exclusionary rule, bankruptcy debtors found a workaround: a short-term dismissal strategy.

Advanced Power Technologies LLC, Starplex Corp., Chip's Southington LLC and Cosi Inc. dismissed their bankruptcy cases, applied for funding, then reinstated their cases.

As the risks of economic dislocation continue and the possibilities of continued government intervention have increased, four cases highlight the benefits and risks associated with reliance on government funding programs for Chapter 11 debtors.

Short-Term Dismissal

Advanced Power filed for protection under Chapter 11 the Bankruptcy Code on March 11, 2020, in the U.S. Bankruptcy Court for the Southern District of Florida.

It filed an emergency motion seeking to dismiss its case on April 22, 2020, for the sole



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purpose of applying for a PPP loan in the amount of \$1.8 million.[12]

The court granted dismissal on April 24, 2020, then Advanced Power applied for and obtained its PPP loan.[13] On May 5, 2020, Advanced Power sought to reinstate its case, which the court granted on May 12, 2020 — about two and a half weeks after the case was dismissed.[14]

On June 24, 2021, the court confirmed Advanced Power's plan of reorganization.[15]

Starplex filed for bankruptcy protection under Subchapter V of Chapter 11 of the U.S. Bankruptcy Code on March 4, 2020, in the U.S. Bankruptcy Court for the District of Arizona. Starplex moved to dismiss its case on May 21, 2020, so it could apply for a PPP loan.[16]

The court dismissed the case on May 22, 2020, after which Starplex obtained a PPP loan for approximately \$1.57 million.[17] On June 29, 2020, the court reinstated the case.[18]

On Oct. 22, 2020, the court confirmed Starplex's plan of reorganization.[19]

Chip's Southington filed its bankruptcy petition on December 29, 2020, in the U.S. Bankruptcy Court for the District of Connecticut. Chip's Southington filed a proposed plan of reorganization and anticipated using a PPP loan to help fund its plan.[20]

Because it could not obtain a PPP loan until the court confirmed the plan, it moved to dismiss the case on April 9, 2021.[21] The court granted dismissal on April 23, 2021.[22]

Chip's Southington obtained a PPP loan in the amount of \$300,000 and reinstated its case.[23] On Dec. 22, 2021, the court confirmed Chip's Southington's plan of reorganization.[24]

Cosi filed for bankruptcy protection on Feb. 24, 2020, just weeks before state and local governments throughout the U.S. implemented stay-at-home orders. As a result of these restrictions, Cosi's monthly revenues fell as much as 80% from historic levels.

Faced with an existential threat to the entire restaurant industry, Cosi was forced to sideline its original plans of reorganization and focus primarily on survival.

After determining that PPP funding was not a viable option, Cosi found a lifeline in the American Rescue Plan, under which it would have been eligible for a \$10 million RRF grant.

Initially, Cosi argued that so long as it obtained conditional approval of a plan of reorganization it would be eligible to apply for an RRF grant. So, it filed a proposed plan of reorganization based on the assumption it would receive an RRF grant.[25]

On May 7, 2021, the SBA notified Cosi of its position that only bankruptcy debtors with a confirmed plan of reorganization are eligible to apply for an RRF grant, meaning conditional approval was not sufficient to permit funding under the RRF.[26]

On May 10, 2021, Cosi filed an emergency motion to dismiss its case to obtain an RRF grant and on May 11, 2021, the court dismissed the case.[27] The same day, Cosi applied for an RRF grant.[28]

In connection with dismissal, the court granted interim approval of the Cosi's disclosure statement allowing Cosi to solicit approval of its proposed plan of reorganization while it

applied for an RRF grant.[29]

Unfortunately, the RRF had exhausted all funds before Cosi's application was processed so Cosi never received a grant.[30]

The RRF grant was integral to Cosi's initial proposed plan of reorganization, without those funds Cosi could not successfully reorganize.[31]

Cosi was in a risky position: It no longer had the protection of the Bankruptcy Code and, without the anticipated RRF grant, could not reinstate its case to pursue its plan of reorganization.

After more than a year, Cosi fortunately was able to garner support from major stakeholders that culminated in a restructuring support agreement that provided additional funding and set forth terms of a new reorganization strategy.[32]

On June 30, 2021, Cosi filed a motion to reinstate its bankruptcy case, which the court granted on July 11, 2021, exactly one year and two months after the case was dismissed.[33]

Cosi returned to court with a prepackaged amended plan of reorganization that had unanimous support of all voting creditors.

On July 27, 2022, just over two weeks after reinstating its case, the court confirmed Cosi's amended plan of reorganization.[34]

Dismissal Has Risk: Proceed with Stakeholder Support

To allow bankruptcy debtors to achieve a fresh start, the Bankruptcy Code affords many protections such as the automatic stay and a structured claims process.

Section 362 of the Bankruptcy Code essentially prohibits lawsuits against a bankruptcy debtor, subject to limited exceptions, and automatically takes effect upon the filing a petition. This eliminates the race to the courthouse by creditors and provides for fair treatment of creditors' claims.[35]

Creditors, then file claims against the bankruptcy debtor's estate, which are prioritized and paid in order prescribed under Section 507 of the Bankruptcy Code.[36]

Cosi is a prime example of the significant risk bankruptcy debtors incur when pursuing a short-term dismissal strategy especially for programs that are new and limited in funding.

When a bankruptcy debtor dismisses its case, it will lose protections afforded to it by the Bankruptcy Code, unless protections are secured in the order dismissing the case, such as in a structured dismissal.

For a short-term dismissal strategy, the goal should be to have a case reinstated as fast as possible. The longer a debtor exists in a world without bankruptcy protection, the greater the chance that the debtor's return to bankruptcy will be impracticable or unsuccessful.

