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SBA issues new guidance on change of ownership of PPP borrowers

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On October 2, 2020, the Small Business Administration (SBA) issued important new guidance regarding change of ownership of Paycheck Protection Program (PPP) loan borrowers in the form of [Procedural Notice No. 5000-20057](#) (the Notice). The Notice clarifies the treatment of a PPP loan where the borrower undergoes a “change of ownership” while the loan is outstanding. Most common M&A transactions qualify as a change of ownership under SBA rules, making the Notice relevant to borrowers, buyers, and other deal participants.

The Notice specifically provides comfort that in most scenarios, a deal involving the acquisition of a PPP borrower may proceed without prior SBA consent, if (i) lender consent has been secured, and (ii) funds are escrowed to repay the PPP loan to the extent ultimately not forgiven by the SBA.

The Notice grants welcome relief to many in the deal community, working with acquisition targets with PPP loans. PPP lenders developed their own forms of PPP loan documentation using a standard pre-PPP form of SBA promissory note. These include a provision that treats a transaction in which the borrower “[r]eorganizes, merges, consolidates, or otherwise changes ownership or business structure without Lender’s prior written consent” as an event of default.

Different banks and SBA loan servicing centers have taken inconsistent positions on lender and SBA approval requirements in the M&A context over recent weeks. As a result, some buyers have chosen a conservative but costly position: insisting that the PPP loan be repaid before the deal closes. This path deprives the borrower of the opportunity to secure forgiveness of its PPP loan (to the extent used for eligible purposes such as payroll, benefits, rent, and mortgage costs). For most PPP borrowers, loan forgiveness was a key driver for taking a PPP loan in the first place. Loan forgiveness is an important rationale for dealmakers to treat a PPP loan as something other than straight debt on the balance sheet when setting deal terms.

While some buyers will still require pre-closing payoff of PPP loans, the Notice increases the viability of alternative approaches.

The Notice is effective on October 2, 2020, and does not pertain to PPP borrowers whose change of ownership transactions closed on or before that date.

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Change of ownership

For PPP borrowers, “change of ownership” includes any of the following:

- 20%+ of the borrower’s equity interests are sold or otherwise transferred,
- 50%+ of the borrower’s assets are sold, or
- The borrower is merged with or into another entity.

Multiple transactions are subject to aggregation. Some transactions with related parties are included within the definition of change of ownership, and special rules apply for determining ownership changes of publicly traded PPP borrowers.

Notice of change of ownership to PPP lender

A PPP borrower with a PPP loan outstanding must notify the PPP lender in writing prior to closing any change of ownership transaction.

Change of ownership where PPP loan paid in full or forgiven before closing

There are no restrictions on change of ownership where the PPP borrower has completed the loan forgiveness process, and (i) the SBA has remitted funds to the PPP lender in full satisfaction of the loan **or** (ii) the PPP borrower has repaid any remaining balance on the PPP loan. We are not currently aware of any banks that have received funds from the SBA in respect of forgiven PPP loans. Most PPP borrowers have either not yet applied for forgiveness or have applied for forgiveness, and their requests are being considered by (i) the PPP lender (which has 60 days to do) or (ii) the SBA (which has an additional 90 days).

Change of ownership where PPP loan is paid in full at closing

The Notice does not specifically address this scenario. Still, we believe that out of an abundance of caution, it is preferable, where PPP loan payoff is a closing condition, that it occurs prior to other closing actions so as to clearly occur prior to closing. Additional SBA guidance would be welcome here. In non-PPP loan contexts, a target’s indebtedness is often paid in full at closing out of the purchase price or merger consideration paid by the buyer.

Deals for which prior SBA approval of a change of ownership is not required

The Notice clarifies that SBA approval for a change of ownership is **not** required in the following situations:

- *Sale of Majority Stake in Equity or Assets, and Some Mergers, in all Cases with Escrow.* A merger or stock sale involving the sale of more than 50% of the ownership interests of the PPP borrower, or a sale of 50% or more of the PPP borrower’s assets (by fair market value), does not require SBA approval so long as (i) the borrower has used all of its PPP loan funds, (ii) the borrower has submitted a forgiveness application, and (iii) an interest-bearing escrow account controlled by the PPP lender is established with funds equal to the outstanding balance of the PPP loan, to be used to pay off any unforgiven PPP loan balance.
- *Sale of Less than Majority Stake in Equity and Some Mergers.* A sale of 50% or less of the ownership interests in the PPP borrower does not require SBA approval, even if the borrower has not yet utilized all of the PPP loan proceeds (and, therefore, is not yet in a position to submit a forgiveness application). The Notice refers to the merger of the

borrower into another entity as potentially so qualifying. Although not clearly spelled out in the Notice, the SBA likely includes here any merger in which the PPP borrower is the surviving entity, such as the commonly used reverse triangular merger structure, so long as there is 50% or lower change of ownership.

All ownership transfers occurring since the date of approval of the PPP loan must be aggregated to determine whether the relevant threshold has been met. There are slightly different rules for determining ownership changes in publicly traded PPP borrowers.

While prior SBA approval is not required for the types of transactions described above, additional requirements apply, including PPP lender approval, as described below.

Deals for which prior SBA approval of a change of ownership is required

In any other change of ownership scenario, *prior* SBA approval of the change of ownership is required, and the PPP lender may not unilaterally approve it. In these cases, a change of control application must be submitted to the SBA detailing:

- The reason that the PPP borrower cannot fully satisfy the PPP loan prior to the change of ownership (deal closing);
- Any letter of intent and purchase agreement or merger agreement setting forth the responsibilities of the borrower and other parties to the deal regarding the PPP loan; and
- A list of all 20%+ owners of the buyer.

The SBA may approve the transaction as submitted or may require additional risk mitigation measures as a condition of its approval. The SBA is required to make a determination within 60 days of receipt of a “complete” request.

The timing of SBA approval, uncertainty about what additional information may be sought by the SBA to render the request “complete,” as well as confidentiality concerns (as to both deal terms and buyer ownership information) may lead a potential buyer to require the target to repay its PPP loans if the transaction cannot be structured to avoid SBA approval (See section above).

Other requirements applicable to a change of ownership

PPP borrowers, buyers, and lenders must communicate closely on these transactions. Regardless of the form of transaction, the PPP lender is required to notify the appropriate SBA loan servicing center within five business days of completion of the transaction, providing the SBA with details on the change of ownership.

Regardless of the form of change of ownership, the PPP borrower remains responsible for its certifications. The PPP borrower (and, if applicable, any successor entities) will remain subject to PPP loan obligations. In addition, if the new owner(s) use PPP funds for unauthorized purposes, SBA will have recourse against the owner(s). In case of change of the legal entity, PPP lenders have typically also been requiring the buyer/successor to enter into an affirmation of the SBA loan, confirming responsibility for all of the original borrower’s PPP loan obligations.

If a buyer/successor has a separate PPP loan, then the acquired PPP borrower and buyer/successor must segregate and delineate their PPP funds and expenses and provide documentation demonstrating compliance with PPP requirements by each borrower entity in respect of each PPP loan.

The bottom line for buyers and sellers

For transactions structured following the Notice, deal participants, including borrowers, buyers, and lenders, have additional certainty regarding when SBA consent is required. With this information, they can more confidently structure deals to reduce the potential complications attendant to prior SBA approval, while preserving the value of potential PPP loan forgiveness.

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