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6 **IN THE UNITED STATES DISTRICT COURT**
7 **FOR THE DISTRICT OF ARIZONA**
8

9 Jovita Carranza,

No. CV-20-01307-PHX-DJH

10 Appellant,

ORDER

11 v.

12 PCT International Incorporated,

13 Appellee.
14

15 This is a bankruptcy appeal arising from an Order and Judgment of Bankruptcy
16 Judge Paul Sala of the District of Arizona (the “bankruptcy court”). Pending before the
17 Court is Appellee PCT International, Inc.’s (“PCT”) Motion to Dismiss (Doc. 21).
18 Appellant Jovita Carranza¹, Administrator of the Small Business Administration (“SBA”)
19 filed a Response (Doc. 25), and PCT filed a Reply (Doc. 27).

20 **I. Background**

21 **A. The Paycheck Protection Program (“PPP”)**

22 Congress enacted the Coronavirus Aid, Relief, and Economic Security Act
23 (“CARES Act”) on March 27, 2020. Coronavirus Aid, Relief, and Economic Security Act,
24 Pub. L. No. 116-136, 134 Stat. 281 (2020). Title I of the Act – the Keeping American
25 Workers Paid and Employed Act – established that the SBA would administer the
26 Paycheck Protection Program (“PPP”). 15 U.S.C. § 636(a)(36). The PPP provides
27 guaranteed, forgivable loans to eligible small businesses for the coverage of certain
28

¹ Carranza left the position of Administrator of the SBA on January 20, 2021. (Doc. 32).

1 expenses including payroll costs, rent, and utilities among other things. CARES Act §
2 1102(a)(2); 15 U.S.C. §§ 636(a)(36)(G) and 9005(b). The SBA does not extend the loan,
3 but it does guarantee the loans made by participating lenders. CARES Act § 1106; 15
4 U.S.C. § 9005(b), (c)(3). Therefore, if the loan qualifies for forgiveness, the SBA will pay
5 the lender for the amount forgiven with funds allocated by Congress. CARES Act § 1106;
6 15 U.S.C. § 9005(b), (c)(3).

7 After passage of the CARES Act, the SBA issued several interim final rules
8 concerning the administration of the PPP program. Only the fourth is relevant to this
9 proceeding. The fourth interim final rule prohibits businesses presently in bankruptcy
10 proceedings from receiving PPP loans. Promissory Notes, Authorizations, Affiliation, and
11 Eligibility, 85 Fed. Reg. 23450 (Apr. 28, 2020). The Rule provides:

12 The Administrator, in consultation with the Secretary, determined that
13 providing PPP loans to debtors in bankruptcy would present an unacceptably
14 high risk of an unauthorized use of funds or non-repayment of unforgiven
15 loans. In addition, the Bankruptcy Code does not require any person to make
16 a loan or a financial accommodation to a debtor in bankruptcy. The Borrower
17 Application Form for PPP loans (SBA Form 2483), which reflects this
18 restriction in the form of a borrower certification, is a loan program
19 requirement. Lenders may rely on an applicant's representation concerning
20 the applicant's or an owner of the applicant's involvement in a bankruptcy
21 proceeding.

19 *Id.*

20 **B. Procedural History**

21 On November 15, 2019, involuntary Chapter 7 bankruptcy petitions were filed
22 against PCT and its parent corporation. (Docs. 21 at 1; 25-1 at ¶ 4). PCT converted its
23 bankruptcy case to a reorganization case under Chapter 11 of the U.S. Bankruptcy Code,
24 11 U.S.C. § 101, by which it would continue to operate the business during the proceedings.
25 (Docs. 21 at 1; 25-1 at ¶¶ 5–6). On April 14, 2020, PCT submitted a PPP application to its
26 lender indicating PCT was engaged in bankruptcy proceedings, which the lender ultimately
27 rejected. (Doc. 25-1 at ¶¶ 31, 37). On May 5, 2020, PCT commenced an adversary
28 proceeding against Appellant Jovita Carranza in her capacity as Administrator for the U.S.

1 Small Business Administration (“SBA”) in the bankruptcy court, seeking the court to rule
2 that the SBA improperly denied PCT a PPP loan. (Doc. 25 at 2). On June 12, 2020, the
3 bankruptcy court entered its final judgment against the SBA and in favor of PCT, holding
4 that the SBA arbitrarily and capriciously exceeded its authority in issuing the fourth interim
5 rule, by barring Chapter 11 debtors from obtaining PPP loans. (Docs. 25-1 at ¶¶ 41–42; 27
6 at 2).

