
The PPP Meets M&A: Pitfalls for the Unwary Borrower and Lender

Gray Reed Legal Alert

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The Small Business Administration (SBA) issued a [Procedural Notice](#) on October 2, 2020, detailing required procedures impacting Paycheck Protection Program (PPP)^[1] borrowers and lenders if: (i) twenty percent or more of the common stock or other ownership interest of the PPP borrower (an Equity Interest), including a publicly-traded entity, is sold or otherwise transferred, whether in one or more transactions since the date that the PPP loan was approved, including to an affiliate or existing equity owner (a 20% Equity Transfer),^[2] (ii) the PPP borrower sells or otherwise transfers fifty percent or more of its assets, measured by fair market value, whether in one or more transactions (a 50% Asset Transfer) or (iii) the PPP borrower merges with or into another entity. This article outlines the procedures and the potential serious consequences to both a PPP lender and a PPP borrower for failing to comply with the procedures.

The Procedural Notice deems all of the above transactions to constitute a “change of ownership” requiring the PPP borrower to notify its lender in writing and provide copies of the agreements that would effectuate these transactions. PPP borrowers desiring to undergo a change of ownership will need to review their loan documents to determine if PPP lender consent is required and should consider the potential impact of this on the timing of their transaction. If a borrower’s PPP loan documents require that the borrower obtain the lender’s consent to a change of ownership, then failure to do so may result in the borrower being in default, acceleration of the loan payment obligations and loss of potential forgiveness of the principal and/or interest that may otherwise have been forgivable under the PPP.

In addition, SBA consent is required for a the sale or other transfer of over fifty percent of the PPP borrower’s Equity Interests (an Over 50% Equity Transfer) or if a PPP borrower merges or desires to undergo a 50% Asset Transfer, and the onus is on the lender to obtain the SBA’s consent. Failing to obtain SBA consent could have disastrous results for the lender – loss of the SBA guaranty of the PPP loan, which could result in the lender not being repaid if the PPP borrower defaults.

Background

PPP loans are classified as “7(a) Loans” under the Small Business Act, resulting in PPP loans being subject to the statutes and regulations that apply to all 7(a) Loans. One such [Regulatory Guideline](#) (Guideline) requires lenders to obtain the consent of the Small

Business Administration (SBA) before a borrower is permitted to undergo a change in its ownership in the first twelve months after final disbursement of a 7(a) loan, including a PPP loan. PPP lenders themselves are not authorized under the Guideline to approve any PPP borrower change in ownership. A SBA Procedural Notice confirming this can be found [here](#).

The consent requirement under the Guideline appears to be triggered by any change of the equity ownership of the borrower, material or immaterial. The Guideline does not specifically address whether the sale of a 7(a) Loan borrower's assets outside the ordinary course of business would constitute a change in ownership of the borrower triggering prior SBA consent. As discussed below, the Procedural Notice clarifies the Guideline with respect to these issues.

Mergers and Equity Ownership Sales and Transfers

When SBA Approval Is Not Required

Pursuant to the Procedural Notice, SBA prior approval is not required in the following four circumstances:

1. SBA prior approval is not required for the sale or other transfer of fifty percent or less of the Equity Interests of a PPP borrower. All sales and other transfers since approval of the PPP loan are to be aggregated in determining if a sale or other transfer exceeds this fifty percent threshold.
2. SBA prior approval 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 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. After the forgiveness process is completed, including any appeal of SBA's decision, the escrow funds must be disbursed first to repay any remaining PPP loan balance plus interest. This referred to in this article as the "Escrow Account Process."
3. SBA prior approval is not required if the PPP note has been paid in full prior to the sale or transfer.
4. SBA prior approval is not required if the loan forgiveness process has been completed, the SBA has remitted funds to the PPP lender in full satisfaction of the PPP note or the PPP borrower has repaid the remaining balance of the loan. This is referred to as "Full PPP Note Satisfaction" in this article.

When SBA Approval Is Required

Prior written approval of the SBA is required for a Plus 50% Equity Transfer. The PPP lender would not be able to unilaterally approve the change of ownership. As noted above, the onus is on the lender to obtain the SBA consent.

Asset Sales

When SBA Prior Approval Is Not Required

A PPP borrower may undergo a 50% Asset Transfer without the SBA's prior approval only if the Escrow Account Process is complied with. The PPP lender is required to 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 transaction.

