

## Strategies to Reduce the Impact of the New SBA Procedural Notice on the Rights of a Secured Lender

---

October 15, 2020

In the SBA Procedural Notice dated October 2, 2020 (the “Approval Notice”), the Small Business Administration (“SBA”) has issued mandates that may impact the ability of a recipient of a Paycheck Protection Program (“PPP”) loan to raise capital, to transfer ownership, to sell assets, or to liquidate. While the Approval Notice is strikingly broad in scope, there are ways of reducing, if not eliminating, its effect on these types of transactions.

The Approval Notice requires obtaining the lender’s approval for any change of ownership of 20% or more, including a merger, and for any sale of 50% or more of the assets. If a PPP lender is using the standard SBA form of note, such transfers likely would trigger a default absent the lender’s prior approval. Needless to say, no approval is required once the PPP Loan is forgiven or otherwise paid in full.

The Approval Notice does not require the SBA’s prior approval for a change of ownership when (1) the change of ownership is 50% or less; or (2) the forgiveness application has been filed and the balance, if any, owed on the PPP Loan is “escrowed” in an interest bearing account controlled by the PPP lender, for the benefit of the SBA and the PPP lender. For a sale of 50% or more of the assets, the SBA’s prior approval is required unless the forgiveness application has been filed and the balance, if any, owed on the PPP Loan is escrowed in an interest bearing account controlled by the PPP lender. These escrows are for purposes of paying the unforgiven balance on the PPP Loan.

In all other cases, the SBA’s prior approval is required. The Approval Notice states that the SBA will provide a determination within 60 calendar days of receipt of the request for approval. However, the Approval Notice does not say what happens if the SBA does not respond within the 60 calendar days, and there is no reason to assume that a lack of a timely response is the same as an approval.

The requirement for SBA approval for a borrower change of ownership is odd, as the borrower remains obligated for the PPP Loan regardless, and a PPP Loan does not require either a personal guaranty or collateral. Even odder, with a sale of 50% or more of the assets, the Approval Notice requires the buyer of the assets to assume the PPP Loan obligation; again on a loan that that has no collateral and no personal guaranty.

The Approval Notice effectively elevates the SBA from an unsecured creditor to a priority creditor, and perhaps to a super priority creditor. Assume the PPP lender is also the secured lender to the PPP borrower, and that the PPP Borrower is unable to continue in business and needs to liquidate. In order for the PPP Borrower to sell its assets, it must obtain the SBA’s approval. In that situation, the Approval Notice also mandates that the buyer assume the balance owed on the PPP loan. The buyer will not do this out of the goodness of its heart. Rather, the buyer will reduce the purchase price by the amount of the PPP loan obligation. This means that other unsecured creditors will have less to share. It also might mean that a secured lender will take a loss; solely to allow the SBA to do what Congress did not mandate – to become a secured, priority lender.

What to do to avoid the SBA from inserting itself into what should be a routine transaction for a distressed loan? There are some strategies that should be considered.

Continued

---

When liquidation of assets is needed, the PPP borrower can allow the secured lender to repossess the assets, and the secured lender can liquidate the assets. Alternatively, a receiver can be appointed over the assets of the PPP borrower, either voluntarily or involuntarily, to allow for the orderly liquidation of the assets. The PPP borrower can file a bankruptcy case, either a chapter seven or a liquidating 11. Indeed, the Small Business Reorganization Act might be used as a form of a liquidating 11. Other alternatives to consider are a dissolution proceeding or perhaps an Assignment for Benefit of Creditors. These alternatives merit further exploration in a distressed credit setting.

While there may be ways to mitigate the impact of the Approval Notice, it is clear that the Approval Notice will disrupt a number of transactions, increase the cost and burden to PPP lenders, and further overwhelm the SBA staff.

If you have questions or wish to discuss this matter, please contact one of the authors or your Miller Canfield attorney.