
WISCONSIN LENDERS CONFERENCE 7(a) LOAN LIQUIDATION

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YOUR SBA LEGAL DEPARTMENT®

TODAY'S PRESENTER



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OVERVIEW

- Liquidation
- Litigation Plan

RESOURCES

- SBA SOP 50 57 2: 7(a) Loan Servicing and Liquidation
 - Effective December 1, 2015
 - SBA is working on an update to release SOP 50 57 3
- Servicing and Liquidation Actions 7(a) Lender Matrix
 - Version 15
- Procedural Notices
 - 5000-19009-Effective April 1, 2019
 - 5000-1394-Effective October 4, 2016

GENERAL LIQUIDATION STANDARDS

- Lenders must service and liquidate their SBA loans in a prompt, cost-effective, commercially reasonable manner that is free of conflicts of interest and preferences, and is consistent with the Loan Authorization, prudent servicing and prudent liquidation practices, including prudent liquidation deadlines and the SBA loan program requirements in effect at the time the action is taken.
 - 13 C.F.R. § 120.535

GENERAL LIQUIDATION STATUS

- When liquidation actions are necessary, lenders should reflect a balance of SBA's interest in:
 - Achieving the goals of the loan program, i.e. helping entrepreneurs start, build, and grow viable small businesses
 - Maintaining the integrity of the loan program, i.e. ensuring that the Agency can maximize its recovery if the borrower defaults on the loan

ENTERING A 7(a) LOAN INTO LIQUIDATION

- Payment Default—when the loan is past due 60 days or more
- Lenders should make a good faith effort to help the borrower keep loan current
- When payment default cannot be cured, lenders should classify a loan into liquidation
- Lenders should rely on their own policies and procedures for similarly-sized, non-SBA guaranteed commercial loans

WHAT ABOUT NON-MONETARY DEFAULTS?

- Remember the difference between:
 - Right to Accelerate vs. Right to Request Guaranty Repurchase
- Generally, a borrower **must** be in default on a payment for more than sixty (60) calendar days before a lender can request a guaranty repurchase
- Lenders **may not** request a guaranty repurchase based solely on a **non-payment default**, however this limitation does not *per se* preclude lenders from accelerating the note

ACCELERATE FOR NON-MONETARY DEFAULT?

- Where there is sufficient collateral to fully compensate the lender and SBA for amounts due under the note
- No purchase request will be submitted to SBA
- Thoroughly document the reason for the non-monetary default, noting the lender's attention to protecting both the lender's and SBA's interests

LOAN GUARANTY PURCHASE REQUESTS

- Lenders may request that SBA purchase its guaranteed portion of the loan if:
 - Borrower is in default on any installment for more than 60 calendar days
 - Default has not been cured
 - Loan is classified as in “liquidation” status on monthly Form 1502 report
 - Generally, all business personal property has been liquidated
 - But must submit purchase package within 45 days of SBA purchasing guaranteed portion from the secondary market investor
 - In all cases, must submit purchase package within 180 days after maturity of the loan or after completion of liquidation
- Best practice is to assess whether there may be a repair or a denial before sending demand

IDENTIFYING POSSIBLE REPAIRS OR DENIALS

- Review the Authorization to determine if there may be any repairs or a denial **before** sending out a demand letter
- Maximize obligors' cooperation
- Attempt to correct or mitigate errors prior to liquidation
- May mitigate or eliminate possible repairs or denials

IN LIQUIDATION, NOW WHAT?

