

## Congress Permits SBA to Make PPP Loans to Debtors in Bankruptcy, SBA Says "No"

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January 15, 2021

In **June** and **December** of 2020, Miller Canfield reported that the Fifth and Eleventh Circuits had held that the Small Business Administration ("SBA") may exclude debtors in bankruptcy from consideration for Paycheck Protection Program ("PPP") loans, albeit for differing reasons. The recent Consolidated Appropriations Act, 2021 ("CAA"), signed into law on December 27, 2020, could have changed that. It contains provisions that provide some debtors with access to the program, but with a catch: these provisions do not take effect until the SBA provides its blessing in writing. The SBA has not provided its written blessing. Rather, it has expressly stated in its Interim Final Rule regarding the Business Loan Program Temporary Changes; Paycheck Protection Program as Amended by Economic Aid Act that debtors in bankruptcy do not qualify for PPP loans. **IFR, Section B.2(c) (pages 26-27)**. The additional PPP lending under CAA will expire on March 31.

The PPP was a central component of the CARES Act. Through August of 2020, the PPP allowed eligible small businesses to obtain guaranteed loans to pay certain expenses, such as payroll costs, rent, and utilities. Although the CARES Act did not discuss whether companies who have filed for bankruptcy protection are eligible to participate in the PPP, the SBA took the position that they are not. A number of bankrupt debtors sued the SBA over this bankruptcy exclusion. Although a few were successful, both Appellate Courts that have weighed in on the issue have determined that the SBA can properly exclude debtors from the PPP program.

The CAA contains provisions that could change that. These provisions would allow certain debtors in bankruptcy to apply for PPP loans. If not forgiven, a PPP loan would be treated as priority debt in the debtor's bankruptcy case—coming after secured debt in priority, but ahead of all non-priority unsecured debt. Debtors would be allowed to provide in their plans that their PPP loan is to be repaid in full under the loan's terms, which represents a slight change to how priority unsecured debt is normally treated in bankruptcy. Finally, the CAA provides that a bankruptcy court must hold a hearing within a week of a debtor's request for permission to incur a PPP loan.

The catch? The CAA does not overrule the SBA. These provisions do not take effect until the SBA submits a written determination to the Office of the United States Trustee (a.k.a., the government's watchdog in bankruptcy), stating that debtors are eligible to participate in the PPP program if they otherwise meet the eligibility requirements. Even then, not all business debtors would qualify – only businesses filing under the Small Business Reorganization Act of chapter 11 or under chapters 12 (farmers) or 13 (self-employed) would be eligible. Ordinary chapter 11 debtors need not apply.

**What does this mean for lenders?** For now, the SBA's position—that bankrupt debtors are excluded from consideration for PPP loans—stands. Rather than undermine the SBA, the CAA appears to bolster the Appellate Court holdings, as it provides the SBA with the power to determine debtor eligibility for PPP loans. But, under the CAA, the SBA could change its position simply by issuing a letter to the Office of the United States Trustee. Thus, lenders should remain vigilant and monitor the SBA closely for further developments—even though it is unlikely that the SBA will do so, given the most recent IFR.

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**What does this mean for debtors?** Under the most recent IFR and the most recent PPP application, the existence of a currently pending bankruptcy makes a debtor ineligible for a PPP loan. Given the language in the CAA Act, it is highly unlikely that a bankruptcy court will order that a PPP loan under the CAA (either under the new round of PPP loans or as a second PPP loan) must be made. Debtors should avoid trying to "game" the system, as the SBA is vigilantly pursuing debtors who have done so, with over 65 criminal investigations currently pending.

Miller Canfield is following the implementation of the CARE and CAA Acts, the PPP program, and their effects on bankruptcy cases. Miller Canfield also assists its clients that are subject to an SBA audit relating to a PPP loan through its **PPP Loan Audit Team**. Should you have any questions regarding these matters and wish assistance, please feel free to contact us.

*This information is based on facts and guidance available at the time of publication and may be subject to change.*