7 The SBA orally requested a stay moments after the bankruptcy court’s ruling which
8 the court denied, finding the SBA was not likely to succeed on the merits. (Doc. 27 at 2).
9 The SBA did not subsequently file a renewed motion to stay with the bankruptcy court or
10 with this Court. Thereafter, the bankruptcy court found that PCT was authorized, pursuant
11 to § 364(b) of the Bankruptcy Code, to apply for a PPP loan in an amount up to the
12 maximum amount available to it under the PPP. (Doc. 21-2).

13 Based on the authority granted under § 364(b) and pursuant to the bankruptcy court’s
14 order, PCT filed a PPP application with MidFirst Bank on June 22, 2020. (Doc. 27 at 2).
15 The SBA voluntarily stated in writing that it would guaranty the loan before MidFirst
16 proceeded. (Doc. 27 at 3). MidFirst then approved the PPP loan application on June 24,
17 2020. (Doc. 27 at 2; Doc. 25-4 at 5) On June 25, 2020, MidFirst advanced the PPP loan
18 to PCT in the amount of \$847,600.00. (Doc. 25-6 at 4). PCT subsequently spent the entire
19 PPP loan on payroll, utilities, and rent, which are all allowable expenses under the PPP.
20 (Doc. 21-1 at 3). On July 1, 2020, this Court received an appeal of the bankruptcy court’s
21 order filed by the SBA. (Doc. 1).

22 **C. Appeal**

23 In its appeal, the SBA argues that the bankruptcy court erred in holding that it
24 exceeded its authority in issuing the interim rule. (Doc. 1). PCT filed a Motion to Dismiss
25 the appeal, arguing that the appeal is equitably moot because SBA did not protect its rights
26 by seeking a stay as required by Rule 8007, and because the money has already been spent.
27 (Doc. 21). By the time SBA filed its appeal, PCT had spent the entire \$847,600.00 on
28 qualifying expenses, including payroll for dozens of employees.

1 **II. Legal Standard**

2 This Court has jurisdiction to hear appeals from bankruptcy court final judgments
3 under 11 U.S.C. § 1121(d); 28 U.S.C. § 158(a). Federal Rule of Bankruptcy Procedure
4 Rule (“Rule”) 8007 establishes that to appeal, “a party must move first in the bankruptcy
5 court for . . . a stay of a judgment, order, or decree of the bankruptcy court pending appeal.”
6 Rule 8007(a)(1)(A). If a party brings an appeal without moving first in the bankruptcy
7 court, they must show that “moving first in the bankruptcy court would be impracticable.”
8 *Id.* at (b)(2)(A).

9 Where a party fails to seek a stay of the judgment, any future appeal of that judgment
10 may be moot. “Equitable mootness is a prudential doctrine by which a court elects not to
11 reach the merits of a bankruptcy appeal.” *In re Transwest Resort Props., Inc.*, 801 F.3d
12 1161, 1167 (9th Cir. 2015). Courts invoke the equitable mootness doctrine to dismiss a
13 bankruptcy appeal “when there has been a comprehensive change of circumstances . . . so
14 as to render it inequitable for this court to consider the merits of the appeal.” *Rev Op Grp.*
15 *v. ML Manager LLC*, 771 F.3d 1211, 1214 (9th Cir. 2014).

16 Courts in the Ninth Circuit apply a four-factor test to determine whether an appeal is
17 equitably moot:

18 We will look first at whether a stay was sought, for absent that a party has
19 not fully pursued its rights. If a stay was sought and not gained, we then will
20 look to whether substantial consummation of the plan has occurred. Next, we
21 will look to the effect a remedy may have on third parties not before the court.
22 Finally, we will look at whether the bankruptcy court can fashion effective
23 and equitable relief without completely knocking the props out from under
the plan and thereby creating an uncontrollable situation for the bankruptcy
court.

24 *In re Thorpe Insulation Co.*, 677 F.3d 869, 881 (9th Cir. 2012).

25 The first factor, whether a stay was sought, is in line with Rule 8007, which provides
26 for the party seeking the appeal to make an “initial motion in the Bankruptcy Court,” and
27 a “Motion in the District Court.” Rule 8007 (a), (b). After a party has moved for a stay in
28 the bankruptcy court and been denied, or has shown that for some reason it was

1 “impracticable” to move the bankruptcy court, the party who seeks appeal of the judgment
2 may make application to stay the judgment in the district court. Rule 8007(b)(1). When a
3 party fails to seek a stay of the judgment pending an appeal, there is a presumption of
4 mootness. Failure to diligently seek a stay renders it inequitable for the court to consider
5 the appeal. *In re Roberts Farms, Inc.*, 652 F.2d 793, 798 (9th Cir. 1981) (finding where a
6 stay was not sought that the “appellants flunked the first step”).

