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SBA Issues Guidance for Ownership Changes Under PPP

Businesses contemplating mergers and/or acquisitions (M&A) during this worldwide pandemic have wrestled with the question of how to treat a target company that reveals an outstanding Paycheck Protection Program (PPP) loan on its books. The promissory note with the PPP lender may have a provision deeming the borrower to be in default if it changes ownership or business structure, or sells its assets, without the lender's prior written consent. Default under the PPP loan could accelerate repayment obligations, requiring the borrower (or the borrower's successor) to immediately pay back all amounts owing under the note. Borrowers and other parties to such M&A transactions are encouraged to review the specific terms of the PPP promissory note.

PPP lenders have also been wrestling with the question of whether or not Small Business Administration (SBA) consent to these various M&A transactions is required in order to preserve the SBA guarantee of the PPP loans. Typically, SBA consent is required if: (1) there is a change in ownership of a borrower in the first 12 months after final disbursement of SBA government-backed funds or (2) there is a sale of assets that results in the transfer of the loan or release of the original borrower.

Until recently, the SBA had not provided guidance relating to its procedure for reviewing and consenting to a PPP borrower's change of ownership. However, on October 2, 2020, the SBA issued a Procedural Notice defining a "change of ownership" and explaining the SBA's requirements and procedure for reviewing such proposed changes. This is a welcome development for lenders, borrowers and other businesses contemplating these transactions.

SBA definition of "change of ownership"

For purposes of the PPP, the SBA considers a "change of ownership" to have occurred in one of the following three scenarios:

- (1) *at least 20 percent* of the common stock or other ownership interest of the 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
- (3) the PPP borrower is merged with or into another entity.

The SBA has made it clear that, regardless of any such change of ownership, the PPP borrower remains responsible for: (1) performing all obligations under the loan, (2) the certifications it made in connection with the loan application (including economic necessity), and (3) compliance with all other requirements applicable to the PPP. Borrowers also remain responsible for obtaining, preparing and retaining all required PPP forms and supporting documentation, and for providing these forms and documentation to the lender or SBA upon request. In the event of a merger of the PPP borrower into another entity, the successor to the PPP borrower also remains subject to all obligations under the PPP loan.

PPP lender consent

If the transaction at issue is deemed to be a “change of ownership” then, prior to the closing of the transaction, the PPP borrower is required to provide its PPP lender with written notification of the contemplated transaction. This includes providing the PPP lender with a copy of the proposed agreements or other documents that would effectuate the proposed transaction (i.e., stock purchase agreement, asset purchase agreement, or merger agreement).

Procedure for SBA consent to change of ownership

The next question to be answered is whether SBA consent to the change of ownership is also required. The SBA has provided separate procedures depending on the circumstances of the borrower’s change of ownership. Each circumstance, and its corresponding procedure, is set forth, below:

1. **The PPP note is fully satisfied.** In the event the PPP borrower has, prior to closing of the sale or transfer, repaid the PPP note in full, then there are no restrictions on the ownership change. Furthermore, if the PPP borrower has completed the loan forgiveness process, and either the SBA has remitted funds to the lender in satisfaction of the note or the borrower has repaid any remaining balance on the PPP loan, then there are similarly no restrictions on the ownership change. In other words, SBA consent to the transaction is not required.
2. **The PPP note is not fully satisfied.** In the event the PPP note is not fully satisfied prior to closing the sale or transfer, then the following applies:

PPP lender may **unilaterally** approve ownership change; SBA consent **not** required. When the change of ownership is structured as a **sale or other transfer of common stock or other ownership interest** or as a **merger**, the ownership interest in the PPP borrower may be so transferred *without the prior approval of the SBA so long as:*

- the sale or transfer is of *50 percent or less* of the common stock or other ownership interest of the borrower, or
- the PPP borrower has submitted a complete forgiveness application to its lender **and** an interest-bearing escrow account controlled by the lender is established with funds equal to the outstanding balance of the PPP loan. After the forgiveness process (including any appeal of SBA decision) is completed, the escrow funds must be disbursed first to repay any remaining PPP loan balance plus interest.

Alternatively, if the transaction is structured as an **asset sale**, then the PPP borrower **does not** need prior SBA approval if it is selling 50 percent or more of its assets, submits a complete forgiveness application to its lender, **and** an interest-bearing escrow account controlled by the lender is established with funds equal to the outstanding balance of the PPP loan. After the forgiveness process (including any appeal of SBA's decision) is completed, the escrow funds must be disbursed first to repay any remaining PPP loan balance plus interest.

SBA prior approval is required. If the change of ownership does not meet the conditions, above, then prior SBA approval **is** required and the lender may **not** unilaterally approve the change of ownership. To obtain such approval from the SBA, the lender must submit a request to the applicable SBA Loan Servicing Center, which includes the following:

- the reason that the borrower cannot fully satisfy the PPP note or escrow the funds,
- the details of the requested transaction,
- a copy of the executed PPP note,
- any letter of intent and the purchase or sale agreement setting forth the responsibilities of the PPP borrower, seller and buyer,
- disclosure of whether the buyer has an existing PPP loan and, if so, the SBA loan number, and

- a list of all owners of 20 percent or more of the purchasing entity.

The SBA has reserved the right to require additional risk mitigation measures as a condition of its approval of the transaction. Additionally, SBA approval of any change of ownership involving the sale of **50 percent or more of the PPP borrower's assets** will be conditioned on the buyer assuming all of the borrower's obligations under the PPP loan, including compliance with PPP loan terms.

If SBA approval is required, it is important to note that the SBA has 60 calendar days from its receipt of a completed request to provide its determination.

What this means to you

The SBA's Procedural Notice serves as an important roadmap for PPP lenders and borrowers alike in navigating the structure, required conditions and timeline associated with PPP loans and borrower changes of ownership.

For a discussion of other PPP rules relating to forgiveness, please see our Frequently Asked Questions.

Contact us

If you would like more information regarding PPP, SBA guidance or change of ownership, please contact Jessica Zeratsky, Chis Peterson or your Husch Blackwell attorney.

Comprehensive CARES Act and COVID-19 guidance

Husch Blackwell's CARES Act resource team helps clients identify available assistance using industry-specific updates on changing agency rulemakings. Our COVID-19 response team provides clients with an online legal Toolkit to address challenges presented by the coronavirus outbreak, including rapidly changing orders on a state-by-state basis.