

## **SBA Announces New Guidance on Consent Requirements for Changes of Ownership of PPP Loan Borrowers**

The U.S. Small Business Administration (SBA) released a procedural notice (the Notice) on October 2, 2020, that describes the process and requirements that Paycheck Protection Program (PPP) borrowers and lenders must follow when ownership of the PPP borrower is changing. The Notice provides a roadmap for how PPP borrowers and their prospective acquirers and investors may structure transactions to avoid the need to obtain a prior consent from the SBA.

Although the CARES Act did not require that PPP loans be documented on a particular form of promissory note, many PPP lenders utilized a promissory note based on the SBA's form of promissory note for other loans made under the SBA's 7(a) business loan program. This form provides that a PPP borrower is in default if the borrower "[r]eorganizes, merges, consolidates, or otherwise changes ownership or business structure without Lender's prior written consent." That form of promissory note provides that a change of ownership transaction will not cause a default if consented to by the lender, but the SBA's previous guidance indicated that lenders could not unilaterally approve changes in the ownership of a borrower for 12 months after the disbursement of the loan. The SBA has taken the position that this prior guidance applies equally to PPP lenders and PPP loans. As a result, until now many PPP lenders have been unwilling to consent to transactions without first obtaining the SBA's approval.

### **Summary: Change of Ownership Definition**

The Notice begins by defining "change of ownership" to mean when:

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

For private companies, all sales and other transfers occurring since the date its PPP loan application was approved must be aggregated to determine whether the relevant threshold has been met. For example, a private company that has experienced several transactions involving a change in ownership of stock since obtaining a PPP loan would need to aggregate the shares transferred for purposes of the 20% test. For publicly traded borrowers, 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. The Notice does not specifically state whether it applies to new equity issuances (e.g., in a financing) or only with respect to transfers, but prior to this Notice many practitioners were viewing a financing the same way as a stock transfer. The Notice also does not specify whether the 20% test is measured on a fully diluted basis or based on the borrower's outstanding shares or equity interests (i.e., it is not clear whether a transaction that results in a transfer of more than 20% of a PPP borrower's outstanding shares but less than 20% of that borrower's outstanding shares on a fully diluted basis would trigger the 20% threshold).

The Notice provides that prior to the closing of any "change of ownership" transaction (i.e., in excess of the 20% test), the PPP borrower must notify the PPP lender in writing of the contemplated transaction and provide the PPP lender with a copy of the definitive acquisition agreement(s). The Notice does not specify whether this requirement applies in situations where the PPP promissory note did not require consent to a change of ownership, but appears to have broader application for all PPP loans. While we would expect most lenders to follow the SBA's definition of "change of ownership," they are not required to do so. Accordingly, a PPP borrower considering a transaction should review its PPP promissory note carefully with counsel in order to make an independent determination of whether a consent is required or advisable.

### **Summary: Change of Ownership Rules Applied to Various Transaction Structures**

The Notice outlines the following procedures that will apply depending on the circumstances of the change of ownership, including whether the PPP loan has been fully satisfied or forgiven.

In situations where the PPP loan has been repaid in full, or where the loan forgiveness process has been fully completed and the SBA has reimbursed the PPP lender for the forgiven portion of the loan, no SBA approval or other requirements apply.

In situations where the PPP loan has not yet been repaid or forgiven, including where the borrower may have begun but not yet completed the forgiveness process, SBA approval or other procedures will be required:

**Minority Transactions.** For changes of ownership involving the sale or other transfer of 50% or less of the common stock or other ownership interest of the PPP borrower, SBA approval is not required and the PPP lender may unilaterally approve the change of ownership so long as the PPP lender notifies the appropriate SBA Loan Servicing Center, within five business days of completion of the transaction, of the following (the New Owner Information):

- Identity of the new owner(s) of the common stock or other ownership interest.
- New owner(s)' ownership percentage(s).
- Tax identification number(s) for any owner(s) holding 20% or more of the equity in the business.

