

SBA Issues Long-Awaited Guidance on Change of Ownership Transactions Involving PPP Loan Borrowers

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Who Needs to Know

SBA employees and Paycheck Protection Program (PPP) lenders/borrowers on the “changes of ownership” procedures.

Why It Matters

On October 2, the Small Business Administration (SBA) issued a Procedural Notice to provide guidance to SBA employees and Paycheck Protection Program (PPP) lenders on the required “changes of ownership” procedures for an entity receiving a PPP loan (PPP borrower). This notice addresses the uncertainty and inconsistency in how PPP lenders view various equity raising, reorganization, and sale of business transactions involving PPP borrowers in determining whether, under SBA’s loan program requirements for 7(a) loans, the PPP lender must obtain prior SBA approval as a condition to the PPP lender’s transaction approval.

On October 2, the Small Business Administration (SBA) issued a [Procedural Notice](#) to provide guidance to SBA employees and Paycheck Protection Program (PPP) lenders on the required “changes of ownership” procedures for an entity receiving a PPP loan (PPP borrower). This notice addresses the uncertainty and inconsistency in how PPP lenders view various equity raising, reorganization, and sale of business transactions involving PPP borrowers in determining whether, under SBA’s loan program requirements for 7(a) loans, the PPP lender must obtain prior SBA approval as a condition to the PPP lender’s transaction approval.

SBA 7(a) Loan Program Requirements Generally

PPP loans are authorized and administered under SBA’s 7(a) business loan program. SBA’s standard form 7(a) note provides that an event of default occurs if the borrower “reorganizes, merges, consolidates, or otherwise changes ownership or business structure without Lender’s prior written consent.” However, many PPP lenders used their own form of note and other loan documentation to evidence the PPP loan because they were not required to use SBA’s standard form. Therefore, PPP borrowers should always review their PPP note and other related loan documents as a threshold matter to confirm what, if any, actions require PPP lender approval.

SBA’s loan program requirements for 7(a) loans include [SBA SOP 50 57 2](#) and “[Servicing and Liquidation Matrix](#),” which delineates the actions requiring prior SBA approval and those which do not.

The relevant portion of the SOP is Chapter 3 (Lender Responsibility and Authority), particularly Part C (pages 22-25) and Part E (pages 26-27). Part C sets forth Loan Actions — “an activity or decision regarding a specific SBA loan including a decision to engage or not to engage in a particular activity . . .” — over which the lenders have unilateral approval ability without prior SBA approval. However, PPP lenders must notify SBA as to any of these Loan Actions.

The Servicing and Liquidation Matrix separates Loan Actions occurring before the disbursement of the loan and those Loan Actions taking place after the disbursement of the loan. For Loan Actions generally applying to equity raising, reorganization, and sale of business transactions after the disbursement of the loan, the Servicing and Liquidation Matrix provides that:

- A “Change in the ownership of a Borrower in the first 12 months after final disbursement” requires prior SBA approval. Specifically, Footnote 17 states that a lender may not unilaterally approve any adjustment to or change in the ownership of a borrower, including a change in percentage of ownership, for 12 months after final disbursement on any loan.
- A “Change in Borrower’s legal structure” does not require prior SBA approval, but does require notice to SBA. Footnote 8 states that SBA must be notified of a change in a borrower’s legal structure if it results in a change to EIN or SSN of any obligor.

Many PPP lenders have been unsure how to apply the foregoing requirements to various equity raising, reorganization, and sale of business transactions involving PPP borrowers, particularly since the loan is intended (and expected) to be forgiven, assuming that the PPP borrower was eligible to receive the PPP loan, the PPP borrower applied the proceeds to permitted (and forgivable) uses and the PPP borrower otherwise complied with all other applicable PPP requirements. For example, PPP lenders were uncertain if any percentage change in ownership of a PPP borrower would trigger a prior SBA approval requirement or whether some minimum threshold percentage was necessary. Some PPP lenders were also unsure if certain reorganizations or transactions structured as a sale of assets were considered a “change in ownership” or a change in the PPP borrower’s legal structure for purposes of these program requirements. Uncertainty further surrounded whether and the extent to which a buyer could (or would be required to) assume the PPP loan. Consequently, this uncertainty together with the possibility to eliminate any risk of not receiving payment on account of SBA’s 100% guaranty of the PPP loan, caused many PPP lenders to take the position that they would require SBA approval before approving any transaction involving a change of ownership, reorganization, or sale of the PPP borrower’s business.

October 2 Procedural Guidance

SBA’s October 2 Procedural Guidance provides welcome clarification and guidance about what constitutes a “change of ownership” for most types of equity raising, reorganization, and sale of business transactions. Although some interpretative questions may arise on a transaction-by-transaction basis, this guidance provides useful information to PPP borrowers as they consider how to structure and implement these transactions.

What Constitutes a “Change of Ownership” and Procedures to Follow

For purposes of the PPP, a “change of ownership” will occur when:

- at least 20% 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;

Note: For purposes of determining a change of ownership of the common stock or other ownership interest of a PPP borrower, all sales and other transfers occurring since 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.

- the PPP borrower sells or otherwise transfers at least 50% of its assets (measured by fair market value) in one or more transactions; or
- a PPP borrower is merged with or into another entity.

