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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

In Re: ASTRIA HEALTH, et al.[1] Debtors and Debtors in Possession,	Lead Case No. 19-01189-11 Adv. Proc. Case No. 20-80016-WLH
ASTRIA HEALTH, et al., Plaintiffs, v.	MOTION FOR MANDATORY WITHDRAWAL OF REFERENCE Hearing: July 23 at 6:30 p.m. Without Oral Argument

[1] The Debtors, along with their case numbers, are as follows: Astria Health (19-01189-11), Glacier Canyon, LLC (19-01193-11), Kitchen and Bath Furnishings, LLC (19-01194-11), Oxbow Summit, LLC (19-01195-11), SHC Holdco, LLC (19-01196-11), SHC Medical Center - Toppenish (19-01190-11), SHC Medical Center - Yakima (19-01192-11), Sunnyside Community Hospital Association (19-01191-11), Sunnyside Community Hospital Home Medical Supply, LLC (19-01197-11), Sunnyside Home Health (19-01198-11), Sunnyside Professional Services, LLC (19-01199-11), Yakima Home Care Holdings, LLC (19-01201-11), and Yakima HMA Home Health, LLC (19-01200-11).

UNITED STATES SMALL BUSINESS ADMINISTRATION and JOVITA CARRANZA, in her capacity as Administrator for the United States Small Business Administration,

Defendants.

MOTION FOR MANDATORY WITHDRAWAL OF REFERENCE

The United States of America (the "United States"), on behalf of Jovita Carranza, in her capacity as Administrator for the U.S. Small Business Administration ("SBA"), hereby moves (this "Motion") to withdraw the reference of the above-captioned adversary proceeding ("Adversary Proceeding"). This Motion is brought pursuant to 28 U.S.C. § 157(d), Rule 5011 of the Federal Rules of Bankruptcy Procedure, and Rule 5011-1 of the Local Bankruptcy Rules.

INTRODUCTION

Withdrawal of the reference here is mandatory under 28 U.S.C. § 157(d) because Plaintiffs' claims in the Adversary Proceeding require the Bankruptcy Court to interpret new non-bankruptcy law—the Coronavirus Aid, Relief, and Economic Stimulus ("CARES") Act, Pub. L. 116-136, 134 Stat. 281, and the emergency rules issued by the SBA as authorized by the CARES Act in section 1114. Plaintiffs' claims relate to the Paycheck Protection Program ("PPP"), CARES Act § 1102, 15 U.S.C. § 636(a)(36), a $659 billion loan guarantee program created under the CARES Act that has extended hundreds of thousands of loans to small businesses and non-

profits across the nation over the past two months. Plaintiffs argue, among other things, that the SBA violated the Administrative Procedures Act ("APA"), 5 U.S.C. § 701 *et seq.*, by exceeding its statutory authority, or acting arbitrarily or capriciously, when it issued an emergency rule excluding bankrupt entities or entities with an owner in bankruptcy from the PPP. ECF No. 1 at ¶¶ 87-97 (requesting the bankruptcy court to set aside, under 5 U.S.C. §§ 706(2)(A) and (C) of the APA, the SBA's rulemaking "that is in excess of statutory jurisdiction… [and] that is arbitrary and capricious or an abuse of discretion").

The SBA addressed the bankruptcy exclusion in two separate agency rules. Congress, through the CARES Act and Small Business Act, explicitly delegated authority to the Administrator to issue those rules. Resolving the issues raised in the Adversary Proceeding requires an interpretation—not merely an application—of the newly enacted CARES Act, which necessitates withdrawal of the reference.

On June 3, 2020, in the Adversary Proceeding, after briefing and oral argument, the Bankruptcy Court orally granted Plaintiff's request for a preliminary injunction. ECF No. 19. On June 10, 2020, the Bankruptcy Court entered an Order Granting Preliminary Injunction, Denying Stay Pending Appeal, and Certifying Issues to the Ninth Circuit Court of Appeals. ECF No. 22.

The Bankruptcy Court concluded that the Plaintiffs were likely to succeed on the merits on its APA claims that the SBA exceeded its statutory authority to implement the CARES Act PPP and that the SBA's determination to exclude bankrupt

entities or entities with an owner in bankruptcy from participation in the PPP was arbitrary and capricious. ECF No. 22, Exhibit A, Tr. at 15:5-23:14.

The Court asserted that Plaintiff's APA claims were "core" and that the Court had authority to issue a final order because the "APA claim is … a matter concerning the administration of this bankruptcy estate." *Id.,* Tr. at 12:9-12.