7 This doctrine emerged from the public policy that values finality of bankruptcy
8 judgments because debtors, creditors, and third parties are entitled to rely on final
9 bankruptcy court orders. *See, e.g., In re Onouli–Kona Land Co.*, 846 F.2d 1170, 1172 (9th
10 Cir. 1988) (noting the need for finality in bankruptcy); 13B FEDERAL PRACTICE &
11 PROCEDURE § 3533.2.3 (3d ed.) (“Bankruptcy appeals provide numerous examples of
12 the need to protect third party interests arising from substantial implementation of a
13 reorganization plan pending appeal.”). Equitable mootness arises “when there has been a
14 comprehensive change of circumstances . . . so as to render it inequitable for this court to
15 consider the merits of the appeal.” *Rev Op Grp. v. ML Manager LLC*, 771 F.3d 1211, 1214
16 (9th Cir. 2014). For an appeal to be equitably moot, “[t]he question is whether the case
17 presents transactions that are so complex or difficult to unwind that the doctrine of
18 equitable mootness would apply.” *In re Thorpe*, 677 F.3d at 880 (internal citation omitted).
19 In other words, “[e]quitable mootness concerns whether changes to the status quo
20 following the order being appealed make it impractical or inequitable to unscramble the
21 eggs.” *Castaic Partners II, LLC v. Daca-Castaic, LLC*, 823 F.3d 966, 968 (9th Cir. 2016).

22 While originally applied in the plan confirmation context, equitable mootness has
23 also been applied to cash collateral orders², debtor-in-possession financing arrangements³,

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25 ² Cash collateral is property of a Chapter 11 debtor that a creditor has interest in based on
26 a lien, but which the bankruptcy court allows the debtor to use for its ordinary business
27 expenses, so long as the property is “adequately protected” by collateral. 11 U.S.C. §
28 363(a). Authorizing Chapter 11 debtors to use cash in this way allows the debtor to remain
open during the reorganization proceeding, preventing employees from losing their jobs.
Id.

³ The use of financing obtained subsequent to the bankruptcy filing is referred to as “debtor-
in-possession financing” and is governed by 11 U.S.C. § 364. This is in line with the

1 and settlement agreements. Both of these Sections allow the debtor to use cash to continue
2 its operations and pay employees to continue working. 11 U.S.C. §§ 363 and 364. Courts
3 have applied equitable mootness in these financing situations. *See Motors Samson Energy*
4 *Resources Co. v. Semcrude, L.P.*, 728 F.3d 314 (3d Cir. 2013) (application of equitable
5 mootness to approval of asset sales); *Drawbridge Special Opportunities Fund v. Shawnee*
6 *Hills, Inc.*, 125 Fed. App'x 466 (4th Cir. 2005) (application of equitable mootness to
7 payment of prepetition wages); *In re Sonora Desert Dairy, L.L.C.*, 2015 WL 65301, at *10
8 (B.A.P. 9th Cir. Jan. 5, 2015) (holding that where bank failed to seek a stay of the DIP
9 financing order, that alone may be enough to render these appeals equitably moot).

10 **III. Discussion**

11 Before determining whether to reach the merits of the appeal, the Court will examine
12 whether this appeal is equitably moot.

13 **A. Whether a Stay Was Sought**

14 The parties agree that the SBA orally requested a stay from the bankruptcy court
15 immediately following the court's ruling. However, PCT argues that the SBA neglected
16 to seek a stay of the Judgment or the PPP Approval Order from this Court pursuant to Rule
17 8007, and therefore, did not diligently pursue its rights. (Doc. 21 at 5). PCT argues that
18 this fact alone is sufficient grounds to dismiss this appeal as equitably moot pursuant to
19 Ninth Circuit case law. *See In re Roberts Farms*, 652 F.2d at 798 (“Appellants have failed
20 and neglected diligently to pursue their available remedies to obtain a stay of the
21 objectionable orders of the Bankruptcy Court and have permitted such a comprehensive
22 change of circumstances to occur as to render it inequitable for this court to consider the
23 merits of the appeal . . . Appellants flunked the first step”).