The PPP borrower must, before the closing of any change of ownership transaction, 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.

There are different procedures to follow, depending on the circumstances of the change of ownership. These procedures are described below.

Circumstances When No Approval is Required

No restriction on any change of ownership applies (and therefore, no need to obtain PPP lender or SBA approval regarding a change of ownership arises) if, before the closing of the change of ownership, either:

- the PPP borrower repays the PPP loan in full; or
- the PPP borrower completed the loan forgiveness process according to PPP requirements and SBA remitted funds to the PPP lender in full satisfaction of the PPP note, or the PPP borrower repaid any remaining balance on the PPP loan.

Circumstances When Prior SBA Approval is Not Required

Prior SBA approval is not required for a PPP lender to approve a change of ownership under either of the following circumstances:

- the change of ownership (whether as a sale or other transfer of common stock or other ownership interest or as a merger) is of 50% or less of the common stock or other ownership interest of the PPP borrower. To determine if a sale or other transfer exceeds the 50% threshold, all sales and other transfers occurring since the date of approval of the PPP loan must be aggregated; or
- the PPP borrower submitted the loan forgiveness application and all required supporting documentation to the PPP lender before the closing of the transaction, and an interest-bearing escrow account controlled by the PPP lender holding an amount equal to the outstanding PPP loan balance is established to be used as payment for

the PPP loan to the extent it is not forgiven.

Note: If the buyer or the seller (or both) has an outstanding PPP loan, and the change of ownership transaction is financed in whole or in part with an SBA 7(a) loan, then the 7(a) loan financing the change of ownership cannot be used to finance the escrow account.

Circumstances When Prior SBA Approval is Required

If neither circumstance described under “Circumstances When Prior SBA Approval is Not Required” applies, SBA approval will be required for a PPP lender to approve the change in ownership, and the PPP lender cannot approve the change of ownership unilaterally. To obtain SBA’s prior approval for requests for changes of ownership, the PPP lender must submit the request to the appropriate SBA Loan Servicing Center. The request must include:

- why the PPP borrower cannot fully satisfy the PPP note or escrow funds;
- details of the requested transaction, including a copy of the executed PPP note, any letter of intent, and the purchase or sale agreement setting forth the responsibilities of the PPP borrower, seller (if different from the PPP borrower), and buyer;
- whether the buyer has an existing PPP loan and, if so, the SBA loan number; and
- a list of those who own 20% or more of the buyer.

SBA approval of any change of ownership involving the sale of 50% or more of the assets (measured by fair market value) of a PPP borrower will be conditioned on the purchasing entity assuming compliance of all PPP borrower’s obligations under the PPP loan, including following the PPP loan terms. In such cases, the purchase or sale agreement must include appropriate provisions about the assumption of the PPP borrower’s obligations under the PPP loan by the purchasing person or entity, or a separate assumption agreement must be submitted to SBA.

SBA will review and provide a determination within 60 calendar days of receipt of a complete request. SBA may require additional risk mitigation measures as a condition of its approval of the transaction if it deems appropriate.

Conditions Applicable to All Changes of Ownership Whether or Not Prior SBA Approval is Required

Within five (5) business days of the closing of the transaction, the PPP lender must notify the appropriate SBA Loan Servicing Center of the:

- identity of the new owner(s) of the common stock or other ownership interest;
- new owner(s)’ ownership percentage(s);
- tax identification number(s) for any owner(s) holding 20% or more of the equity in the business; and

- location of, and the amount of funds in, the escrow account under the PPP lender's control, if an escrow account is required.

Responsibility for PPP Loan After a Change of Ownership

The PPP borrower (and, in the event of a merger of the PPP borrower into another entity, the successor to the PPP borrower) remains responsible for:

- performance of all obligations under the PPP loan;
- the certifications made for the PPP loan application, including the certification of economic necessity; and
- compliance with all other applicable PPP requirements, including obtaining, preparing, and retaining all required PPP forms and supporting documentation and providing those forms and supporting documentation to the PPP lender or to SBA upon request.

If the new owner(s) use PPP funds for unauthorized purposes, SBA will have recourse against the owner(s) for the unauthorized use.

If any of the new owners or the successor arising from such a transaction has a separate PPP loan, then following consummation of the transaction: (1) for a purchase or other transfer of common stock or other ownership interest, the PPP borrower and the new owner(s) must segregate and delineate PPP funds and expenses and provide documentation to demonstrate compliance with PPP requirements by each PPP borrower; and (2) for a merger, the successor must segregate and delineate PPP funds and expenses and provide documentation to demonstrate compliance with PPP requirements for both PPP loans.

SBA reserves all rights and remedies available under the law in the event of fraud, false statements, and/or unauthorized uses of PPP loan proceeds.

Additional PPP Lender Requirements

PPP lenders must continue submitting the monthly 1502 reports until the PPP loan is fully satisfied irrespective of any change in ownership.

If a PPP loan of a PPP borrower associated with a change of ownership transaction is pledged by the PPP lender to secure a loan under the Federal Reserve's Paycheck Protection Program Liquidity Facility (PPPLF), the PPP lender must comply with any notification or other requirements of the PPPLF.

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