- Once a default cannot be cured, a lender should:
 - Accelerate the note
 - Make demand on all obligors
 - Notify SBA/classify the loan as “in liquidation”
 - Request repurchase of loan sold on secondary market
 - Conduct a site visit, if required
 - Prepare a liquidation plan

DEMAND LETTERS

- Lenders **must** send a demand letter unless prohibited by law
- Demand letter should be sent by regular mail and by certified mail or other method that enables lenders to confirm delivery
- Lenders should make reasonable efforts to contact any obligors that fail to respond, either by telephone or email, to determine his/her/its intentions with regards to repaying the loan
- A good faith effort should be made to locate any obligors missing or difficult to locate, i.e., skip tracing

OBLIGOR'S MILITARY STATUS

- Determine the military service status of any obligors before taking liquidation action that could adversely impact the obligors
- If an obligor is in active military service, all actions **must** comply with the Servicemember's Civil Relief Act

POST-DEFAULT SITE VISITS

- A post-default site visit is **mandatory** unless specifically exempted
- Generally, post-default site visits are required within sixty (60) calendar days of an uncured payment default
- For non-payment defaults (such as bankruptcy filing, business shutdown, or foreclosure by a prior lienholder), the site visit must occur within fifteen (15) calendar days of the occurrence of the adverse event
- Site visits should occur earlier if there is concern that the collateral could be removed, lost, or dissipated

SITE VISIT REPORT

- Whether or not a loan is exempt from a post-default site visit or the site visit was conducted, all lenders must prepare a post-default Site Visit Report
- A post-default Site Visit Report should include why the site visit was not necessary or detail the lender's findings from the inspection, including an inventory of the remaining collateral and an assessment of its condition and value

RECOVERABLE VALUE

- Recoverable Value = the net dollar amount that a prudent lender could reasonably expect to recover by liquidating a particular piece of collateral
- Liquidation Value = likely price collateral will sell for if sold quickly and with limited exposure to potential buyers

RECOVERABLE VALUE

- Recoverable Value = Liquidation Value minus:
 - Balance owed on senior liens (less amounts waived or subordinated by a loan document)
 - Recoverable Expenses associated with any necessary lien foreclosure action and/or sale
 - If the collateral is likely to be acquired by SBA or the lender at the foreclosure sale or disposition, the expenses associated with the care, preservation, and resale of the acquired collateral

WHEN MUST YOU LIQUIDATE?

- All collateral with Recoverable Value should be liquidated
- Lenders must liquidate when the Recoverable Value of real estate collateral is equal to or more than \$10,000 per parcel
- Lenders must liquidate when the Recoverable Value of personal property collateral is more than \$5,000
- Recovery efforts can be abandoned if the collateral has no Recoverable Value

LIQUIDATION PLANS

- What is a Liquidation Plan?
 - A lender's written plan outlining the actions it intends to take to maximize recovery on a specific SBA loan
- SBA generally does not need to approve a Liquidation Plan
- Prepare BEFORE taking any material action to liquidate a loan

LIQUIDATION PLANS

Should include:

- Copy of demand letter
- Site visit findings
- Feasibility of workout
- Recoverable Value of collateral
- Available methods of liquidation
- Need for litigation, if necessary
- Status of senior liens, if any
- Obligators' repayment ability
- Lender's non-SBA loans to obligors, if any
 - Template is available at: <https://www.sba.gov/document/sba-form-1979-liquidation-plan-format>

LIQUIDATION

- All collateral with Recoverable Value should be liquidated
- Determine best procedure for liquidation
 - Must be liquidated in manner that will maximize recovery on the loan in shortest amount of time
- Rely on information obtained from the site visit to assess potential liquidation options

LIQUIDATION OF REAL PROPERTY

- The most efficient method of liquidation will vary depending on variety of factors, including:
 - State specific foreclosure requirements
 - Military status of obligors
 - Use of property
 - Loan document covenants
 - Title report results
 - Senior liens
 - Environmental risks
 - Estimated net recovery
 - Need to pursue deficiency balance

LIQUIDATION OF REAL PROPERTY

- Voluntary sale of property by obligors
 - May be appropriate provided that sale would:
 - Maximize recovery of loan
 - Obligors have possession or control of property
 - All other lien holders provided written consent to sale
 - Appraisal has been obtained
 - Recoverable Value has been established
 - Sale is supervised by the lender
 - Sale is arms-length and not to an associate of obligors
 - Costs of sale is reasonable, necessary, and customary
 - SBA lien is released only in exchange for cash in amount equal to or greater than the Recoverable Value of property
 - All net proceeds are applied to the principal balance of SBA loan

