United States Bankruptcy Court
Eastern District of Washington

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WHITMAN L. HOLT
UNITED STATES BANKRUPTCY JUDGE

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July 17, 2020

VIA CM/ECF DOCKETING

Hon. Rosanna Malouf Peterson
U.S. District Court, Eastern District of Washington
P.O. Box 1493
Spokane, WA 99210

Re: Motion to Withdraw the Bankruptcy Reference of *Astria Health, et al. v. United States Small Business Administration, et al. (In re Astria Health, et al.)*, Adv. Proc. No. 20-80016-WLH (Bankr. E.D. Wash.)

Dear Judge Peterson:

I write pursuant to Local Bankruptcy Rule 5011-1(c) to provide comments regarding the government's motion to withdraw the bankruptcy reference filed in the above-referenced adversary proceeding. I do not urge a specific disposition of the motion, but hope to provide some context and perspective that may prove useful to your analysis of the issues.

Overview of the Action

This litigation addresses the Small Business Administration's decision to categorically exclude bankrupt entities from eligibility for the Paycheck Protection Program ("PPP") loans that Congress enacted as part of the Coronavirus Aid, Relief, and Economic Security or CARES Act. The plaintiffs, several debtors in pending complex chapter 11 cases, operate two rural hospitals and several healthcare clinics in the Yakima Valley, among other things. The debtors initiated this adversary proceeding against the SBA after their applications for PPP loans were rejected based solely on their status as debtors under title 11. The debtors challenge the SBA's bankruptcy exclusion on several grounds, including under the Bankruptcy Code and the Administrative Procedures Act. Because of certain time constraints, the debtors also sought an order enjoining rejection of the debtors' loan applications based on the bankruptcy exclusion.

On June 10, 2020, after briefing and oral argument, I granted the requested preliminary injunction and incorporated an oral ruling I read into the record on June 3, 2020. Both sides appealed the preliminary-injunction order. These appeals are pending before Your Honor as case numbers 20-cv-03089-RMP and 20-cv-03098-RMP. Simultaneous with its notice of appeal, the government filed the motion to withdraw the reference at issue here, which seeks to transfer all litigation (including discovery, pre-trial practice, and any trial) remaining after disposition of the pending appeals from this court to the District Court.

Statutory Framework

As you know, the Judicial Code invests federal district courts with jurisdiction over all bankruptcy cases, as well as disputes "arising in" or "related to" such cases, but permits district courts to order automatic and mandatory referral of all bankruptcy cases and all bankruptcy-related matters to the district's bankruptcy judges (who are designated as "units" of the district court).[1] In this district, the bankruptcy reference tracks the statutory framework in Local Civil Rule 83.5(a). There is no disagreement that the dispute at issue here falls within the broad scope of federal bankruptcy jurisdiction and thus was properly referred to me in the first instance.

The government's motion invokes Judicial Code section 157(d), a mechanism to potentially reallocate work between district judges and bankruptcy judges by providing two bases for the district court to withdraw its default bankruptcy reference, one "permissive" and the other "mandatory." Under either, "[t]he burden of persuasion is on the party seeking withdrawal."[2] The burden is allocated in this fashion because withdrawal of the reference is an "exception to the rule," one not intended to provide an "escape hatch" out of bankruptcy courts.[3] Rather, as the Court of Appeals for the Ninth Circuit has consistently recognized, the system designed by the Judicial Code promotes judicial economy by "making use of the bankruptcy court's unique knowledge of Title 11 and familiarity with the actions before them."[4]

Standards for Mandatory Withdrawal

The Court of Appeals for the Ninth Circuit has explained that mandatory withdrawal "hinge[s] on the presence of *substantial and material* questions of federal law."[5] District courts have concluded that the mere *presence* of nonbankruptcy issues is insufficient; rather, withdrawal is mandatory only if those issues "dominate" the bankruptcy issues.[6] District courts have also concluded that the mandatory withdrawal analysis requires that "there at least must be a threshold level of showing" that detailed, substantive interpretation of nonbankruptcy federal law will be required and "that resolution of the claims begs for more than straight forward application of facts to well-established federal law."[7] Furthermore, the *possibility* that nonbankruptcy federal law may play some role in the litigation is insufficient; mandatory withdrawal applies only when substantial and material consideration of such law is *necessary* to resolve the proceeding.[8] Based on these standards, I do not believe that this case presents any issues triggering this narrow exception to the general framework of the bankruptcy reference.

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1 *See* 28 U.S.C. §§ 151, 157(a), 1334.

2 *FTC v. First Alliance Mortg. Co. (In re First Alliance Mortg. Co.)*, 282 B.R. 894, 902 (C.D. Cal. 2001).

3 *See, e.g.*, *Official Comm. of Unsecured Creditors of Neuman Homes, Inc. v. Neumann (In re Neumann Homes, Inc.)*, 414 B.R. 383, 387 (N.D. Ill. 2009).

4 *Sigma Micro Corp. v. Healthcentral.com (In re Healthcentral.com)*, 504 F.3d 775, 787-88 (9th Cir. 2007).

