

COVID-19 Alert: SBA Change of Ownership

Small Business Administration Issues New Guidance That Impacts M&A Transactions Involving PPP Loan Recipients

By: Matthew L. Mitchell and Scott R. Bleier
October 08, 2020



Small Business Administration (“SBA”) “7(a) loans” are loans of up to \$5 million that are partially guaranteed by the SBA. The CARES Act established the Paycheck Protection Program (“PPP”) as a new 7(a) loan program, and, as such PPP loans are subject to the same regulations that apply to 7(a) loans generally. The 7(a) loan regulations include, among other rules, procedures that require lenders, in certain circumstances, to obtain SBA consent before permitting a borrower to complete a “Change of Ownership” transaction. The stated purpose of this consent is to provide the SBA with an enforcement mechanism to better ensure repayment of loans.

On October 2, 2020, the SBA issued new guidance (the “Guidance”) that applies these SBA Change of Ownership procedures to the PPP context.

The Guidance should be consulted in connection with any M&A transaction in which seller or buyer is a PPP borrower.

Definition of Change of Ownership

Under the Guidance, for purposes of the PPP, a “Change of Ownership” occurs when:

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

For purposes of determining a Change of Ownership, all sales and other transfers occurring on or after the date of approval of the PPP loan must be aggregated to determine whether the relevant threshold has been met. 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.

When Notification and SBA Consent is Required

Prior to the closing of any Change of Ownership transaction, a PPP borrower with an outstanding PPP loan must notify its PPP lender in writing of the contemplated transaction and provide the PPP Lender with a copy of the proposed agreements or other documents that would effectuate the proposed transaction. Unless the PPP borrower satisfies one of the following criteria, 1-3 below, the PPP lender must obtain SBA consent prior to the lender authorizing the Change of Ownership transaction:

If, prior to the closing of a Change of Ownership transaction, the PPP borrower has satisfied the PPP note in full, either through forgiveness or repayment (or a combination thereof), there are no restrictions on a Change of Ownership, and SBA consent is not required.

If, prior to the closing of a Change of Ownership transaction, the PPP borrower has not satisfied the PPP note, then the following applies:

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

In the Context of a Stock Sale:

SBA consent is not required if the sale or transfer is of 50% or less of the common stock or other ownership interest of the PPP borrower.

SBA consent is not required if the PPP borrower completes a forgiveness application reflecting its use of all of the PPP loan proceeds and submits it, together with any required supporting documentation, to the PPP lender, and an interest-bearing escrow account controlled by the PPP lender is established with funds equal to the outstanding balance of the PPP loan. Any funds in the escrow account are to be released upon forgiveness of the PPP loan, minus any amounts that were not forgiven (plus interest), which would be required to be repaid out of the escrow funds.

In the Context of an Asset Sale:

A PPP borrower may sell 50% or more of its assets (measured by fair market value) without the prior approval of SBA only if the PPP borrower completes a forgiveness application reflecting its use of all of the PPP loan proceeds and submits it, together with any required supporting documentation, to the PPP Lender, and an interest-bearing escrow account controlled by the PPP Lender is established with funds equal to the outstanding balance of the PPP loan. Any funds in the escrow account are to be released upon forgiveness of the PPP loan, minus any amounts that were not forgiven (plus interest), which would be required to be repaid out of the escrow funds.

If a Change of Ownership transaction does not meet the above criteria, a PPP lender is not authorized to permit a Change of Ownership transaction to close without prior SBA approval. To obtain such SBA prior approval, the PPP lender (at the request of the PPP borrower) must submit a request to the appropriate SBA Loan Servicing Center that includes: (i) the reason the PPP Borrower cannot repay the note or satisfy the forgiveness application and escrow requirements, (ii) the details of the requested transaction, (iii) a copy of the PPP note, (iv) copies of any agreements associated with the Change in Ownership transaction, (v) disclosure of whether the purchasing entity has an existing PPP loan, and (vi) a list of all owners of 20% or more of the purchasing entity.

If the Change of Ownership transaction is an asset sale, SBA approval will be conditioned on the buyer assuming all of the PPP borrower's obligations under the PPP loan, including responsibility for compliance with the PPP loan terms.

Post Change of Ownership Obligations

In all Change of Ownership transactions, whether or not SBA consent is required, the PPP borrower (or, in the case of a merger, the successor to the PPP Borrower) will remain subject to all obligations under the PPP loan. The buyer will be responsible for ensuring that any PPP funds are used only for authorized purposes and the SBA will have recourse against the buyer for any unauthorized use.

If the buyer is a recipient of a PPP loan, the buyer will be responsible for “segregating and delineating PPP funds and expenses” and will be required to provide “documentation to demonstrate compliance with PPP requirements with respect to each separate PPP loan.”

Open Questions

While the Guidance clarifies when SBA consent is and is not required for Change of Ownership transactions, it does not address the consequences to a PPP lender or to a PPP borrower for failing to obtain SBA consent. Several commentators have suggested the following penalties are within the enforcement authority of the SBA:

- Denying of forgiveness for the subject PPP loan;
- Requiring the PPP lender to accelerate all obligations under the loan; or
- Holding the buyer accountable for fraudulent transfer liability.

Morse continues to review the evolving regulatory landscape related to PPP loans and is focused on assisting our clients through these unprecedented and challenging times. Please contact **Matt Mitchell** or **Scott Bleier** should you have questions concerning this subject, or any other COVID-19 response matters.

[Go to our full COVID-19 Resource Collection.](#)