24 In Response, the SBA argues that “there was no reason” to seek a stay from this
25 Court. (Doc. 25 at 9). It reasons that because PCT quickly applied for its PPP loan, a stay
26 from this Court would not have prevented the loan from being disbursed. (*Id.*) While this

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28 purpose of Chapter 11, which is to allow the Debtor to reorganize its debts and continue to
operate its business during the proceedings. To that end, the debtor is authorized by statute
to continue using its property and to obtain financing to continue its operations. *Id.*

1 is not necessarily the case, it is not possible to know what would have happened with
2 certainty. However, even if the loan had been disbursed during the time it took SBA to put
3 together a motion to stay, it is possible that PCT would not have yet spent the funds.
4 Ultimately though, and notwithstanding Rule 8007's direction with respect to seeking a
5 stay in the district court, the SBA argues that it is not required "to engage in pointless
6 motions practice," and neglected to file a motion to stay with this Court. (*Id.* at 10). In
7 regard to Chapter 11 reorganizations, "[t]he purpose of a stay in this context is to prevent
8 transactions that might otherwise occur in reliance on the plan of reorganization and that
9 would be difficult or painful to undo if the appeal were to succeed." *In re Cont'l Airlines*,
10 91 F.3d 553, 572 (3d Cir. 1996). Thus, seeking a stay is far from pointless. As the SBA
11 did not file a motion to stay as it was permitted to do by Rule 8007, the Court finds that
12 this factor weighs in favor of a finding of equitable mootness.

13 The SBA also argues that the Court can refuse to find that equitable mootness
14 applies, even where a party failed to formally seek a stay. *See In re Thorpe*, 881–82 ("The
15 failure to gain a stay is one factor to be considered in assessing equitable mootness, but is
16 not necessarily controlling."). Because there appears to be a discrepancy in the case law
17 as to whether the failure to seek a stay is on its own controlling, the Court will examine the
18 other three factors.

19 **B. Substantial Consummation**

20 PCT argues that the bankruptcy court's order, allowing PCT to apply for and use
21 PPP funds, has been substantially consummated. (Doc. 21 at 5-6). PCT has already sought,
22 received, and distributed the PPP funds for SBA-approved purposes, including payroll for
23 PCT's employees. It is undisputed that the entire PPP loan of over \$800,000.00 has been
24 spent. (Docs. 21 and 25). This was apparently of no surprise to anyone, as PCT made it
25 known on the bankruptcy court record that it intended to apply for and use the PPP funds
26 as soon as possible. In fact, it appears that the SBA acknowledged this, when it stated to
27 the bankruptcy court that "the Debtor made clear they intend to use [the loan] immediately
28 and so that it will be difficult to recover . . . it's possible that by the time any appeal is

1 resolved that we'll be unable to recover if we ultimately prevail.” (Doc. 19-4 at 193). This
2 is precisely what occurred.

3 The Court finds that the bankruptcy court's order allowing the use of PPP funds has
4 been fully consummated. Therefore, this factor weighs in favor of a finding of equitable
5 mootness.

6 **C. Effect on Third Parties**

7 Next, the Court must consider the effect any remedy may have on third parties not
8 before the court. PCT argues that the effect of attempting to claw back these funds would
9 wreak havoc on its entire reorganization and business operations, and would have a
10 detrimental impact on its employees who were paid with the PPP funds. (Doc. 21 at 6-7).
11 Here, none of the individuals who received the funds—employees, utility providers, and
12 landlords—are before the Court. The Court presumes that those third parties spent this
13 money long ago. Attempting to recover those funds from these individuals and entities is
14 not practicable. *In re Samuel*, 2018 WL 3639047, at *3 (B.A.P. 9th Cir. July 31, 2018)
15 (“Clawing back money from these third parties would be largely impracticable, even if
16 possible.”).

17 The SBA argues that PCT is effectively attempting to persuade the Court into
18 honoring the wishes of third parties over the SBA's appeal rights. (Doc. 25 at 11).
19 Moreover, the SBA argues that the effect on third parties is not relevant, because the
20 impairment to creditors is simply what happens under the Bankruptcy Code in these
21 situations. (*Id.*) The SBA argues that if it succeeds on appeal, PCT will be required to
22 repay the PPP loan, which is another typical occurrence in the bankruptcy process. Thus,
23 it argues that funds would not necessarily have to be clawed back from third parties. (*Id.*)
24 The Court is not persuaded.

