SBA Issues Procedural Notice on PPP and Changes of Ownership

On Oct. 2, 2020, the Small Business Administration (SBA) issued SBA Procedural Notice 5000-20057 (the Notice), which provides information and procedures for Paycheck Protection Program (PPP) borrowers when any change of ownership takes place. The Notice defines a change in ownership, as well as any subsequent changes in the responsibilities of the borrower, the lender and the SBA. The guidance from the Notice is meant to provide clarity for PPP borrowers and lenders regarding expectations for SBA consent, including when consent is required and the expected approval process.

Highlights from the guidance have been summarized below as follows:

CHANGE OF OWNERSHIP DEFINED

The Notice defines a change in ownership based on the following:

1. When at least 20 percent of common stock or other ownership interest of the borrower is sold or transferred, whether in one or more transactions, including an affiliate or other existing owner.
2. The borrower sells or transfers at least 50 percent of its assets in one or more transactions.
3. The borrower is merged with or into another entity.

To calculate whether the 20 percent threshold has been reached, all transfers should be aggregated from the date of the approval of the PPP loan. If the borrower is a publicly traded company, only transfers that result in one entity owning 20 percent or more of the borrower’s ownership interests should be aggregated.

SBA APPROVAL REQUIREMENTS

The Notice states that prior to the closing of any change of ownership transaction, the PPP borrower must notify and provide relevant documents in writing to the PPP lender, e.g., merger agreement, sale agreement, etc. Depending on the change of ownership and the current status of the PPP loan, the Notice defines different procedures and levels of approval required.

If the PPP note is fully satisfied, then there are no restrictions on a change of ownership. A PPP note is considered fully satisfied:

1. If the borrower has repaid the PPP note in full; or,
2. If the borrower has completed the loan forgiveness application and the SBA has remitted funds to the PPP lender in satisfaction of the PPP loan note.

If there is still an outstanding loan amount after the SBA has remitted funds to the lender, the outstanding balance must be repaid by the borrower to meet the definition of “fully satisfied.”
When SBA Approval is Not Required

Even if the PPP loan is not fully satisfied prior to a change of ownership transaction, SBA approval of the transaction may not be required in certain cases. Prior approval of the SBA for a change of ownership transaction is not required in the following scenarios:

1. If a sale or transfer of the borrower’s company ownership interests exceeds 50 percent of the ownership interests aggregated since the date of the PPP loan approval, the borrower must complete and submit a forgiveness application to the lender showing the appropriate usage of all PPP proceeds and must also open an interest-bearing escrow account with the PPP lender, depositing a balance equal to the outstanding PPP loan balance into the bank account. Once the PPP application is approved and payment is remitted to the lender, the funds from the escrow account are released to pay any remaining balance from the PPP loan, with the remainder being disbursed in accordance with contractual obligations defined in the change of ownership documents.

2. If the change of ownership is defined as an asset sale (the transfer of 50 percent or more of the borrower's assets measured at fair market value), then the borrower must abide by the same provisions mentioned previously for a transfer of ownership interests (e.g., stock sale). The borrower must submit a completed PPP forgiveness application to the lender showing the use of PPP funds and establish an escrow account containing a balance equal to the outstanding amount of the PPP loan.

When SBA Approval is Required

Prior approval of the SBA for a change of ownership transaction is required if the change of ownership does not meet the equity or asset sale scenarios described above where a completed forgiveness application is submitted to the lender and an escrow account is established to secure the PPP loan. In situations when SBA approval is required, the lender cannot unilaterally approve the change of ownership without first submitting a request for approval to the SBA. When the SBA's approval is required, the SBA has committed to providing a review and determination of the change of ownership transaction within 60 days of receiving the appropriate request documentation.

REQUIRED DOCUMENTATION

If the lender must obtain the SBA’s approval for a change of ownership transaction, the lender must submit the request to the appropriate SBA Loan Servicing Center, including why the borrower cannot either fully satisfy the loan or escrow funds securing the loan. The lender must also provide the SBA with the following:

1. Details of the proposed change of ownership transaction.
2. A copy of the executed PPP loan note.
3. A list of all 20 percent or greater owners of the acquiring entity.
4. Relevant transaction documents describing the responsibilities of the buyer and seller regarding the PPP loan.
5. The loan number of any PPP loans held by the buyer, if applicable.

If the change of ownership transaction is structured as an asset sale of more than 50 percent of the borrower's assets, the purchasing entity must assume all of the selling entity's obligations regarding the PPP loan, including appropriate use of PPP loan funds. The purchase agreement must contain language defining the assumption of the seller’s PPP loan obligation by the purchaser.
OTHER PROVISIONS

The Notice concludes by providing certain requirements in any change of ownership transaction, mergers or other transfers of ownership interests, regardless of whether SBA’s prior approval is involved. The borrower, and any successor entities that acquire the borrower, remain responsible for the proper use of PPP funds, including using the funds for only authorized purposes, and are subject to the SBA’s available remedies for improper usage. The acquirer must segregate the PPP funds and use them only for eligible expenses of the acquiree.

If an acquirer also has a separate PPP loan, the two PPP must remain segregated and only used for eligible expenses of each individual borrower. Even if SBA approval is not required for the transaction, the PPP lender is required to provide to the SBA the identity of any new owners, their ownership percentages and tax identification numbers if holding more than 20 percent of the borrower’s equity.

Regardless of whether SBA approval is required, PPP borrowers should refer to the terms of their loan documents to ensure proper approval is obtained from the lender prior to a change of ownership transaction. Note that most PPP lender notes contained default clauses, wherein an event of default could be triggered on the PPP loan upon any change in ownership if the PPP lender did not provide prior approval of the transaction.

DHG is prepared to answer your questions regarding PPP loans and guidance from the SBA. Reach out to us for more information at CARESActQuestions@dhg.com.