LIQUIDATION OF REAL PROPERTY

- Foreclosure = an action taken to enforce mortgage or deed of trust and ultimately sell the real property
- Procedure varies state by state
- Judicial Foreclosure
 - Requires commencement of a court action
- Non-Judicial Foreclosure
 - Commenced without court supervision
 - Not available in all states

LIQUIDATION OF REAL PROPERTY

- Deed in Lieu of Foreclosure
 - Debtor conveys fee-simple title to secured creditor as a substitute for foreclosure
 - Must be accomplished by written agreement executed by all obligors as to the amount to be applied to the loan balance once title has been transferred
 - There are potential risks to consider
 - Varies by state
 - Could eliminate right to collect any deficiency
 - Could eliminate possibility to foreclose SBA lien and remove junior liens

LIQUIDATION OF REAL PROPERTY

- Collection of rents
 - If lender has an assignment of rents, consult legal counsel as to applicable state laws to enforce
- Appointment of receiver
 - A receiver is appointed by the court to preserve and protect collateral, generally in connection with, or in lieu of, foreclosure
 - **This is Non-routine Litigation—Approved Litigation Plan Required**
- Short sale
 - Varies by state
 - Could eliminate right to collect any deficiency
- Release of lien on collateral
 - For Consideration
 - Without Consideration

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 - Sale is arms-length and not to an associate of obligors
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LIQUIDATION OF PERSONAL PROPERTY

- UCC Article 9 Sale
 - Lender must be able to repossess collateral without a breach of the peace or lender will need a court order and assistance of law enforcement to facilitate repossession
 - Must provide reasonable notice of sale, as required by UCC
 - Every aspect of the sale must be commercially reasonable
 - Bill of sale should state that the personal property is being sold “as is” and “without warranties of any kind including those relating to title, possession, quiet enjoyment, or the like”
- Private Sale
 - Although public sales are preferred, a private sale may be conducted if doing so would maximize recovery
- Public Sale
 - Open to the public where the collateral is sold to the highest bidder
 - May be conducted by auction/retail or sealed bid

LIQUIDATION OF PERSONAL PROPERTY

- Release of Lien on Collateral
 - For Consideration
 - Without Consideration
- Judicial Foreclosure
 - Fixtures
- Collection of Account Receivables
 - By Borrower
 - By Lender
- Set-off against Deposit Accounts

RECEIVERS

- Extraordinary remedy available in only narrow circumstances.
- Lenders must perform a cost benefit analysis to demonstrate that the net recovery will be greater if a receiver is used as opposed to the lender liquidating the collateral directly.
- Must be approved by SBA in advance pursuant to an approved Litigation Plan

LITIGATION

- Litigation on SBA loans should be
 - Necessary, reasonable, and customary for the locality
 - Cost effective
 - Conducted in the lender's name
 - NOTE: Any litigation expenses that exceed the recovery on affirmative litigation taken **without** an SBA approved Litigation Plan are presumed **unreasonable!**
- Prepare a Litigation Plan
 - Only "non-routine" litigation must be approved by SBA
 - If legal fees will exceed \$10,000.00, the litigation is "non-routine" and a Litigation Plan must be submitted to and approved by SBA
- Note whether action requires SBA prior written approval
 - Refer to most recent lender matrix for 7(a) Loans

TIMING OF LITIGATION

- Litigation takes place after borrower defaults on payments of a Note and loan is placed “in liquidation.”
- Following applicable notice of default and cure period
- A lawsuit affecting repayment of the loan is brought by Lender against obligors.
- Bankruptcy filed by any obligors.

BASIC RESPONSIBILITIES

It is the Lender's job to:

- Conduct any litigation
and
- Manage its outside counsel

SELECTING OUTSIDE COUNSEL

- An attorney retained by Lender must:
 - Be licensed in the state where the litigation will be conducted.
 - Be competent and have the appropriate experience.
 - Be local – SBA generally will not reimburse travel expenses
 - Be covered by adequate legal malpractice insurance.
 - Have no conflicts of interest with *any* parties to the loan.