Contemporaneous with filing this Motion, the United States is filing a Notice of Appeal of the Bankruptcy Court's Order Granting Preliminary Injunction, Denying Stay Pending Appeal, and Certifying Issues to the Ninth Circuit Court of Appeals.

BACKGROUND

I. THE SMALL BUSINESS ADMINISTRATION

Through the Small Business Act, 15 U.S.C. § 631 *et seq.*, Congress created the SBA to "aid, counsel, assist, and protect, insofar as is possible, the interests of small-business concerns," in order to preserve the system of free competitive enterprise that is "essential" to the economic well-being and security of the Nation. 15 U.S.C. § 631(a). To promote that objective, Congress placed the SBA under the management of a single Administrator, *id*., § 633(a), (b)(1), who is given "extraordinarily broad powers" under section 7(a) of the Act, 15 U.S.C. § 636(a), to provide a wide variety of technical, managerial, and financial assistance to small-business concerns. *SBA v. McClellan*, 364 U.S. 446, 447 (1960); *see generally* 15 U.S.C. § 636(a) (describing numerous varieties of general small-business loans the Administrator is "authorized" and "empowered" to make); 13 C.F.R. § 120.1. In the performance of these authorized

functions, the Administrator is further empowered to "make such rules and regulations as [she] deems necessary to carry out the authority vested in [her]," and to "take any and all actions . . . [that she] determines . . . are necessary or desirable in making . . . loans." 15 U.S.C. §§ 634(b)(6)–(7). SBA also has the power to establish general policies "which shall govern the granting and denial of applications for financial assistance by the Administration." 15 U.S.C. § 633(a).

II. SECTION 7(a) LENDING

The section 7(a) loan program is the SBA's primary program for providing financial assistance to small businesses. Under the terms of the Small Business Act, assistance under section 7(a) may take the form of loans or loan guarantees. 13 C.F.R. § 120.2(a); *see Valley Nat'l Bank v. Abdnor*, 918 F.2d 128, 129 (10th Cir. 1990); *Cal. Pac. Bank v. SBA*, 557 F.2d 218, 219 (9th Cir. 1977). In practice, the SBA ordinarily guarantees loans made by private lenders rather than disbursing funds directly to borrowers, *see United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 719 (1979), thus reducing risk for lenders and making it easier for them to access capital and for small business to obtain loans. https://www.sba.gov/funding-programs/loans.

III. SECTION 7(a) LOAN UNDERWRITING

Ordinarily, to qualify for an SBA general business loan an applicant must be an operating business organized for profit that is located in the United States, 13 C.F.R. § 120.100(a)–(c); meet the size standards for a "small" business set forth under the statute and SBA rules (usually stated in terms of number of employees, or average

annual receipts), *see* 15 U.S.C. § 632(a)(2); 13 C.F.R. § 120.100(d); 13 C.F.R. Part 121; and demonstrate that the desired credit is not available elsewhere on reasonable terms, 15 U.S.C. § 632(h); 13 C.F.R. §§ 120.100(e), 120.101. Additionally, the Small Business Act requires that "[a]ll loans made under this subsection *shall* be of such sound value or so secured as reasonably to assure repayment." 15 U.S.C. § 636(a)(6) (emphasis added). Form 1919 (attached to the Miller Decl.) serves as the application for section 7(a) loans. It asks whether the applicant has "ever filed for bankruptcy protection." *See also* Standard Operating Procedure 50 10 5(K) (Lender and Development Company Loan Programs) at 37 (allowing lenders to consider "past bankruptcy"). By regulation, requirements listed on Form 1919 and other official SBA forms comprise part of the "Loan program requirements." 13 C.F.R. § 120.10. Lenders agree to abide by these requirements when joining the section 7(a) lending program. *Id.*; *see also* SBA Forms 3506 and 3507 (addressing new PPP lenders).

IV. THE CORONAVIRUS AID, RELIEF, & ECONOMIC STIMULUS (CARES) ACT

On March 27, 2020, the President signed into law the Coronavirus Aid, Relief, and Economic Stimulus (CARES) Act, Pub. L. 116-136, 134 Stat. 281, providing an unprecedented package of emergency economic assistance and other support to assist businesses and Americans coping with the enormous economic and public health crises triggered by the worldwide coronavirus (COVID-19) pandemic. *See* SBA, Interim Final Rule, "Business Loan Program Temporary Changes; Paycheck

Protection Program" (the First Interim Final Rule), 85 Fed. Reg. 20,811 (April 15, 2020). Section 1102 of the CARES Act established the PPP to assist eligible small businesses experiencing economic hardship as a result of COVID-19 measures. *See id.* Section 1102(a)(2) adds a new paragraph (36) to section 7(a) of the Small Business Act, 15 U.S.C. § 636(a)(36), extending loans to eligible small businesses for certain covered uses, including among other things payroll costs. CARES Act § 1102(a)(2); 15 U.S.C. § 636(a)(36)(F)(i).

