



OCTOBER 26, 2020 • NO. 15

SBA Issues Guidance on Change of Ownership Transactions in Which SBA Consent Is Not Required

The U.S. Small Business Administration (the “SBA”) recently provided important and long anticipated guidance on requirements and exceptions for SBA consent in certain “change of ownership” transactions involving companies with loans issued under the Paycheck Protection Program (the “PPP”).¹ The new guidance was effective October 2, 2020, by the publication of a new Procedural Notice (the “Notice”).² The Notice provides a framework that will allow many PPP borrowers to proceed with change of ownership transactions without the delay and expense of attempting to obtain SBA consent so long as they comply with the requirements set forth in the Notice.

Although the Notice provides substantial comfort to transaction parties, it still leaves open several important additional issues, including how to comply with the requirements for change of ownership transactions that closed prior to October 2, 2020, whether the escrow account controlled by the PPP lender must be held by that PPP lender, whether the amount funded in the escrow must also include accrued interest and fees, and other issues that are beginning to emerge across numerous pending or completed transactions. A detailed analysis of the Notice yields potential solutions to some of the currently known concerns.

CHANGE OF OWNERSHIP

The Notice provides that a **change of ownership** will be considered to have occurred when:

- (1) at least 20 percent 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,³ including to an affiliate or an existing owner of the PPP borrower, or
- (2) the PPP borrower sells or otherwise transfers at least 50 percent of its assets (measured by fair market value), whether in one or more transactions, or
- (3) a PPP borrower is merged with or into another entity.

Regardless of whether a change of ownership has occurred, the original PPP borrower remains responsible for (1) performance of all obligations under the PPP loan documents, (2) the certifications made in connection with the PPP loan application, including the certification of economic necessity, and (3) compliance with all other applicable PPP requirements.

Additionally, the PPP borrower remains responsible for obtaining, preparing, and retaining all required PPP forms and supporting documentation and providing those forms and supporting documentation to the lender or person servicing the

PPP loan (as applicable, the “PPP Lender”) or to the SBA upon request.⁴ Although it should be readily apparent, the Notice makes clear that, notwithstanding any change of ownership, the SBA reserves all rights and remedies available against the PPP borrower under applicable law in the event of fraud, false statements, and/or unauthorized uses of PPP loan proceeds.

Further, the Notice provides that prior to the closing of any change of ownership transaction, the PPP borrower must 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. These provisions make clear that a PPP borrower should be in communication and providing information and documentation to its PPP Lender during the course of any proposed change of ownership transaction.

The Notice has different requirements for PPP borrowers depending upon the contemplated type of change of ownership transaction. In all cases, the PPP Lender is required to continue submitting the monthly 1502 reports to the SBA until the PPP loan is fully satisfied.

The following scenarios are provided in the Notice as examples of what the SBA considers to be facts surrounding changes of ownership, and how the Notice impacts them:

POST REPAYMENT OR FORGIVENESS

There are no requirements or consent required if, prior to closing a sale or transfer, the PPP borrower has:

- (1) repaid the PPP note in full; or
- (2) completed the loan forgiveness process in accordance with the PPP requirements and:
 - SBA has remitted funds to the PPP Lender in full satisfaction of the PPP note; or
 - the PPP borrower has repaid any remaining balance on the PPP loan.

CONDITIONS FOR SALE OF OWNERSHIP OR MERGER

If the following conditions are met for (1) a sale or other transfer of common stock or other ownership interest or as a merger or (2) an asset sale, the PPP Lender may approve the change of ownership **without** the SBA’s prior approval:

If the change of ownership is structured as a sale or other transfer of common stock or other ownership interest or as a merger and if:

- (1) the sale or other transfer is of **50 percent or less** of the common stock or other ownership interest of the PPP borrower;⁵ or

- (2) the PPP borrower completes the submission of all necessary parts of the forgiveness application reflecting its use of all of the PPP loan proceeds **and** the PPP borrower establishes an interest-bearing escrow account *controlled* by the PPP Lender in the amount of the outstanding balance of the PPP loan. After the forgiveness process (including any appeal of the SBA’s final decision) is completed, the escrow funds must be disbursed first to repay any remaining PPP loan balance plus interest and fees.

In all events, change of ownership transactions must be completed in accordance with the guidance below under “Requirements Applicable to All Change of Ownership Transactions” and “PPP Lender Notice Requirements,” including notifying the 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.

CONDITIONS FOR SALE OF ASSETS

The Notice provides that a PPP borrower may sell 50 percent or more of its assets (measured by fair market value) **without** the prior approval of the SBA only if:

- (1) the PPP borrower completes a submission of all necessary parts of the forgiveness application reflecting its use of all of the PPP loan proceeds **and**
- (2) the PPP borrower establishes 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 (including any appeal of the SBA’s decision) is completed, the escrow funds must be disbursed first to repay any remaining PPP loan balance plus interest and fees.

In all events, change of ownership transactions must be completed in accordance with the guidance below under “Requirements Applicable to All Change of Ownership Transactions” and “PPP Lender Notice Requirements,” including notifying the 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.

REQUIRED SBA CONSENT

If a change of ownership of a PPP borrower does not satisfy the conditions above, prior SBA approval of the change of ownership is required and the PPP Lender may not unilaterally approve the change of ownership.

To obtain the 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:

- (1) the reason that the PPP borrower cannot either fully satisfy the PPP note by repayment or forgiveness (completed before the transaction) or establish an escrow fund, in each case as set discussed above;
- (2) the details of the requested transaction;
- (3) copy of the executed PPP note;
- (4) 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;
- (5) disclosure of whether the buyer has an existing PPP loan and, if so, the SBA loan number; and
- (6) a list of all owners of 20 percent or more of the purchasing entity.

