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US: Change of ownership requirements for Paycheck Protection Program borrowers

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On October 2, 2020, the Small Business Administration ("SBA") issued new guidance addressing questions regarding change of ownership transactions involving borrowers that received Paycheck Protection Program ("PPP") loans. The guidance provides a roadmap of the steps that PPP borrowers must complete in connection with a change of ownership transaction.

A "change of ownership" for the purposes of the PPP occurs when:

- at least 20 percent of the common stock or other ownership interests of a PPP borrower is sold or otherwise transferred, including to an affiliate or an existing owner of the entity;
- a PPP borrower sells or otherwise transfers at least 50 percent of its assets (measured by fair market value); or
- a PPP borrower is merged with or into another entity.

The new guidance requires a PPP borrower to notify its PPP Lender regarding any change of ownership transaction prior to the closing of such transaction and provide its PPP Lender with copies of the proposed transaction documents. As described below, in the event the PPP loan has not been fully repaid or forgiven, consent from the PPP Lender or the SBA will also be required. Regardless of any change of ownership, a PPP borrower remains liable for performance of all obligations under its PPP loan, the certifications it made when applying for the PPP loan, including the certification of economic necessity, and compliance with all other PPP requirements.

If a PPP loan is fully satisfied prior to the closing of the change of ownership transaction (i.e., the PPP loan has been repaid in full, fully forgiven or partially forgiven and the remaining balance has been repaid by the PPP borrower), then there are no restrictions on the change of ownership transaction and consent of the PPP Lender and SBA is not required.

If a PPP loan is not fully satisfied prior to the closing of the change of ownership transaction, the PPP Lender may approve the transaction (and SBA approval will not be required) if: (1) the change of ownership is structured as an equity sale or as a merger and less than 50 percent of the ownership interests in a PPP borrower is sold or transferred; or (2) the change of ownership is structured as an equity sale, as a merger or as an asset sale and the PPP borrower meets the following conditions:

- submits a loan forgiveness application outlining its use of all of the PPP loan proceeds along with all required supporting documentation;
- provides the PPP Lender with copies of the proposed transaction documents; and
- sets up an interest-bearing escrow account controlled by the PPP Lender with funds equal to the outstanding balance of the PPP loan. After the forgiveness process with the SBA is concluded, the funds in the escrow account must first be disbursed to repay any remaining PPP loan balance and interest.

In cases where the above conditions cannot be met, the PPP borrower will need to request prior SBA approval for the change of ownership transaction. Importantly, SBA approval will be conditioned upon the purchasing entity assuming all of the PPP borrower's obligations under the PPP loan and the transaction documents must include appropriate language regarding the purchasing entity's assumption of such obligations (or a separate assumption agreement may be submitted to the SBA). Obtaining SBA approval also entails that the PPP borrower provide the SBA with (i) the reason it is unable to fully satisfy the PPP loan or escrow funds, (ii) details regarding the change of ownership transaction, (iii) a copy of the executed PPP note, (iv) copies of the transaction documents for the contemplated transaction, (v) disclosure of whether the purchasing entity has an existing PPP loan, and (vi) a list of all owners of 20 percent or more of the purchasing entity. The guidance provides that the SBA will review the approval request and provide a determination within 60 calendar days after its receipt.

For all sales, transfers of common stock or other ownership interest, or mergers, regardless of whether prior SBA approval is needed, the PPP borrower (or any successor to the PPP borrower) will remain subject to all obligations under the PPP loan. In addition, if the new owner(s) use the PPP funds for unauthorized purposes, the SBA will have recourse against the new owners for such unauthorized use. Buyers should consider these consequences and adequately address PPP liabilities in the purchase and sale agreement. Compliance with the PPP loan program also remains essential throughout the transaction process and, in situations where the two entities (the buyer and the PPP borrower) have separate PPP loans and the entities are combined as a result of the change of ownership transaction, the funds from the PPP loans must be segregated and delineated.

In summary, the new guidance provides an overview of the actions that buyers, sellers and PPP lenders should take when engaging in a M&A transaction involving a PPP borrower, while also reinforcing the importance of complying with PPP rules and the proper use of PPP funds.