5 *Sec. Farms v. Int'l Bd. of Teamsters*, 124 F.3d 999, 1008 n.4 (9th Cir. 1997) (emphasis added).

6 *See, e.g.*, *Hawaiian Airlines, Inc. v. Mesa Air Grp., Inc.*, 355 B.R. 214, 222 (D. Haw. 2006).

7 *See, e.g.*, *Siegel v. Caldera*, 2010 U.S. Dist. LEXIS 34355, at *11 (C.D. Cal. Mar. 19, 2010).

8 *See, e.g.*, *In re Ionosphere Club, Inc.*, 103 B.R. 416, 418-19 (S.D.N.Y. 1989).

First, although the debtors assert claims under the APA (and I concluded when analyzing the injunctive factors that these claims have a high probability of success), final resolution of these claims on the merits will tread no novel legal ground nor involve resolution of any substantial and material legal questions. The standards and analytic framework for resolving the APA claims raised here are firmly established by robust, clear, and binding Supreme Court and Ninth Circuit precedent.[9] Resolution of the litigation thus merely requires straightforward application of settled and well-developed legal standards to the specific facts presented here.

Second, to the extent a resolution necessitates considering aspects of the CARES Act, that consideration will almost certainly be ancillary to the primary issues presented (including whether the SBA engaged in a process of reasoned analysis and developed the type of record the APA requires) and not involve resolution of *substantial and material* questions of federal law. Only a handful of CARES Act provisions have any conceivable relevance to the issues presented here and the deciding court need not engage in substantial construction to resolve competing, outcome-determinative interpretations of that statute. To the extent analyzing a given sub-issue involves some incidental statutory construction, such task is susceptible to the simple application of well-established canons without addressing any material legal questions. Finally, to the extent any of the debtors' APA claims implicate the purpose of the CARES Act, I do not believe there is any material question or dispute about the Act's legislative purpose, which Congress evidently enacted as a prompt and forceful response to the economic impact of the COVID-19 pandemic. For these reasons, I see nothing triggering a mandatory withdrawal.

Withdrawal for "Cause"

One factor bearing on permissive withdrawal of the reference is whether the litigation is a "core" bankruptcy proceeding or otherwise within the scope of final bankruptcy adjudication. This factor is relevant but not determinative as district courts often conclude that principles of judicial economy favor leaving all bankruptcy-related matters with the bankruptcy court, even non-core proceedings, subject to review by an Article III judge.[10]

To the extent it is relevant to the present motion, the issues arising in this adversary proceeding are core. Judicial Code section 157(b)(2) provides a non-exclusive list of "core"

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[9] *See, e.g.*, *Dep't of Homeland Sec. v. Regents of the Univ. of Cal*., 207 L. Ed. 2d 353, 366-67, 369-77 (2020); *Motor Vehicle Mfrs. Ass'n of the U.S. v. State Farm Mut. Auto. Ins. Co*., 463 U.S. 29, 43 (1983); *Latino Issues Forum v. United States EPA*, 558 F.3d 936, 941 (9th Cir. 2009); *Ariz. Cattle Growers' Ass'n v. United States Fish & Wildlife, BLM*, 273 F.3d 1229, 1235-36 (9th Cir. 2001).

[10] *See, e.g.*, *In re Temecula Valley Bancorp, Inc.*, 523 B.R. 210, 223-24 (C.D. Cal. 2014); *Siegel v. FDIC (In re IndyMac Bancorp Inc.)*, 2011 U.S. Dist. LEXIS 78418, at *17-18 (C.D. Cal. July 15, 2011). Through the report and recommendation process used for non-core and *Stern* claims, the district court benefits from the bankruptcy court's specialized expertise with bankruptcy issues and context, as well as the bankruptcy court's greater familiarity with the case, all consistent with the traditional allocation of work between the two courts. *See, e.g.*, *In re Healthcentral.com*, 504 F.3d at 787-88. In a ruling in harmony with a practical division of judicial responsibility, the Supreme Court held that de novo review by the district court, regardless of the precise process that is followed, eliminates any constitutional concerns associated with the non-Article-III status of bankruptcy judges. *See Exec. Benefits Ins. Agency v. Arkison*, 573 U.S. 25, 35-40 (2014); *see also, e.g.*, *Mastro v. Rigby*, 764 F.3d 1090, 1094-95 (9th Cir. 2014).

bankruptcy proceedings, which includes "matters concerning the administration of the estate."[11] The debtors here intend to use the PPP funds to administer their bankruptcy estates under my supervision, including by paying front-line nurses' wages and other costs of administration during the pendency of their bankruptcy cases. As such, the dispute about whether the debtors may participate in PPP funding is a "matter concerning" the administration of their estates and, hence, a "core" bankruptcy proceeding.