Otherwise, the existing section 7(a) requirements and limitations remain unaltered and govern PPP lending. The CARES Act provides, "*Except as otherwise provided in this paragraph*, the [SBA] *may* guarantee [PPP] covered loans"—not make loans directly, however—"under the same terms, conditions, and processes as a loan made under this subsection," *i.e.*, section 7(a). 15 U.S.C. § 636(a)(36)(B) (emphasis added). The CARES Act then sets forth in extensive detail the precise ways in which PPP covered loans differ from other section 7(a) loans by authorizing the SBA to guarantee covered loans to particular types of businesses not previously eligible for section 7(a) loans under the SBA's rules. *Id.* § 636(a)(36)(D)−(R). Specifically, it allows SBA to guarantee PPP loans to various nonprofit organizations, independent contractors, and self-employed individuals, as well as to small business concerns, *id.* § 636(a)(36)(D)(i), (ii); relaxes size limitations to allow businesses with as many as 500 employees (or more, depending on the industry in which they operate) to receive assistance, *id.* § 636(a)(36)(D)(i)(I); and (iii) selectively waives certain of

the SBA's affiliation rules used to determine small business "size." Notably, while expanding eligibility to those specified types of businesses, the CARES Act leaves unaltered the requirement that "[a]ll loans made under this subsection *shall* be of such sound value or so secured as reasonably to assure repayment." 15 U.S.C. § 636(a)(6) (emphasis added).

The CARES Act initially allocated $349 billion to guarantee PPP loans. CARES Act § 1102(b)(1). On April 16, 2020, the SBA issued a notice that PPP was closed to new applications. Congress then passed the Paycheck Protection Program and Health Care Enhancement Act (CARES Act II) on April 24, 2020 to add $310 billion to the PPP. PL 116-139 § 101(a)(1).

V. EMERGENCY RULEMAKING AUTHORITY

The CARES Act authorizes the Administrator of the SBA to issue emergency regulations to implement the PPP more rapidly than it could under typical notice and comment requirements. CARES Act § 1114. The Administrator of the SBA posted her First Interim Final Rule on the SBA website on April 3, 2020, which was subsequently published in the Federal Register on April 15, 2020. 85 Fed. Reg. 20,811. The First Interim Final Rule "streamlin[es] the requirements of the regular 7(a) loan program." *Id.* at 20,812. The rule states that lenders need not comply with case-by-case underwriting requirements of 13 C.F.R. § 120.150. *Id.* Instead, under a section titled "What Do Lenders Have to Do in Terms of Loan Underwriting," it states: "Each lender's underwriting obligation under the PPP is limited to [the

enumerated] items above and reviewing the 'Paycheck Protection Application Form.'" The Paycheck Protection Application Form itself requires the borrower to certify, among other things, that it is "not presently involved in a bankruptcy." SBA Form 2483.

On April 24, concurrent with Congress' extension of additional PPP funding, SBA posted a new interim final rule, which was subsequently published in the Federal Register on April 28, 2020, entitled "Business Loan Program Temporary Changes; Paycheck Protection Program –Requirements – Promissory Notes, Authorizations, Affiliation, and Eligibility" (the Fourth Interim Final Rule). 85 Fed. Reg. 23,450. The Fourth Interim Final Rule provides additional information regarding a number of eligibility requirements. Section III(4) of the Fourth Interim Final Rule specifically addresses applicants in bankruptcy. It provides:

> *4. Eligibility of Businesses Presently Involved in Bankruptcy Proceeding.*
>
> *Will I be approved for a PPP loan if my business is in bankruptcy?*
>
> No. If the applicant or the owner of the applicant is the debtor in a bankruptcy proceeding, either at the time it submits the application or at any time before the loan is disbursed, the applicant is ineligible to receive a PPP loan. . . .
>
> . . .
>
> 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. In addition, the Bankruptcy Code does not require any person to make a loan or a financial accommodation to a debtor in bankruptcy. The Borrower Application Form for PPP loans (SBA Form 2483), which reflects this restriction in the form of a borrower certification, is a loan program requirement.