The short-term dismissal strategy employed by Advanced Power, Starplex, Chip's Southington and Cosi to obtain uncertain government funds was highly risky because to obtain the funds each needed to relinquish the powerful protections afforded to debtors by

the Bankruptcy Code, thus exposing each to lawsuits by creditors.

While Advanced Power, Starplex and Chip's Southington successfully obtained funding and returned to bankruptcy quickly, Cosi was unable to obtain its RRF grant and was stuck outside of bankruptcy for more than a year.

To mitigate risk associated with a short-term dismissal strategy, each bankruptcy debtor obtained prior stakeholder support.

Obtaining stakeholder support is important in bankruptcy proceedings generally, but critically important when a debtor is pursuing a high-risk strategy such as dismissing a case to receive the funds needed to proceed with a plan of reorganization.

With stakeholder support, a debtor can keep creditors at bay while operating outside of bankruptcy.

As shown by Cosi, garnering stakeholder support can help a bankruptcy debtor plan for a worst-case scenario — not receiving the very funds that the debtor dismissed the case to receive — and can provide an additional post hoc breathing spell to a distressed company that needs to formulate a new plan to get back into bankruptcy.

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[1] Pub L. No. 116-136, 134 Stat. 281 (2020).

[2] Pub L. No. 117-2, 135 Stat. 4 (2021).

[3] Pub L. No. 116-136, 134 Stat. 286, §§ 1101-1102 (2020) (codified at 15 U.S.C. § 636(a)(36)).

[4] 15 U.S.C. § 9009c; 1800 Mich. Ave. v. SBA of the United States, 2022 U.S. Dist. LEXIS 131514, at *1 (E.D. Mich. July 25, 2022); Melendez v. City of N.Y., 16 F.4th 992, 998 (2d Cir. 2021).

[5] 15 U.S.C. § 9009c(c)(4).

[6] 85 Fed. Reg. 23,450, 23,451 (Apr. 28, 2020); See, e.g., Carranza v. PCT Int'l Inc., No. CV-20-01307-PHX-DJH, 2021 U.S. Dist. LEXIS 169271 (D. Ariz. Sept. 7, 2021); USF Fed. Credit Union v. Gateway Radiology Consultants, P.A. (In re Gateway Radiology Consultants, P.A.), 983 F.3d 1239 (11th Cir. 2020).

[7] In re Cosi, Inc., et al., Case No. 20-10417 (Bankr. D. Del. June 30, 2022), ECF No.

354.

[8] Frank Barbosa Jr. and Howard Berkower, "Chapter 11 Debtors with Confirmed Plans Are Now Eligible for PPP Loans." JD Supra (Apr. 30, 2021), <https://www.jdsupra.com/legalnews/chapter-11-debtors-with-confirmed-plans-9468591/>

[9] See SBA v. Roman Catholic Church of the Archdiocese of Santa Fe, 632 B.R. 816 (D.N.M. 2021); Vestavia Hills, Ltd. v. SBA (In re Vestavia Hills, Ltd.), 630 B.R. 816 (S.D. Cal. 2021); In re Penobscot Valley Hosp., 626 B.R. 350 (Bankr. D. Me. 2021); Organic Power LLC v. SBA.(In re Organic Power LLC), 619 B.R. 540 (Bankr. D.P.R. 2020); Henry Anesthesia Assocs. LLC v. Carranza (In re Henry Anesthesia Assocs. LLC), No. 20-06084-LRC, 2020 Bankr. LEXIS 1471 (Bankr. N.D. Ga. June 4, 2020).

[10] See Id.

[11] See, e.g., In re Gateway Radiology Consultants, P.A., 983 F.3d 1239, 1264.

[12] See In re Advanced Power Technologies, LLC, Case No. 20-13304 (Bankr. S.D. Fla. Apr. 22, 2020), ECF No. 51.

[13] See Id. ECF Nos. 60 & 64.

[14] See Id. ECF No. 67.

[15] See Id. ECF No. 294.

[16] See In re Blue Ice Investments, LLC, et al., Case No. 2:20-bk-02208 (Bankr. D. Ariz. May 21, 2020), ECF No. 49.

[17] See Id. ECF Nos. 53 & 55.

[18] See Id. ECF No. 58.

[19] See Id. ECF No. 124.

[20] See In re Chip's Southington, LLC, Case No. 20-21458 (Bankr. D. Conn. Apr. 9, 2021), ECF No. 140.

[21] Id.

[22] See Id. ECF No. 183.

[23] See Id. ECF No. 214.

[24] See Id. ECF Nos. 241 & 424;; see also 2021 Bankr. LEXIS 1900 (Bankr. D. Conn. July 16, 2021).

[25] In re Cosi, Inc., et al., Adv. Case No. 20-50591 (Bankr. D. Del. May 11, 2021), ECF No. 40.

[26] Id.; see also ECF No. 343.

[27] See ECF Nos. 40, 343 & 347.

[28] See Id. ECF No. 354.

[29] See Id. ECF No. 347.

[30] See Id. ECF No. 354.

[31] Id.

[32] Id.

[33] See ECF Nos. 354 & 369.

[34] See ECF Nos. 354 & 391.

[35] *United States v. Nicolet, Inc.*, 857 F.2d 202, 207 (3d Cir. 1988) (stating that the purpose of the automatic stay is to provide debtors with a "breathing spell" and to "replace the unfair race to the courthouse with an orderly liquidation procedure designed to treat all creditors equally").

[36] 11 U.S.C. §§ 501, 503, 506, 507; Fed. R. Bankr. P. 3001, 3002, 3003.