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## SBA Issues PPP Loan Guidance Regarding M&A Transactions

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The U.S. Small Business Association (the “SBA”) released on October 2, 2020 a Procedural Notice providing guidance as to a change of ownership of companies (a “PPP Borrower”) which received a loan (a “PPP Loan”) through the Paycheck Protection Program (the “PPP”). This guidance addresses some of the uncertainty as to how a PPP Borrower should proceed when there is a contemplated change of ownership, whether through a sale of equity or assets or a merger. This Alert confirms the importance of considering the effect of a PPP Loan when planning a transaction involving a PPP Loan.

### WHEN DOES A CHANGE OF OWNERSHIP OCCUR FOR PURPOSES OF PPP?

The SBA considers a Change of Ownership under the PPP as occurring upon (i) the sale of at least 20 percent of the equity of a PPP Borrower whether in one or more transactions, including to an affiliate or an existing owner of the entity, (ii) the sale of at least 50 percent of a PPP Borrower’s assets (measured by fair market value) whether in one or more transactions, or (iii) a PPP Borrower being merged with or into another entity. If a Change of Ownership is to occur, the SBA requires that the PPP Borrower take certain actions.

Please keep in mind that the promissory note and loan documents under the PPP Loan may also contain provisions which may require the Borrower to obtain consents. For example, the promissory note may provide that certain other activities may be a default under the PPP Loan. Accordingly, it is necessary to review the loan documents when considering a possible transaction even if not constituting a Change of Ownership as defined under the Notice.

### WHAT MUST BE DONE BEFORE THE CLOSING OF A CHANGE OF OWNERSHIP OF A PPP BORROWER?

Under the Notice, prior to any Change of Ownership, the PPP Borrower must notify its PPP lender in writing of the contemplated transaction and provide the PPP lender with copies of the proposed agreements. The approval of both the PPP lender and the SBA is required unless certain conditions are satisfied as discussed below.

- 1. The approval of the PPP lender must be obtained before the closing of the Change of Ownership of a PPP Borrower (but the approval of the SBA is not required) if:**
  - The proposed change of ownership is a sale of equity which consists of 50 percent or less of the PPP Borrower’s equity; or
  - The proposed change of ownership is a sale of less than 50 percent (measured by market value) of the PPP borrower’s assets; or
  - The PPP Borrower has completed and submitted to the PPP lender its forgiveness application, and an interest-bearing escrow account controlled by the PPP lender is funded with an amount equal to the outstanding balance of the PPP loan. (The proposed change of ownership transaction can presumably be structured so that the required escrow can be funded with transaction proceeds.) Then, after the forgiveness process is completed, the escrowed funds must first be applied to pay down any unforgiven amount of the PPP Loan, and any remaining balance can be released to the PPP borrower.
- 2. The PPP Borrower must give notice to its PPP lender, but is not required to obtain its consent, before the Change of Ownership of the PPP Borrower if:**
  - The PPP Borrower has repaid the PPP Loan in full (i.e., without obtaining forgiveness for all or any part of the PPP Loan); or
  - The PPP Borrower has completed and submitted to the PPP lender its forgiveness application; and either:
    - The SBA has remitted funds to the PPP lender in full satisfaction of the PPP loan; or
    - The PPP Borrower has repaid any remaining balance of the PPP loan.

3. **The approval of both the SBA and the PPP lender must be obtained before the closing of any Change of Ownership of a PPP Borrower that is not described in paragraphs 1 or 2 above.** The SBA said that it will provide a determination within 60 days of receipt of a complete request.

The SBA announced that its approval of any Change of Ownership involving the sale of 50 percent or more of the assets of a PPP Borrower will be conditioned on the purchaser assuming all of the PPP Borrower's obligations under the PPP Loan.

As a practical matter, this may mean that the closing of asset sales of PPP Borrowers will be delayed in cases where the SBA's consent is required since purchasers may not want to agree to assume all of the PPP Borrower's obligations under the PPP Loan. Accordingly, purchasers may want to postpone the closing until the PPP Borrower is in a position to submit to the PPP lender a forgiveness application with all supporting documentation so that the process described in paragraph 2 above can be completed.

#### WHO IS RESPONSIBLE AFTER THE TRANSACTION?

The SBA stated that regardless if SBA approval is required or not, in the event of a sale of equity or a merger of a PPP Borrower that does not involve the forgiveness or repayment of the balance of the PPP Loan, the PPP Borrower (and, in the case of a merger of the PPP Borrower into another entity, the successor to the PPP Borrower) will remain subject to all obligations under the PPP Loan. The new owner(s) will be liable if they use PPP funds for unauthorized purposes.

Under the Notice, if any of the new owners or the successor arising from such a transaction is itself a PPP Borrower by reason of a separate PPP Loan transaction, then, following the consummation of the transaction:

- in the case of a purchase of equity, the PPP Borrower and the new owner(s) are required to segregate and delineate PPP funds and expenses and demonstrate compliance by each PPP Borrower, and
- in the case of a merger, the successor is required to segregate and delineate PPP funds and expenses and demonstrate compliance with respect to both PPP Loans.

#### POINTS TO CONSIDER

The requirements set forth in the Notice make it crucial to consider the impact of a PPP Loan at the outset of planning for any transaction involving a PPP Borrower.

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