25 A recent decision from the Ninth Circuit Bankruptcy Appellate Panel (“BAP”) is
26 instructive. *In re Samuel*, 2018 WL 3639047, at *3. There, the court authorized the use of
27 cash collateral payments to third parties for the purposes of operating and maintaining the
28 debtor's businesses. In finding that the appeal was equitably moot, the BAP noted that the

1 “third parties who received the cash collateral funds are not before this court. They have
2 relied on the bankruptcy court’s order and presumably spent the funds long ago. Thus,
3 clawing back money from these third parties would be largely impracticable, even if
4 possible.” *Id.* Other courts throughout the country have similarly held that appeals are
5 moot where the cash has already been spent, and where the matter was not stayed pending
6 an appeal. *See Dahlquist v. First Nat’l Bank*, 737 F.2d 733, 735 (8th Cir. 1984) (appeal of
7 a cash collateral order is moot once the funds have been spent); *Congress Fin. Corp. v.*
8 *Shepard Clothing Co.*, 2002 WL 1739021, at *1 (D. Mass. July 26, 2002) (appeal moot
9 where the cash collateral authorized to be spent had been used); *Bankwest, N.A. v. Todd*,
10 49 B.R. 633, 637-38 (D.S.D. 1985) (appeal equitably moot as to both spent and unspent
11 funds because it would be both “economically unwise and inequitable” to reverse the cash
12 collateral order).

13 Here, it is undisputed that the PPP funds have been spent on a number of third parties
14 not before this Court. The Court finds that it would be unpracticable to unwind the
15 payments made to the third parties. Therefore, this factor weighs in favor of a finding of
16 equitable mootness.

17 **D. Availability of Effective and Equitable Relief**

18 Finally, the Court must determine whether the bankruptcy court can fashion
19 effective and equitable relief if this Court reverses on appeal, without creating a difficult
20 situation for the bankruptcy court to unravel.

21 The SBA first argues, without citing any authority, that PCT cannot meet its burden
22 to establish equitable mootness because it “requires showing that the appeal would render
23 the bankruptcy case uncontrollable.” (Doc. 25 at 9). While the word “uncontrollable” does
24 appear along with 95 others in the four-factor test for equitable mootness, it is only a single
25 word in one of the factors. *In re Thorpe*, 677 F.3d at 881.

26 PCT argues that the relief the SBA seeks cannot be obtained, because the money
27 has already been paid to and spent by dozens of third parties. PCT argues that any remedy
28 would render its bankruptcy case uncontrollable, because it would substantially threaten

1 the future of the entire reorganization plan. Moreover, PCT contends that the entirety of
2 its case depended on obtaining the PPP funds to survive. (Doc. 21 at 7). Douglas Drury,
3 general counsel of PCT, stated in his Declaration that had it not received the PPP loan, the
4 Plan of Reorganization that has now been approved by a majority of PCT’s creditors may
5 not have been proposed. (Doc. 21-1 at 4).

6 The SBA seems to agree that reversing the bankruptcy court’s order would create a
7 turbulent situation, but argues that the present situation is PCT’s doing because “PCT chose
8 to file an adversary complaint asserting claims that have been denied by the great majority
9 of courts that have addressed them.” (Doc. 25 at 9). While the SBA would like the Court
10 to find that the underlying issues are meritless, it is difficult for the Court to fault PCT for
11 filing a proceeding that it was ultimately victorious on in the bankruptcy court, which
12 enabled it to obtain over \$800,000.00 in financing to continue to operate its business and
13 pay its employees. What is undisputed is that the PPP funds have been spent. These funds
14 have been paid out to dozens of individuals and entities, and in accordance with SBA rules.
15 While the bankruptcy court may be able to fashion some sort of relief on remand, it is also
16 certain that the issues are certainly much more complicated now that the money has been
17 paid out to numerous third parties. However, because PCT has not established that the
18 bankruptcy court would be completely unable to fashion an effective and equitable remedy,
19 the Court finds that this factor is neutral.

20 **IV. Conclusion**

21 Having found that three of the four factors warrant a finding of equitable mootness,
22 including the first factor which some courts consider dispositive on its own, the Court finds
23 this appeal is equitably moot. Therefore, the Court will not reach the merits of the appeal
24 and will dismiss this matter.

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Accordingly,

IT IS HEREBY ORDERED that PCT’s Motion to Dismiss (Doc. 21) is **granted**.

The Clerk of Court is directed to enter judgment in PCT’s favor and terminate this matter.

Dated this 7th day of September, 2021.


Honorable Diane J. Humetewa
United States District Judge