

SBA Provides Guidance on Rules for M&A Transactions Involving PPP Loans

Hinshaw Alert | 6 min read

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In a [previous client alert](#), we had advised you of issues facing a purchaser of a business which had received a Paycheck Protection Plan (PPP) loan.

PPP loans are Small Business Administration (SBA) Section 7(a) loans. Consequently, they are subject to the same regulatory guidelines. These guidelines include provisions directing lenders to obtain the consent of the SBA before allowing a borrower to perform certain activities. Notably, one of the guidelines requires a lender to secure the SBA's permission before approving a change of ownership of a borrower occurring within 12 months of the final disbursement of the Section 7(a) loan, including a PPP loan.

Since the SBA began advising lenders that PPP borrowers were subject to these change of ownership rules, PPP borrowers who were in the process of selling their businesses have confronted a number of challenges. For example, the guideline applies to change of ownership, but it does not specify any minimum threshold that would trigger a change of ownership, nor is it clear whether an asset sale is subject to the guideline. Furthermore, there were concerns over whether the SBA would consent to the change in ownership; how long it would take the SBA to give its consent; and whether the consent would contain restrictions that were not acceptable to a buyer. These and other concerns have impacted the structure of proposed transactions and the timeline for completing such transactions, especially if SBA approval was required.

The SBA issued a procedural notice designed to address the change in ownership guideline on October 2, 2020.

Change in Ownership Defined

Under the notice, “change of ownership” will be deemed to have occurred when (1) at least 20% of the common stock or other ownership interest of a PPP borrower—including a publicly traded entity—is sold or otherwise transferred 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% of its assets (measured by fair market value) in one or more transactions, or (3) a PPP borrower is merged with or into another entity.

When determining whether a change of ownership has occurred, all sales and other transfers occurring since the date of the approval of the PPP loan must be aggregated to determine whether the relevant threshold has been met.

For publicly traded borrowers, only sales or 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.

SBA Approval Not Required

The notice further provides that the following transactions do not have to be approved by the SBA:

- Prior to the closing of the transaction, the PPP loan is paid in full.
- Prior to the closing of the transaction, the PPP borrower has completed the loan forgiveness process, and (1) The SBA has remitted the funds to the PPP lender in full payment of the PPP loan; or (2) the PPP borrower has repaid any balance on the PPP loan.
- A sale of 50% or less of the common stock or other ownership interests of the PPP borrower.

SBA Approval Not Required But With Conditions

- The merger of a PPP borrower with and into another entity or the sale of 50% or more of the common stock or other ownership interests of the PPP borrower, if the following conditions are satisfied: (1) the PPP borrower has completed and submitted a forgiveness application reflecting its use of the PPP loan proceeds, with all of the supporting documentation, to the PPP lender; (2) an interest bearing escrow account is established at the closing with the PPP lender which will hold an amount equal to the outstanding balance of the PPP loan; and (3) after the forgiveness process and any related appeals have been completed, the escrow proceeds are disbursed first to pay the balance of the PPP loan, if any, and any interest.
- The sale of 50% or more of the assets of a PPP borrower if all three conditions set forth above are complied with by the PPP borrower and the PPP lender.

Prior to the closing of any change of ownership transaction, the PPP borrower must notify its PPP lender in writing of the contemplated transaction and provide its PPP lender with a copy of the proposed agreements or other documents that would effectuate the proposed transaction.

Additionally, for either of the scenarios described above, 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 five business days of completion of the sale.

SBA Approval Required

If a change in ownership does not meet one of the tests set forth above, it will have to be approved by the SBA. A PPP lender may not approve such transactions without the SBA's approval.

PPP Lender's Submission Obligation. To secure the SBA's prior approval, the PPP lender must submit the request to the appropriate SBA Loan Servicing Center which submission must include the following:

- the reason that the PPP borrower cannot fully satisfy the PPP loan or comply with the escrow requirements discussed above in the previous two sections;
- the details of the proposed 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 (if different from the PPP borrower), 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% or more of the purchasing entity.

The notice states that the SBA may require additional risk mitigation measures as a condition of its approval of the proposed sale.

Buyer's Assumption Obligation in Asset Sales. The SBA will only approve a sale of 50% or more of the assets—measured by fair market value—of a PPP borrower if the buyer assumes all the PPP borrower's obligations under the PPP loan, including responsibility for compliance with the PPP loan terms. The P&A agreement must include appropriate language regarding the assumption of the PPP borrower's obligations under the PPP loan by the buyer, or the obligation must be set forth in a separate assumption agreement. The P&A agreement and the assumption agreement, if any, must be submitted to SBA.

SBA Review. SBA will review and provide a determination within 60 calendar days of receipt of a complete request.

Post-Closing Obligations. Following the completion of the sale or merger, the PPP borrower—and, in the event of a merger of the PPP borrower into another entity, the successor to the PPP borrower—will be responsible for all the obligations under the PPP loan, including (1) the certifications made in connection with the PPP loan application, including the certification of economic necessity, (2) obtaining, preparing and retaining all required PPP forms and supporting documentation and delivering such documentation to the PPP lender and the SBA, and (3) complying with all other applicable PPP requirements.

SBA Warnings

In the notice, the SBA stated that it reserves all rights and remedies available under the law in the event of fraud, false statements, and/or unauthorized uses of PPP loan proceeds. The SBA also warned that if a new owner used PPP funds for unauthorized purposes, the SBA would have recourse against the owner for such unauthorized use.

Buyer's PPP Loan

If the new owners or the successors have a separate PPP loan, then, following consummation of the transaction: (1) in the case of a purchase or other transfer of common stock or other ownership interest, the PPP borrower and the new owner 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 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.

Lender Notice to the SBA

Within five business days of completion of the transaction the PPP lender must notify the appropriate SBA Loan Servicing Center of the following:

- identity of the new owner of the common stock or other ownership interest;
- new owner's ownership percentage;
- tax identification number for any owner holding 20% or more of the equity in the business; and
- location of, and the amount of funds in, the escrow account under the control of the PPP Lender, if an escrow account is required.

Purchasing Using the Proceeds of a Section 7(a) Loan

If the buyer or the seller—or both—has an outstanding PPP loan, and the change of ownership transaction is financed in whole or in part with a Section 7(a) loan, all SBA Loan Program Requirements must be satisfied. In addition, if an escrow account is required under the procedures set forth in the notice, the Section 7(a) loan that finances the change of ownership cannot be used to finance the escrow account.

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