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New COVID-19 Relief Law Includes Limited Bankruptcy Protections Regarding PPP Loans

The latest COVID-19 relief legislation provided some additional aid and clarity for a select group of debtors and left many other questions unanswered. The requirements for the next round of the Payroll Protection Program (PPP) and the related changes to the Bankruptcy Code are a small part of the massive appropriations bill signed by President Trump on December 27, 2020. Several key bankruptcy relief sections exclude all Chapter 11 debtors who do not qualify as small business debtors from those provisions.

Section 364 of the Bankruptcy Code was amended specifically to authorize post-bankruptcy filing PPP loans for small business debtors who file under Subchapter V of Chapter 11, family farmers under Chapter 12, and individuals filing under Chapter 13 of the Bankruptcy Code. Unforgiven debt created by postpetition PPP loans receives administrative expense priority status under the Bankruptcy Code, rather than simple general unsecured status. This change in the availability of PPP loans for those debtors only becomes effective after the Small Business Administration (SBA) administrator submits a letter to the executive office of the United States trustee that such relief is authorized provided that the debtors meet the other eligibility requirements.

The new law is silent about whether (1) general Chapter 11 debtors are barred from receiving a PPP loan during a bankruptcy case, and (2) unforgiven debt under prepetition PPP loans is entitled to priority or may be treated as general unsecured debt. Absent any contrary statutory guidance, it seems likely that courts will restrict post-bankruptcy PPP loans to the types of debtors explicitly listed in the statute and that prepetition PPP loans will not be entitled to special priority status in bankruptcy. Courts may infer that Congress intended to exclude general Chapter 11 debtors from postpetition PPP loans and that Congress removed rulemaking discretion from the SBA regarding debtor eligibility.

One wrinkle to this guidance is the change to what generally constitutes property of the bankruptcy estate as listed in Bankruptcy Code Section 541. The new legislation excludes federal COVID-19 relief payments from constituting property of the bankruptcy estate. There is no legislative history to help discern Congressional intent. If relief payments are not property of the estate, it is possible that those funds are not available to serve as collateral for postpetition loans and that prepetition transfers of relief payments (i.e., payments to vendors made from relief payments) may not be subject to avoidance.

The new law also protects landlords and suppliers from having payments clawed back in preference actions. If a landlord or supplier entered into a deferred payment agreement with a debtor after March 13, 2020, then the deferred payments (not including fees, penalties, or interest) are exempt from avoidance as a preference under Bankruptcy Code § 547.

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