

PPP Loans and M&A Transactions: New Guidance from the SBA

by Kenneth Logsdon

The Paycheck Protection Program (the “PPP”) created under the CARES Act has provided much needed assistance to millions of businesses and other organizations operating in the United States that have been impacted by the COVID-19 pandemic. This program continues to evolve with the latest development addressing situations in which a PPP borrower is participating in a change of control, merger or an acquisition transaction.

To begin, PPP loans are included among what are known as Small Business Administration (the “SBA”) “7(a) loans” and are therefore subject to the same regulatory guidelines that apply to 7(a) loans generally. Among such guidelines are situations in which a lender must obtain SBA approval before a borrower is permitted to perform or allow certain activities. One such activity is permitting a “change of ownership” (with no threshold specified) of a borrower within 12 months of the final disbursement of a 7(a) loan, including PPP loans. It was becoming clear that, due to the sheer volume of PPP borrowers engaging in “change of ownership” type transactions, the SBA needed to provide additional guidance to both PPP lenders and borrowers on when PPP lender and/or SBA approval or consent would be needed, if at all.

To that end, on October 2, 2020 the SBA published SBA Procedural Notice (5000-20057) (the “Notice”) outlining the rules PPP lenders and borrowers must adhere to when a PPP borrower is contemplating a change of control, merger or an acquisition. To begin, the Notice defines a “change of ownership” cases in which (each a “Change of Ownership”):

- (1) at least 20 percent of the common stock or other ownership interest of a PPP borrower (including a publicly traded entity) is sold or otherwise transferred, whether in one or more transactions, including to an affiliate or an existing owner of the entity;
- (2) the PPP borrower sells or otherwise transfers at least 50 percent of its assets (measured by fair market value), whether in one or more transactions; or

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(3) a PPP borrower is merged with or into another entity.

As for item (1) above, the SBA also states that for purposes of determining a Change of Ownership, “all sales and other transfers occurring since the date of approval of the PPP loan must be aggregated to determine whether the relevant threshold has been met.” If the PPP borrower is publicly traded, only “sales or other transfers that result in one person or entity holding or owning at least 20% of the common stock or other ownership interest of the borrower must be aggregated.”

If it is determined that the transaction will be a Change of Ownership, then prior to the closing of such transaction the PPP borrower must notify the PPP lender in writing of the contemplated transaction and provide the PPP lender with a copy of the documents in connection with the proposed transaction. In any event, there will be no restrictions regarding a Change of Ownership if, prior to or upon consummating such transaction, the PPP borrower has (i) repaid the PPP loan in full or (ii) completed the loan forgiveness process in accordance with the PPP requirements and either (a) the SBA has remitted funds to the PPP lender in full satisfaction of the PPP loan or (b) the PPP borrower has repaid any remaining balance on the PPP loan.

In cases where the PPP loan will not be repaid in full prior to or upon closing the Change of Ownership transaction, the Notice contains specific guidance in cases of an equity transaction (i.e., transactions structured as a sale or other transfer of common stock or other ownership interest or as a merger) (an “Equity Transaction”) and asset sales transactions (i.e. transaction whereby the PPP borrower simply sells its assets) (an “Asset Transaction”). In either case of an Equity Transaction or an Asset Transaction, a PPP lender may consent to the Change of Ownership without SBA approval if the PPP borrower completes a forgiveness application reflecting its use of all of the PPP loan proceeds and submits it, together with any required supporting documentation, to the PPP lender, and an interest-bearing escrow account controlled by the PPP lender is established with funds equal to the outstanding balance of the PPP loan. After the forgiveness process (including any appeal of the SBA’s decision) is completed, the escrowed funds must be disbursed first to repay any remaining PPP loan balance plus interest.

In case of an Equity Transaction, the PPP borrower (or successor entity if a merger) will remain subject to all obligations under the PPP loan and if the new owner(s) use PPP funds for unauthorized purposes, the SBA will have recourse against the owner(s) for the unauthorized use. Furthermore, if any of the new owners or the successor entity arising from an Equity Transaction has a separate PPP loan, then (1) in the case of a purchase or other transfer of common stock or other ownership interest, the PPP borrower and the new owner(s) are responsible for segregating and delineating PPP funds and expenses and providing documentation to demonstrate compliance with PPP requirements by each PPP borrower, and (2) in the case of a merger, the successor entity is responsible for segregating and delineating PPP funds and expenses and providing documentation to demonstrate compliance with PPP requirements with respect to both PPP loans. Finally, in cases of an Equity Transaction, the PPP lender must notify the appropriate SBA Loan

Servicing Center within 5 business days of completion of the transaction of the: (i) identity of the new owner(s) of the common stock or other ownership interest; (ii) new owner(s)' ownership percentage(s); (iii) tax identification number(s) for any owner(s) holding 20 percent or more of the equity in the business; and (iv) the location of, and the amount of funds in, the escrow account under the control of the PPP lender, if an escrow account is required.

Importantly, the SBA approval is not required in the case of an Equity Transaction if the sale or other transfer is of 50% or less of the common stock or other ownership interest of the PPP borrower (aggregated with all sales and other transfers occurring since the date of approval of the PPP loan). Lastly, in cases of an Asset Transaction, the PPP lender must notify the appropriate SBA Loan Servicing Center of the location of, and the amount of funds in, the escrow account within 5 business days of completion of the transaction.

If the Change of Ownership does not fall within the categories described above, prior SBA approval of the Change of Ownership will be required. In such cases, in order for a PPP borrower to obtain SBA approval, the PPP lender must submit the request to the appropriate SBA Loan Servicing Center and include the following:

- (i) the reason that the PPP borrower cannot pay off the PPP loan in full or escrow funds as described above;
- (ii) the details of the requested transaction;
- (iii) a copy of the executed PPP note;
- (iv) any letter of intent and the purchase or sale agreement setting forth the responsibilities of the PPP borrower, seller (if different from the PPP borrower), and buyer;
- (v) disclosure of whether the buyer has an existing PPP loan and, if so, the SBA loan number; and
- (vi) a list of all owners of 20 percent or more of the purchasing entity.

Furthermore, the SBA may require additional risk mitigation measures as a condition of its approval of the transaction, but it must provide a determination within 60 days of receipt of a complete request. Lastly, in cases requiring the SBA approval in respect of an Asset Transaction, such approval will be conditioned on the purchasing entity assuming all of the PPP borrower's obligations under the PPP loan, including responsibility for compliance with the PPP loan terms (note that the purchase or sale agreement must include appropriate language regarding such assumption of obligations or a separate assumption agreement must be submitted to SBA).

It is important to highlight that regardless of whether or not there is a Change of Ownership, the PPP borrower remains responsible for (1) performance of all obligations under the PPP loan, (2) the certifications made in connection with the PPP loan application, including the certification of economic necessity, (3) compliance with all other applicable PPP requirements and (4) preparing, and retaining all required PPP forms and supporting documentation. In cases where the Change of Ownership transaction is financed in whole or in part with a 7(a) loan, all SBA Loan Program Requirements must

be met and no escrowed funds can be with proceeds from a 7(a) loan.