



PPP Loans and Changes of Ownership: Considerations for M&A Transactions

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The Small Business Administration (“SBA”) has issued long-awaited rules governing lender and borrower obligations when there is a change in ownership of an entity that has received a Paycheck Protection Program (“PPP”) loan. The new guidance, issued on October 2, 2020, eliminates the need for SBA approval for many merger or sale transactions, but injects a host of additional procedural and compliance requirements that could create pitfalls for borrowers, buyers and lenders.

Prior to issuance of the new guidance, many M&A practitioners assumed that SBA approval is required for an M&A transaction involving a PPP borrower seller. This is because the SBA’s standard PPP note provides that any change of ownership without lender consent constitutes an event of default. Furthermore, the SBA servicing rules for 7(a) loans, which include PPP loans, require SBA approval before a lender consents to a change in ownership if the change occurs within 12 months of a loan disbursement. However, neither the note nor the rules define when a change of ownership occurs. The new guidelines provide clarity on this issue and describe those circumstances when SBA approval is required.

When Does a “Change in Ownership” Occur for the Purposes of a PPP Loan?

In the new guidance, the SBA considers a “change in ownership” with respect to a PPP borrower to have occurred when:

- at least 20% of the common stock or other ownership interest of the borrower is sold or transferred, whether in one or more transactions, including to an affiliate or an existing entity;
- the borrower sells or otherwise transfers at least 50% of its assets (measured by fair market value), whether in one or more transactions; or
- the borrower is merged with or into another entity.

When is SBA Approval Not Required?

Under the new guidance, SBA approval is not required for a change of control in five situations:

1. The PPP loan has been repaid in full prior to the merger or sale transaction;
2. The borrower has completed the loan forgiveness process and the SBA has remitted funds to the PPP lender in full satisfaction of the PPP note (and the borrower has repaid any unforgiven balance);
3. Less than 50% of the common stock or other ownership interest in the borrower is being transferred;
4. More than 50% of the common stock or other ownership interest in the borrower is being transferred, the borrower completes and submits to the lender a loan forgiveness application and all required documentation and the borrower establishes an interest-bearing escrow account controlled by the PPP lender containing funds equal to the outstanding balance of the PPP loan; or
5. The transaction involves a change in ownership of 50% or more of the borrower's assets, the borrower completes and submits to the lender a loan forgiveness application and all required documentation and the borrower establishes an interest-bearing escrow account controlled by the PPP lender containing funds equal to the outstanding balance of the PPP loan.

PPP lenders are required to notify the SBA of the location and amount of the escrowed funds within five business days of the transaction, and in the case of a transfer of stock or other ownership interests, they must also provide the SBA with information concerning the identity of the new owners. Once the forgiveness process is completed, the escrowed funds must be disbursed to repay the remaining PPP loan balance (if any), plus interest.

When is SBA Approval Required?

If the relevant conditions outlined above are not met, either because the borrower has not submitted a loan forgiveness application or is unable to escrow an amount equal to the outstanding balance of the loan, the PPP lender must seek SBA approval for the transaction.

To obtain the SBA's approval, the lender must submit a request to the appropriate SBA Loan Servicing Center, explaining the reason that the borrower cannot repay the loan or escrow the loan balance and providing the details of the proposed transaction and a copy of the executed PPP note. The PPP lender also must provide the SBA with the letter of intent (if any) and purchase and sale agreement setting forth the responsibilities of the PPP borrower, the seller (if different from the PPP borrower) and the buyer. The request for approval must also disclose whether the buyer has an existing PPP loan, together with a list of all owners of 20% or more of the buyer entity. If it deems necessary, the SBA may impose additional risk mitigation measures as a condition of its approval.

The SBA has committed to providing a determination with respect to these requests within 60 days of receiving a completed request for approval.

What Are the Obligations of the Borrower, Seller (If Different from the Borrower) and the Buyer?

The SBA's approval of a sale of 50% or more of the borrower's assets will be conditioned upon the buyer assuming the PPP borrower's obligations under the PPP loan, including responsibility for compliance with the PPP loan terms. Similarly, for stock or other ownership interest transfers, regardless of whether SBA approval is needed, the successor entity will be subject to all obligations under the PPP loan, including the obligation to use PPP funds only for authorized purposes. Additionally, if the successor entity has a separate

PPP loan, the PPP borrower and the new owner are required to keep separate records and segregate the funds in order to demonstrate compliance with the PPP requirements for each borrower.

Finally, regardless of the nature of change in ownership transactions, the SBA's guidance makes it clear that the borrower remains responsible for all PPP obligations, as well as the original certifications made in its PPP loan application. This includes the certification of economic necessity, which has been addressed in our previous eAlert.

This eAlert is not intended to be an exhaustive summary of the PPP or the information contained in the CARES Act or in SBA guidance. Readers are encouraged to click on the links above and visit the SBA's website for more complete and up-to-date information regarding the PPP.