Beyond the specific classification under section 157(b)(2), this dispute also fits within the scope of "arising in" bankruptcy jurisdiction, which is a term of art that overlaps the core/non-core distinction. "Arising in" bankruptcy proceedings "are those that are not based on any right expressly created by title 11, but nevertheless, would not exist outside of the bankruptcy."[12] That is the case here – the debtors' challenge to the bankruptcy exclusion from PPP eligibility could have no conceivable existence outside of the bankruptcy context. If a non-bankrupt entity attempted to bring such a challenge, a court would necessarily dismiss the suit based on the plaintiff's lack of injury and, therefore, lack of standing.[13] The *only* party that could maintain a viable action challenging the bankruptcy exclusion is a debtor under title 11 actually denied access to PPP funding. The government correctly notes that APA-related actions *generally* can exist outside of the bankruptcy context but ignores that *the present action* could not; this litigation is solely about a bankruptcy exclusion and that specific dispute could never be litigated other than in the context of a bankruptcy case. The action therefore "arises in" a title 11 case.[14]

For similar reasons, there is no constitutional obstacle preventing the bankruptcy court from finally adjudicating this adversary proceeding (subject to the appellate process under Judicial Code section 158). In *Stern v. Marshall*, the Supreme Court made clear that bankruptcy judges may finally resolve disputes whenever "the action at issue stems from the bankruptcy itself."[15] This action inescapably stems from the Astria bankruptcy cases – had the plaintiffs not been debtors in bankruptcy, their PPP applications would not have been rejected on that basis and this litigation would not exist. Once again, this is not antitrust litigation, a state-law contract dispute, or a similar case that could arise or be prosecuted outside of the bankruptcy context – the dispute necessarily relies on a bankruptcy exclusion that only a debtor in bankruptcy has standing to challenge.

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[11] 28 U.S.C. § 157(b)(2)(A).

[12] *See, e.g.*, *Maitland v. Mitchell (In re Harris Pine Mills)*, 44 F.3d 1431, 1435 (9th Cir. 1995) (quoting *In re Wood*, 825 F.2d 90, 96-97 (5th Cir. 1987)).

[13] *See, e.g.*, *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-67 (1992).

[14] The government suggests that this action could have been brought in "another forum" but misses the point of the "arising in" analysis. Cases discussing "another forum" refer to forums not reliant on bankruptcy jurisdiction over the action – such as a state court regarding a nonbankruptcy contract claim or a federal district court regarding an antitrust claim. The point of the "arising in" question is again whether the lawsuit could exist elsewhere absent the bankruptcy case or whether its genesis is the bankruptcy. Although the government mentions two other similar lawsuits filed in federal district courts in the first instance, those lawsuits presumably rested on bankruptcy jurisdiction under 28 U.S.C. § 1334 and it is not clear why the applicable district courts did not apply their standing orders of reference given the plain relationship to title 11 cases.

[15] 564 U.S. 462, 499 (2011).

In sum, this litigation is statutorily "core," is a civil proceeding "arising in" a bankruptcy case, and is an action stemming from the Astria bankruptcy itself. As such, it is a lawsuit over which a bankruptcy judge may properly exercise final adjudicatory authority under Judicial Code section 157 and the United States Constitution.[16]

Standstill Order

The debtors contend that the government's withdrawal motion violates a stipulated order imposing a standstill on further proceedings pending resolution of the appeals before you. Because the government filed its motion before the hearing on the standstill order, it seems reasonable that the parties contemplated the government's motion in discussing their stipulation. I do not know, however, if these discussions or considerations occurred. Regardless, the parties have sought no relief in the bankruptcy court relating to a possible violation of the standstill order. I do not intend to grant any relief that would infringe on your consideration of the withdrawal motion unless Your Honor refers a decision regarding the applicability of the standstill order back to my court. Otherwise, Your Honor might consider deferring argument or a decision regarding the withdrawal motion until after your resolution of the pending appeals.

Impact on the Underlying Cases

Local Bankruptcy Rule 5011-1(c) contemplates that my comments may address "the impact of the adversary proceeding upon the underlying case." Although this dispute is of significant economic consequence for the Astria debtors and a favorable outcome will materially improve the chances of several rural hospitals and clinics successfully reorganizing, I do not believe the pendency of this litigation or any decision regarding the withdrawal motion (or the pending appeals) requires the underlying chapter 11 cases to be held in abeyance or otherwise delayed. The Astria debtors recently filed a chapter 11 plan and are working to prosecute that plan through a confirmation hearing scheduled in September 2020. I anticipate that this process will continue apace regardless of the activity in the adversary proceeding. Put differently, the underlying chapter 11 cases and this adversary proceeding can travel along their separate tracks.

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I hope these comments are helpful during your consideration of the withdrawal motion. If there is anything further that I can provide to assist, I am happy to do so.

Sincerely,

Whitman L. Holt
United States Bankruptcy Judge

[16] Other bankruptcy courts within the Ninth Circuit have reached a similar conclusion. *See, e.g.*, *Vestavia Hills, Ltd. v. United States SBA (In re Vestavia Hills, Ltd.)*, 2020 Bankr. LEXIS 1713, at *12-13 (Bankr. S.D. Cal. June 26, 2020). I am not aware of any decision by a district court within the Ninth Circuit regarding this issue.