LITIGATION PLANS

Two separate and distinct submissions Lenders must make to SBA when pursuing litigation against obligors (borrower(s) and guarantor(s)) of an SBA loan.

- Litigation Plan
 - Lender's litigation strategy, estimate of recovery, and proposed legal budget.
 - Reviewed by SBA *before* litigation commences.
 - This preserves the lender's ability to later seek reimbursement
- Fee Reimbursement Request through CPC Tabs
 - Lender's legal expenses that are eligible for SBA reimbursement.
 - Reviewed by SBA *after* litigation concludes (or every six months)

WHEN TO SUBMIT A LITIGATION PLAN

- Routine litigation—SBA approval not required
 - Uncontested litigation
 - Non-adversarial matters in bankruptcy
 - Uncontested foreclosure actions
 - Litigation when estimated legal fees do not exceed \$10,000
- Non-routine litigation—SBA approval required
 - Any litigation where factual or legal issues are in dispute
 - Any litigation where legal fees are estimated to exceed \$10,000
 - Any litigation involving a loan where a lender has an actual or potential conflict of interest with the SBA
 - Any litigation where the lender has made a separate loan to the same borrower which is not a SBA 7(a); or
 - Any litigation involving receivership proceedings

SOP 50 57 (2)

- SOP 50 57 (2) Chapter 21 Section C:
- Except with regard to emergencies, all Lenders, including PLP Lenders **must** submit a Litigation Plan for SBA's written approval prior to initiating Non-routine Litigation. (13 CFR 120.540(c)).
- Lenders are not required to submit a Litigation Plan to SBA prior to initiating Routine Litigation.

BUT

- All Lenders **must** submit a Litigation Plan if a material change arises during the course of Routine Litigation that transforms it into Non-routine Litigation, e.g. the legal fees exceed \$10,000 in the aggregate. (13 CFR 120.540(c))

HOW TO SUBMIT A LITIGATION PLAN

- A request for approval of a proposed Litigation Plan (or amended Litigation Plan) must be submitted to the appropriate SBA Loan Center.
- Litigation Plans should be submitted containing all information in SBA's template:
<https://www.sba.gov/document/support--litigation-plan-7a-504-loans>

SOP 50 57 (2)

13 CFR 120.540 (c)

(c) *Litigation plan.* A Lender must obtain SBA's prior approval of a litigation plan before proceeding with any Non-Routine Litigation. SBA's prior approval is not required for "Routine Litigation".

If a lender proceeds with litigation before obtaining an approved Litigation Plan or Amended Litigation Plan, SBA may deny a request to reimburse lender for its legal fees-SBA Information Notice 5000-1394.

ELEMENTS FOR OBTAINING APPROVAL

Key Elements in getting your Litigation Plan approved:

- Cost-effectiveness
- Necessity
- Reasonableness
- Customary

LITIGATION PLAN CONTENTS

- SBA provides a Litigation Plan Template for lenders to use
- Law Firm/Attorney Contact Information and billing rates
- Evidence of current malpractice insurance exceeding \$1 million
- Current Environmental Report and Tax Status of Collateral required
- Foreclosure and UCC Reports
- Summary of litigation work to be performed and justification for pursuing the litigation strategy

AMENDMENTS TO LITIGATION PLANS

- Must state amount of legal fees incurred to date and amount expected to be incurred moving forward.
- Must justify the request to amend the litigation plan and the additional fee request.
- Must be submitted when fees and costs are expected to exceed original budget by more than 15%.

LEGAL FEE REIMBURSEMENT REQUESTS

- Legal fees and costs that Lender seeks to recoup from SBA as a Recoverable Expense.
- Requests are submitted to the appropriate SBA Loan Center pursuant to requirements contained in Chapter 22 (*Expenses and Recoveries*) of SOP 50 57 (2).
- SBA only pays for legal fees and expenses that are necessary, reasonable, and customary in the locality.