Fourth Interim Final Rule. 85 Fed. Reg. at 23,451.

VI. THE PAYCHECK PROTECTION FLEXIBILITY ACT OF 2020

On June 5, 2020, the President signed into law the Paycheck Protection Program Flexibility Act of 2020. *See* P.L. No. 116-142. The new act establishes a minimum maturity of five years for PPP loans with a remaining balance after forgiveness, § 2(a), extends the covered period for loans, § 3(a)–(b), alters certain requirements for loan forgiveness for employers unable to rehire employees or individuals similarly qualified, or unable to return to the same level of business as prior to the COVID-19 outbreak, § 3(b)(7), requires that recipients use at least sixty percent of the covered loan amount for payroll costs and up to forty percent for payment of interest on covered mortgage obligations, rent, or utilities, to be eligible for forgiveness, § 3(b)(8), revises the deferral period for PPP loans, § 3(c), and eliminates a provision that rendered loan recipients with a PPP debt that is ultimately forgiven ineligible to defer payroll tax payments. § 4. The Paycheck Protection Flexibility Act of 2020 does not, however, alter the sound value requirement in 15 U.S.C. § 636(a)(6). Nor does it alter SBA Form 2483 excluding debtors in bankruptcy.

ARGUMENT

District courts have original jurisdiction of "all civil proceedings arising under title 11, or arising in or related to cases under title 11." 28 U.S.C. § 1334(b). Each

district court may, however, "provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district." 28 U.S.C. § 157(a).

Pursuant to this authority, the United States District Court for the Eastern District of Washington has referred all bankruptcy cases filed in the district to the bankruptcy court. *See* LCivR 83.5(a) (Pursuant to 28 U.S.C. § 157(a), this Court hereby refers to the bankruptcy judges of this district all cases under United States Code Title 11, and all proceedings arising under Title 11 or arising in or related to cases under Title 11).

However, 28 U.S.C. § 157(d) provides:

> The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely notice of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

28 U.S.C. § 157(d).

The United States' motion, filed prior to the entry of the Bankruptcy Court's scheduling order in the Adversary Proceeding, is timely. *See* LBR 5011-1 (b) (Any motion for withdrawal of reference in an adversary proceeding, in whole or in part, shall be filed in the bankruptcy court no later than 14 days following the entry of the scheduling order").

Mandatory withdrawal of the reference is required here. "The purpose of § 157(d) is to assure that an Article III judge decides issues calling for more than routine application of [federal laws] outside of the Bankruptcy Code." *Ames Dep't Stores, Inc. v. Lumbermens Mut. Cas. Co. (In re Ames Dep't Stores, Inc.)*, 512 B.R. 736, 740 (S.D.N.Y. 2014) (citation omitted) (alteration in original).

The mandatory withdrawal provision of § 157(d) "*mandates* withdrawal in cases requiring material consideration of non-bankruptcy federal law." *Sec. Farms v. Int'l Bhd. of Teamsters, Chauffeurs, Warehousemen & Helpers*, 124 F.3d 999 at 1008 (9th Cir. 1997) (emphasis in original). While "[t]he Ninth Circuit has not squarely addressed mandatory withdrawal," other circuit courts "have held that 'mandatory withdrawal is required only when [non-title 11] issues require the interpretation, as opposed to mere application, of the non-title 11 statute, or *when the court must undertake analysis of significant open and unresolved issues regarding the non-title 11 law.*'" *In re Tamalpais Bancorp*, 451 B.R. 6, 8-9 (N.D. Cal. 2011) (citations omitted) (emphasis added). "Courts within the Ninth Circuit have largely adopted this approach." *Id.* (citations omitted).

Here, the issues raised by Plaintiffs in the Adversary Proceeding require a court to determine whether the SBA exceeded its statutory authority under the newly-enacted CARES Act, or acted arbitrarily or capriciously, in excluding bankrupt entities or entities with an owner in bankruptcy from participation in the PPP. Because the CARES Act was enacted less than three months ago, on March 27, 2020,

this complex issue of statutory interpretation of non-bankruptcy law is an issue of first impression for courts nationwide. The CARES Act is a non-title 11 law and the interpretation of it under the APA inarguably requires a court to undertake an analysis of significant and unresolved issues of non-bankruptcy law. Accordingly, this issue should be heard and resolved in the district court, and therefore, mandatory withdrawal of the reference is required. *See In re Tamalpais Bancorp,* 451 B.R. at 9 (mandatory withdrawal is triggered when the bankruptcy court must "undertake analysis of significant open and unresolved issues regarding the non-title 11 law"); *One Longhorn Land I, L.P. v. Presley*, 529 B.R. 755, 759 (C.D. Cal. 2015) ("The Ninth Circuit has suggested in dicta that mandatory withdrawal hinges 'on the presence of substantial and material questions of federal law.'") citing *Sec. Farms,* 124 F.3d at 1008 n.4.