If deemed appropriate, the SBA may require additional risk mitigation measures as a condition of its approval of the transaction.

SBA approval of any change of ownership involving the sale of 50 percent or more of the assets (measured by fair market value) of a PPP borrower will be conditioned on the purchasing entity assuming all of the PPP borrower's obligations under the PPP loan, including responsibility for compliance with the PPP loan terms. In such cases, the purchase or sale agreement must include appropriate language regarding 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 the SBA.

The SBA will review and provide a determination within 60 calendar days of receipt of a complete request.

REQUIREMENTS APPLICABLE TO ALL CHANGE OF OWNERSHIP TRANSACTIONS

For all sales or other transfers of a PPP borrower's common stock or other ownership interest or merger involving a PPP borrower, whether or not the sale requires the SBA's prior approval, the Notice imposes the following requirement. In the event of a sale or other transfer of common stock or other ownership interest in the PPP borrower, or a merger of the PPP borrower with or into another entity, the PPP borrower (and, in the event of a merger of the PPP borrower into another entity, the successor to the PPP borrower) remains subject to all obligations under the PPP loan. In addition, if the new owner(s) use PPP funds for unauthorized purposes, the SBA will have recourse against the new 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) in the case of a purchase or other transfer of common stock or other ownership interest, the PPP borrower and the new owner(s) are responsible for segregating and delineating PPP funds and expenses and providing documentation to demonstrate compliance with PPP requirements by each PPP borrower, and (2) in the case of a merger, the successor is responsible for segregating and delineating PPP funds and expenses and providing documentation to demonstrate compliance with PPP requirements with respect to both PPP loans.

PPP LENDER NOTICE REQUIREMENTS

The PPP Lender must notify the appropriate SBA Loan Servicing Center, within five business days of completion of the transaction, of the:

- (1) identity of the new owner(s) of the common stock or other ownership interest;
- (2) new owner(s)' ownership percentage(s);
- (3) tax identification number(s) for any owner(s) holding 20 percent or more of the equity in the business; and
- (4) location of, and the amount of funds in, the escrow account under the control of the PPP Lender, if an escrow account is required.

Finally, the Notice reminds the PPP Lender to comply with any notification or other requirements of the Paycheck Protection Program Liquidity Facility ("PPPLF") if the PPP loan of a PPP borrower associated with a change of ownership transaction was pledged by the PPP Lender to secure a loan under the Federal Reserve's PPPLF.

PRACTICAL CONSIDERATIONS REGARDING REMAINING ISSUES

For change of ownership transactions that closed prior to October 2, 2020, transaction parties should expeditiously revise the terms of their agreements to comply with the Notice to the greatest extent practicable. This will largely mean establishing an escrow account with the PPP Lender, ensuring that the PPP Lender has consented to the transaction and the PPP Lender has provided necessary notices to the SBA. The SBA has informally indicated that it will not provide comfort for transactions completed prior to October 2, 2020, that are not in compliance with the Notice. Accordingly, parties will best protect their positions by coming into compliance to the greatest extent possible, even if that means restructuring certain aspects of the transaction.

For most transactions, it will be most efficient to maintain any necessary escrow account with the PPP Lender. Since the Notice requires only that the account be *controlled* by the PPP Lender, it is possible that parties may want or need to establish an escrow arrangement with another financial institution, but should be careful to document the arrangement in such a way to maintain a valid argument that the PPP Lender is in control of the account until the PPP loan balance is fully repaid.

The Notice contemplates that any unforgiven balance on the PPP loan will be paid from the balance in the escrow account. Any outstanding amount will include accrued interest and may include other fees. While the Notice is not explicit on what amount needs to be deposited into the interest-bearing escrow, parties should consider whether a deposit of only the principal amount of the loan will be sufficient to cover the entire unforgiven balance. In many cases, where at least partial forgiveness is attained, the issue will be moot, but parties should consider whether any shortfall is possible and, if so, which party is liable to fund that shortfall.

Because the terms of the escrow agreement are bespoke and likely involve the PPP Lender as both escrow agent and potential beneficiary, the terms of the escrow agreement deserve careful attention—both for purposes of compliance with various SBA guidance, but also to ensure that parties are not subjected to terms that expand potential liability or provide greater protection to the PPP Lender than is anticipated by the Notice and other SBA guidance.

The SBA may provide further guidance addressing these remaining issues, and Blank Rome's [Paycheck Protection Program](#) team will continue to monitor and engage in these and other emerging concerns as they develop.

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1. The Paycheck Protection Program is embodied in Sections 1101-1114 of Title 1, the Keeping American Workers Paid and Employed Act, of the Coronavirus Aid, Relief, and Economic Security Act (Pub. L. 116-136) enacted March 27, 2020 (the "CARES Act"), as amended, including as amended by the Paycheck Protection Flexibility Act of 2020 (Pub. L. 116-142), enacted June 5, 2020.
 2. SBA Procedural Guidance No. 5000-20057, Paycheck Protection Program Loans and Changes of Ownership, effective October 2, 2020.
 3. For purposes of determining a change of ownership, 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 percent of the common stock or other ownership interest of the borrower must be aggregated.
 4. 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 a 7(a) loan, all SBA Loan Program Requirements, as defined in 13 CFR 120.10, must be met. In addition, if an escrow account is required under the procedures set forth in the Notice, the 7(a) loan that finances the change of ownership cannot be used to finance the escrow account.
 5. In determining whether a sale or other transfer exceeds this 50 percent threshold, all sales and other transfers occurring since the date of approval of the PPP loan must be aggregated.