BEST PRACTICES

- To expedite the review of legal fee and expense reimbursement requests, SBA recommends that Lenders have their outside counsel submit billing records that meet the following standards:
 - Monthly invoices should be submitted in order and detail services and reimbursable expenses, itemized by matter;
 - Time entries should include the date services were rendered, a description of all services with the separate time and cost billed for each task, the individual who performed the task and his or her billing rate;
 - Time should be billed in increments of .1 hour (6 minutes); and
 - Reimbursable expenses should be itemized.

GENERALLY REIMBURSABLE

- Reimbursable attorneys' fees and expenses are directly connected to the litigation, such as:
 - Court filing fees
 - Court reporter fees
 - Transcription fees
 - Mailing costs
 - Title work and searches done as part of the litigation
 - Forbearance Agreement or OIC/Settlement executed during the litigation proceeding.
 - Telephone calls as long as the duration and frequency are reasonable and subject of the conversation is identified.
 - Research time, if justified.

EXPENSES

- Recoverable expenses:
 - Searches:
 - UCC lien searches
 - Title reports
 - Credit and asset searches
 - Appraisals
 - Appraisals
 - Environmental reports
 - Site visit reports
 - Litigation expenses
 - Attorneys' fees
 - Costs

EXPENSES

- Recoverable expenses (cont.):
 - Collateral care and preservation
 - Utility bills
 - Insurance premiums
 - Repair costs
 - Taxes (real estate, etc.)
 - Expenses related to senior liens

EXPENSES

- Non-recoverable expenses:
 - Expenses not related to collection or to preserve or dispose of collateral
 - Any fee or cost that is not necessary, reasonable, or customary
 - Lender's overhead costs
 - Fees which SBA allows a lender to collect if the loan is current, but not covered by vendor guaranty
 - Fees/costs incurred by Lender to perform routine loan servicing or liquidation
 - Expenses related to actions taken solely for the benefit of Lender
 - Expenses associated with a claim against Lender unless SBA required Lender to take the action
 - Attorneys' fees and costs listed in the SOP 50 57 (2) Chapter 21 F as non-recoverable

COMMON REASONS FOR DENIAL OF REIMBURSEMENT

- Administrative overhead.
- Intra-law firm communications.
- Communications with SBA.
- Loan servicing or liquidation tasks.
- Legal action taken with respect to claims brought against SBA.
- Rectifying errors that would justify a partial Denial of Liability, Repair or full Denial.
- Defense of a claim brought against Lender by obligors for lender's wrongful actions.
- Services pertaining to litigation that are not reasonable, customary, or cost effective.
- Attorneys' fees for preparation of the Litigation Plan and any Amendments.
- Attorneys' fees for the preparation of demand letters.

COMMON REASONS FOR DENIAL OF REIMBURSEMENT

- Travel expenses, not pre-approved by SBA.
- Multiple law firm billings for the same task.
- Attorneys' fees and costs that exceed recovery, when no Litigation Plan was submitted.
- Appointment of a receiver to perform routine liquidation activities.
- Non-itemized or generic bills.
- Duplicate billing entries.
- Time spent on tasks that is not reasonable.
- Fees incurred to correct Lender's or Lender's Attorneys' errors.
- Excessive hourly rates.
- Non-legal liquidation activities performed by Lender counsel.
- Actions taken for sole benefit of Lender.

COMMON REASONS FOR DENIAL OF REIMBURSEMENT

- Multiple law firms used without SBA pre-approval.
- Receiver appointed without prior approval by SBA, pursuant to a Litigation Plan.
- Failure to litigate in a prompt and prudent manner.
- Services relating to litigation handled by SBA legal counsel without SBA pre-approval.

LENDER CERTIFICATION

- Each Lender who submits a request for reimbursement of legal fees and expenses must certify to SBA that the submission complies with all applicable statutory, regulatory, and contractual requirements.

False Claim Warning

- Knowingly making a false statement to the SBA is a violation of Federal law and could result in criminal prosecution, significant civil penalties, and denial of program participation. A false statement is punishable under 18 U.S.C. §1001 and §3571 by imprisonment of not more than five years and/or a fine of up to \$250,000; under 15 U.S.C. §645 by imprisonment of not more than two years and/or a fine of not more than \$5,000.

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