Withdrawal is also required because the Bankruptcy Court has exceeded its Constitutional authority. The Bankruptcy Court determined that that Plaintiffs' APA claims are "core" and that the Bankruptcy Court had authority to issue a final order because the "APA claim is … a matter concerning the administration of this bankruptcy estate." ECF No. 22, Exhibit A, Tr. at 12:9-12.

The distinction between core and non-core matters is fundamental to a bankruptcy court's jurisdiction. The Ninth Circuit has defined a core proceeding as one that "invokes a substantive right provided by title 11 or ... a proceeding that, by its nature, could arise only in the context of a bankruptcy case." *In re Ray*, 624 F.3d

1124, 1131 (9th Cir. 2010), quoting *Gruntz v. County of L.A. (In re Gruntz)*, 202 F.3d 1074, 1081 (9th Cir. 2000). A matter is core and "arises under" the Bankruptcy Code if "if its existence depends on a substantive provision of bankruptcy law, that is, if it involves a cause of action created or determined by a statutory provision of the Bankruptcy Code" or "arises in" a case under the Bankruptcy Code if "it is an administrative matter unique to the bankruptcy process that has no independent existence outside of bankruptcy and could not be brought in another forum, but whose cause of action is not expressly rooted in the Bankruptcy Code." *In re Ray*, 624 F.3d at 1131. In core proceedings, a bankruptcy judge "may enter appropriate orders and judgments" subject to appellate review by the district court. 28 U.S.C. § 157(b)(1)).

On the other hand, matters are deemed "non-core" if they "do not depend on the Bankruptcy Code for their existence and they could proceed in another court." *Dunmore v. United States*, 358 F.3d 1107, 1114 (9th Cir. 2004). In non-core proceedings, the bankruptcy judge "shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after . . . reviewing de novo." 28 U.S.C. § 157(c)(1)).

The Bankruptcy Court's decision that Plaintiff's APA claims are "core" cannot be reconciled with this controlling authority. Plaintiff's APA claims clearly do not "invoke a substantive right created by the federal bankruptcy law", nor do they concern an "administrative matter unique to the bankruptcy process." Moreover, the claims are not ones that "could not exist outside of the bankruptcy." Plaintiff's APA

claims do not "invoke a substantive right created by the federal bankruptcy law" because the cause of action for these claim is the APA, not anything in the Bankruptcy Code. *See* 5 U.S.C. § 702; *see also In re Penobscot Valley Hosp.,* 2020 WL 3032939, at *4 (Bankr. D. Me. June 3, 2020) ("the Debtor's complaint [concerning a PPP loan] ventures far beyond the confines of the Bankruptcy Code, asserting a claim under the APA. . . this proceeding is not one arising in or arising under the Bankruptcy Code, but rather is one related to a case under the Bankruptcy Code"); *Diocese of Rochester v. U.S. Small Bus. Admin.*, 2020 WL 3071603, at *4 (W.D.N.Y. June 10, 2020) ("It is not clear whether the Bankruptcy Court would have the authority to finally adjudicate Plaintiffs' claims under the APA. . . This lack of clarity supports withdrawing the referral…"); *In re United Air Lines, Inc.*, 337 B.R. 904, 910 (N.D. Ill. 2006) (Debtors' Title IV of ERISA claim "exists outside the Bankruptcy Code and can arise outside the context of a bankruptcy case. . . Accordingly, the termination proceeding neither invokes a substantive right provided by Title 11 nor, by its nature, could it arise only in the context of a bankruptcy case."). Further, Plaintiffs' APA claims are in no way "administrative matters unique to the bankruptcy process." Finally, Plaintiff's APA claims could exist outside of bankruptcy because there can be no dispute that Plaintiff could have filed its APA suit directly in the district court. 28 U.S.C. § 1331.

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CONCLUSION

For the foregoing reasons, the United States respectfully requests mandatory withdrawal of the reference for the Adversary Proceeding.

RESPECTFULLY SUBMITTED: June 23, 2020.

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