

SBA Issues “Change of Ownership” Procedures for PPP Borrowers: M&A Transactions Must Now Be Reviewed for Compliance

Article

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On October 2, 2020, the Small Business Administration (SBA) issued a procedural notice regarding changes of ownership of an entity that has received Paycheck Protection Program (PPP) funds. The notice does three main things – defines when a “change of ownership” is deemed to have occurred, details when and how lenders may unilaterally approve an ownership change, and details when and how SBA approval must be obtained.

A change of ownership is deemed to have occurred if one of the following applies:

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

Prior to the closing of any change in ownership transaction, the PPP borrower must notify the PPP lender in writing of the contemplated transaction and provide a copy of the proposed agreement or other transaction documents. Depending on the circumstances of the change of ownership, there are different procedures to follow.

If the PPP note is fully satisfied prior to the closing of the transaction, by means of full repayment or completion of the forgiveness process, there are no restrictions on a change of ownership.

If the PPP note is not fully satisfied prior to the closing of the transaction, PPP lender approval is required in two circumstances:

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1. If the change of ownership is structured as a merger or as a sale or other transfer of common stock or other ownership interest
2. If the change of ownership is structured as an asset sale.

In the case of a merger, stock sale, or other ownership transfer, the transfer must be of 50% or less of the common stock or other ownership interest, and in the case of an asset sale, the transfer may be of 50% or more of the assets (measured by fair market value). In both instances, the PPP borrower must complete and submit a forgiveness application and supporting documentation reflecting the use of all PPP loan proceeds and the creation of an escrow account controlled by the lender with funds equal to the outstanding loan balance, which funds will be disbursed following the loan forgiveness decision.

In all other circumstances, the PPP lender must seek SBA approval before consenting to the transaction, and the SBA must review and determine whether to approve within 60 calendar days of receipt of the following:

1. The reason that the PPP borrower cannot fully satisfy the note;
2. The details of the requested transaction;
3. A copy of the executed PPP note;
4. Any letter of intent and the purchase or sale agreement setting forth the responsibilities of the PPP borrower, seller (if different from PPP borrower), and buyer;
5. Disclosure of whether the buyer has an existing PPP loan, and if so, the SBA loan number; and
6. A list of all owners of 20% or more of the purchasing entity.

In the case of a change of ownership involving the sale of 50% or more of the assets, approval is conditioned on the purchasing entity assuming all of the PPP borrower's obligations under the PPP loan, including compliance with its loan terms. And in the case of a merger, stock sale, or other ownership transfer, the PPP borrower will remain subject to all obligations under the PPP loan.

Borrowers and their Lenders must now examine M&A transactions in light of the new guidance, with its incentive to either repay a PPP loan or conclude the forgiveness process prior to the transaction closing. Other borrowers should be prepared to escrow funds while awaiting either a forgiveness decision or approval by the SBA under this new review process.

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