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BANK, SBA DEFEAT TRUSTEE'S BID TO RECOUP \$8.1 MILLION FOR RETURNED PPP LOAN

Case name: *Brady v. U.S. Small Business Administration et al. (In re Specialty's Café and Bakery Inc.)*, 71 BCD 66, 2022 WL 318637 (Bankr. N.D. Cal. 2022).

Ruling: A California bankruptcy court has ruled against a Chapter 7 trustee for a restaurant chain on her claim to recoup \$8.1 million in Paycheck Protection Program loan funds that the debtor received in 2020 but returned to the lender days later.

What it means: Lois I. Brady, Chapter 7 trustee for Specialty's Café and Bakery Inc.'s bankruptcy, had alleged that Customers Bank and the U.S. Small Business Administration received a preferential transfer when the company changed its mind about a PPP loan and returned the proceeds right before filing bankruptcy. In a Feb. 2 decision, however, U.S. Bankruptcy Judge Roger L. Efremsky of the Northern District of California granted summary judgment for Customers Bank and the SBA, ruling that Brady's preferential-transfer claims against them under Section 547(b) fail as a matter of law.

Summary: Specialty's had operated a chain of about 45 restaurants in class A office buildings, according to Judge Efremsky's opinion.

The debtor's business suffered a blow starting in March 2020 when COVID-19-related shelter-in-place directives took effect and many office workers began working from home.

In April 2020, Specialty's applied for a PPP loan through a loan broker.

On May 7 the company received approval from Customers Bank for an \$8.1 million loan, and the funds were transferred via wire transfer.

PPP loans, a product of 2020's Coronavirus Aid, Relief and Economic Stimulus, or CARES, Act, were guaranteed by the SBA and generally forgivable if the recipient used the funds on allowed business expenses such as payroll, rent and utilities.

After receiving the loan, Specialty's leadership began to have second thoughts about taking out the loan given changes to the program terms and concerns about the company's future viability, according to the opinion.

The debtor's board decided during a May 12, 2020, special meeting to rescind the loan, and the company returned the \$8.1 million to Customers Bank by wire transfer the next day.

Specialty's returned the money within a window under PPP rules for borrowers to return funds without incurring any liability for representations on the loan application, Judge Efremsky's opinion said.

Specialty's filed its Chapter 7 petition May 27, 2020.

Trustee Brady filed an adversary proceeding against Customers Bank and the SBA, seeking to avoid the transfer of the \$8.1 million in loan funds back to the bank as a preferential transfer under Section 547(b). That section permits trustees to avoid as preferences certain transfer made by an insolvent debtor to a creditor in the 90 days before a bankruptcy filing.

The trustee and the defendants filed competing motions for summary judgment.

Judge Efremsky granted the motions filed by Customers Bank and the SBA, while denying the trustee's motion.

He concluded that the record did not support a Section 547 preference claim because Specialty's no longer owned the loan funds once the board decided to rescind the loan.

The money did not constitute property of the debtor at the time of the transfers but instead was held in a constructive trust or resulting trust for the benefit of the lender, the judge said, explaining that a resulting trust arises to carry out the parties' intentions, while a constructive trust is aimed at preventing unjust enrichment.

Judge Efremsky also said that Specialty's did not make the \$8.1 million transfer to a creditor on account of an antecedent debt, another required element of a preference claim.

The debtor effectively rescinded the loan within the May 14, 2020, deadline under PPP rules, and it was therefore no longer obligated on the debt, even though it had a duty to return the bank's money to complete the loan rescission, the judge said.

Moreover, Customers Bank and the SBA had established an affirmative defense that the transfer back to the bank occurred in the ordinary course of business pursuant to Section 547(c)(2), Judge Efremsky concluded.

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