Bankruptcy Law

New Restaurant Relief Fund Threatens to Stiff Bankrupt Companies

By Daniel Gill
May 18, 2021, 6:00 AM

- Bankrupt companies ineligible until reorganization plan confirmed
- Fund has advantages for restaurants, but expected to run out quickly

---

Bloomberg Law News 2021-05-20T13:48:19759-04:00

New Restaurant Relief Fund Threatens to Stiff Bankrupt Companies

By Daniel Gill 2021-05-18T06:00:46000-04:00

Bankrupt companies ineligible until reorganization plan confirmed

Fund has advantages for restaurants, but expected to run out quickly

Restaurants and bars that filed bankruptcy in the wake of pandemic losses are facing a possible shutout from a new $28.6 billion federal fund meant as a lifeline for the industry.

The Small Business Administration, which administers the Restaurant Revitalization Fund, says bankrupt companies can't apply unless they have a court-approved bankruptcy plan.

That restriction is a major concern, as struggling restaurants may not be able to get their bankruptcy plans approved before the money runs out, insolvency professionals say.

"All companies that file an application are saying that they're having financial difficulty; I don't see why it's different if you're in or out of Chapter 11," said attorney Andrew Helman of Dentons Bingham Greenebaum.

Fast casual restaurants Cosi and Even Stevens Sandwiches already have tried to ditch their bankruptcy cases so they can apply quickly.

"There are lots of restaurants of all shapes and sizes that will take advantage of the fund because they were able to hold off from filing bankruptcy," said Monique Almy, a partner at Crowell & Moring LLP. "The bulk of filed RRF applications so far are from companies that have been holding on" and not filing, she said.

The fledgling program likely won't have enough funds to buoy the industry, said Jennifer Feldsher, a partner with Morgan, Lewis & Bockius LLP's restructuring division.

As of May 12, the SBA received more than 266,000 applications seeking a total of $65 billion, well over the total amount available, the agency said in a statement. The SBA already has disbursed $2.7 billion to more than 21,000 restaurants, it said.

Bankruptcy Exclusion

The RRF, part of the $1.9 trillion Covid relief package passed by Congress in March, focuses "first on those who were left behind by the other relief programs" like the Paycheck Protection Program, President Joe Biden said in a May 6 speech touting the program.

Tailored to small, family-run businesses, the fund doesn't require them to "compete above their weight class" against larger companies in order to access grant money, he said.

Unlike the PPP, restaurants can use the funds for non-payroll expenses.

The first 21 days of the fund's availability also are reserved for "priority" companies owned by women, veterans, or "those who have been subjected to racial or ethnic prejudice or cultural bias" and whose capital and credit opportunities have consequently been impaired, according to the SBA.

It's unclear whether the $28.6 billion fund will even cover these priority businesses, Feldsher said. Priority applicants alone have filed more than 147,000 applications seeking $29 billion in grants, according to the SBA.

Attorneys question the policy behind denying access to bankrupt companies.

"I don't see any reason why a company reorganizing in Chapter 11 shouldn't be authorized to get the funds," Helman said.

"The SBA has a clear bias against bankrupt companies—who knows why?" Almy asked.

The agency didn't respond to a request for comment.

The SBA's similar stance toward PPP eligibility spurred several lawsuits to force the agency to accept bankrupt borrowers, with the courts split on the issue.

About a month ago, the agency quietly updated its guidance to indicate that companies with confirmed plans could apply, even if they hadn't yet emerged from bankruptcy. The SBA has adopted the same policy with respect to the RRF.

In a 2020 court filing, the agency said bankrupt companies should be excluded from the PPP because they carry an "'unacceptably high risk' of both 'unauthorized use of funds' and 'non-repayment of unforgiven loans.'"

Changing Tactics

Some restaurants already in bankruptcy are trying to dismiss their cases to qualify for the new funding source.

It’s an unusual move after the time and money investment, which “proves the benefit of the RRF program,” Almy said.

Fast casual restaurant chain Cosi Inc. originally asked a Delaware bankruptcy court to consider its reorganization plan on an expedited basis so that it could seek up to $10 million from the RRF.

But after the SBA said Cosi’s proposed interim plan approval wouldn’t cut it, Cosi changed course and asked the court to dismiss its case. The court granted the request, with the SBA taking no position on the move.

Covid has led to debtors “doing backflips” and behaving in ways that otherwise wouldn’t be considered rational or normal behavior, Judge Brendan L. Shannon said. “But these are not rational or normal times,” he said.

In a separate case, an Arizona bankruptcy judge wouldn’t allow Even Stevens Sandwiches LLC to dismiss its Chapter 11 case so that it can apply for PPP or RRF funding. Instead, the judge converted the case to Chapter 7.

Better Alternative

Several features of the new fund make it an especially attractive option for survival, when compared with discharging debt in bankruptcy.

The fund “is really good for restaurants, which are incredibly difficult to restructure, primarily because they lack hard assets—just leases and good will,” Helman said.

Concrete assets, like real estate, inventory, accounts receivable, and equipment, are much easier to value than something like good will.

The program also has more far-reaching benefits, Helman said. For example, restaurants will be able to pay their landlords, which must make their own debt payments, he said.

The RRF also is a better option for restaurants than the PPP, which has been difficult for them to access, Feldsher said.

“A key tenet of the PPP is you only get loan forgiveness if you use the funds to pay employees, but most restaurants were forced to furlough or fire their employees,” she said. So even if they received the money, they’d lose the opportunity to have the loans forgiven, she said.

“The RRF addresses these problems because the funds can be used for mortgage payments, rent, debt service, utilities, supplies, and retooling for outdoor dining or other adjustments,” Feldsher said.

The SBA also directly handles the RRF distribution process, in contrast to the PPP, which relies on banking institutions to facilitate funding, Almy said. The agency is “making great progress on approving loans and getting money out the door quickly,” she said.

That efficiency is a double-edged sword, narrowing the window for bankrupt restaurants to confirm their plans and become eligible.

—With assistance from Leslie A. Pappas in Wilmington, Del.

To contact the reporter on this story: Daniel Gill in Washington at dgill@bloomberglaw.com

To contact the editors responsible for this story: Laura D. Francis at lfrancis@bloomberglaw.com; Roger Yu at ryu@bloomberglaw.com