How to Obtain SBA Approval of Requests for Changes of Ownership

To obtain SBA's prior approval of requests for changes of ownership, the PPP lender must submit the request to the appropriate SBA Loan Servicing Center. The request must include: (i) the reason that the PPP borrower cannot perform Full PPP Note Satisfaction or comply with the Escrow Account Process; (ii) details of the requested transaction, (iii) a copy of the signed PPP note, (iv) any letter of intent and the purchase or sale agreement setting forth the responsibilities of the PPP borrower, seller (if other than the PPP borrower) and buyer, (v) disclosure of whether the buyer has an existing PPP loan and, if so, the SBA loan number and (vi) a list of all owners of 20% or more of the purchasing entity.

SBA approval of a 50% Asset Sale will be conditioned upon the buyer assuming the borrower's PPP loan obligations in the purchase agreement and in an assumption agreement submitted to the SBA. The SBA will determine if consent will be given within sixty days after receipt of a complete request.

Lender Requirements Whether or Not SBA Approval is Required

Lenders should be aware of their obligation to notify the appropriate SBA Loan Servicing Center within five business days of a 20% Equity Transfer, Plus 50% Equity Transfer, 50% Asset Transfer or merger of a PPP borrower. The notice needs to include: (i) the identity of the new owners of the equity securities, (ii) the new owners' ownership percentages, (iii) the TINs of the new owners holding twenty percent or more of the equity securities and (iv) the location of and amount of funds in the escrow account under the PPP lender's control if an escrow account is required.

Uncertainty Around Duration of Notification Requirement

Lenders and Borrowers should note that the Guideline appears to require the SBA's consent for a change of ownership only for the 12 month period following final disbursement of the PPP loan in question. However, the Procedural Notice does not address the duration of the SBA's consent requirement, and its wording implies that this requirement persists for the duration of the PPP loan. Borrowers and lenders alike should exercise caution around this point pending further guidance from the SBA.

Key Takeaways

Potential Impact on Lenders of Failing to Obtain SBA Consent

The obligation to obtain SBA consent for a borrower's change in ownership is on the PPP lender. If SBA consent is not obtained, the lender could lose the SBA guaranty of the PPP loan – which could have a disastrous result for the lender if the borrower defaults.

PPP lenders were allowed to utilize their own forms of promissory notes and loan agreements in providing PPP loans. If a PPP lender's loan documents do not impose a lender consent requirement on its borrower engaging in transactions which the SBA deems to constitute a change of ownership, the lender may wish to consider changing its form for future Section 7(a) loans.

Potential Impact on Borrowers of Failing to Obtain Lender Consent

If a borrower's PPP loan documents require that the borrower obtain the lender's consent to a change of ownership, then failure to do so may result in the borrower being in default, acceleration of the loan payment obligations and loss of potential forgiveness of the principal and/or interest that may otherwise have been forgivable under the PPP.

Borrowers should note that the process to obtain the SBA's prior written consent may take up to 60 days from the time that the lender submits its consent request to the SBA. As a result, borrowers should consider raising this issue with their lenders as early in the deal process as possible. Finally, in a change of ownership, if the new owners use PPP funds for unauthorized purposes, SBA will have recourse against the owners for the unauthorized use.

Conclusion

Please contact Gray Reed's Stimulus Task Force if further information would be helpful to you in analyzing SBA's Guideline, Procedural Notice or other PPP matters.

^[1] The PPP was created under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act).

^[2] 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 would be aggregated for purposes of determining if a Change of Ownership occurred.

About the Authors

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Nancy Bostic is the Practice Group Leader for Mergers and Acquisitions and Private Equity and also serves on Gray Reed's CARES Act Task Force. She represents public and private companies and private equity funds in securities issuances, acquisitions and dispositions of assets and equity, joint ventures, recapitalizations, financings and change of control transactions valued at up to \$3.5 billion. She has extensive experience negotiating complex partnership and limited liability company structures. She frequently represents private equity funds investing in or selling portfolio companies and counsels companies in strategic transactions. Her clients focus in the upstream, midstream and downstream oil and gas sectors and in the oilfield service and chemical and product manufacturing industries. Since 2010, Nancy has counseled companies, private equity funds and management teams in transactions valued in excess of \$9 billion.

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