In determining whether a sale or other transfer exceeds the 50% threshold, all sales and other transfers occurring since the date of approval of the borrower's PPP loan application must be aggregated.

**Majority Transactions.** For changes of ownership involving the sale or other transfer of greater than 50% of the common stock or other ownership interest of the PPP borrower, including transactions structured as a merger, SBA approval is not required and the PPP lender may unilaterally approve the change of ownership so long as:

- The PPP borrower completes and submits a forgiveness application reflecting its use of all of the PPP loan proceeds.
- The PPP borrower deposits funds equal to the outstanding balance of the PPP loan in an interest-bearing escrow account controlled by the PPP lender.
- The PPP lender notifies the appropriate SBA loan servicing center, within five business days of completion of the transaction, of the following:
  - The new owner information.
  - The location of, and the amount of funds in, the escrow account under the control of the PPP lender.

**Asset Sales.** For changes of ownership structured as a sale of 50% or more of a PPP borrower's assets (measured by fair market value), SBA approval is not required and the PPP lender may unilaterally approve the change of

ownership so long as:

- The PPP borrower completes and submits a forgiveness application reflecting its use of all of the PPP loan proceeds.
- The PPP borrower deposits funds equal to the outstanding balance of the PPP loan in an interest-bearing escrow account controlled by the PPP lender.
- The PPP lender notifies the appropriate SBA Loan Servicing Center, within five business days of completion of the transaction, of the location of, and the amount of funds in the escrow account under the control of the PPP lender.

**SBA Approval Process.** If a change of ownership does not meet the conditions described above such that prior SBA approval of the transaction is required and the PPP lender may not unilaterally approve the change of ownership, then the following will apply:

- The PPP lender must submit the request for approval to the SBA, which request must include:
  - The reason that the PPP borrower cannot repay or escrow the outstanding balance of the PPP loan.
  - The details of the requested transaction.
  - A copy of the executed PPP note.
  - Any letter of intent and purchase or sale agreement setting forth the responsibilities of the PPP borrower, seller (if different from the borrower), and buyer.
  - Disclosure of whether the buyer has an existing PPP loan and, if so, the SBA loan number.
  - A list of all owners of 20% or more of the purchasing entity.
- The SBA may require additional risk mitigation measures as a condition of its approval of the transaction "if deemed appropriate."
- The SBA's approval of any change of ownership involving the sale of 50% or more of a PPP borrower's assets (measured by fair market value) will be conditioned on the buyer assuming all of the borrower's obligations under the PPP loan, with such assumption documented in the asset purchase agreement or a separate assumption agreement.
- The SBA will review and provide a determination within 60 calendar days of receipt of a complete request.

### **Summary: Considerations for New Owners of PPP Borrowers**

The Notice states that the SBA will have recourse against a new owner of a PPP borrower that uses PPP funds for unauthorized purposes.

In cases where a new owner or successor of a PPP loan has a separate PPP loan, the Notice provides that:

- If the change of ownership is structured as a transfer of common stock or other ownership interest, the PPP borrower and the new owner(s) will be responsible for segregating PPP funds and expenses and providing documentation to demonstrate compliance with PPP requirements by each PPP borrower.
- If the change of ownership transaction is structured as 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.

### **Key Takeaways**

- PPP borrowers must consider whether their PPP lender's consent is required for any transaction. Even transactions for which the SBA's approval to a change of ownership is not required, the PPP lender's consent will typically still be required.
- In determining whether the 20% or 50% thresholds are met for stock transactions, PPP borrowers should be mindful of the aggregation rules that look back to all share sales and transfers since the date the applicable PPP loan application was approved.
- For change of control transactions that require the escrow of funds with the PPP lender, deal participants should allocate sufficient lead time to finalize documentation with the lender.
- For asset sales involving a sale of more than 50% of the borrower's assets, additional procedures may be required to document the acquirors assumption of the borrower's obligations under the PPP loan.

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