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M&A/Private Equity BRIEFING

October 9, 2020

New Guidance on PPP Loans Provides a Route to Avoid SBA Approval of a Borrower's Change-in-Ownership

The Small Business Administration (SBA) issued guidance on October 2, 2020 relating to "changes in ownership" of companies that have obtained Paycheck Protection Program (PPP) loans under the federal CARES Act. Most critically, the guidance provides that prior approval by the SBA will *not* be required for such a transaction if the borrower has completed its forgiveness application and, pending the SBA's determination of forgiveness, an amount equal to the outstanding balance on the PPP loan is deposited into an escrow account under the control of the PPP lender or the lender servicing the loan (the "PPP Lender").

Key Observations. We expect that:

- ***Most PPP borrowers will want to avoid the process of seeking SBA approval of a change of ownership transaction***. Although the new guidance states that the SBA will provide a determination within 60 calendar days after receiving a request for approval of a change of ownership transaction involving a PPP borrower, we would note that, given the general backlog at the SBA, the timeframe could be longer. For this and other reasons, we expect that, in most cases, a PPP borrower, at or prior to closing of a change of ownership transaction, will either (a) if the forgiveness process for the loan has been completed, repay any amount not forgiven, or (b) complete and submit the forgiveness application for the loan to its PPP Lender and establish the required escrow account. Of note, in our experience, to date many PPP Lenders are not yet equipped to accept forgiveness applications--thus, currently, it may often be the case that a PPP borrower will not be able to avoid the SBA approval requirement for a change of ownership transaction.

- ***A buyer of a PPP borrower likely will seek indemnification from the PPP borrower for liability relating to its obtaining the PPP loan and any non-compliance with the PPP requirements.*** The guidance states that, irrespective of a change of ownership transaction, the PPP borrower will remain responsible for all requirements relating to the PPP loan, including with respect to liability for its certifications made at the time of obtaining the loan relating to the economic necessity therefor. We note that the SBA has a 6-year timeframe for bringing claims with respect to noncompliance with PPP requirements.

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Background. Under the PPP program, which was launched in April 2020 and permitted applications for loans through early August 2020, approximately 5.2 million loans, totaling about $525 billion, were issued. The average loan size was just over $100,000. There remains about $130 billion in funding that was appropriated for PPP loans and is unused--although it is uncertain whether Congress will authorize a second round of PPP loan issuances. A Goldman Sachs survey released in early October reflects that 88% of PPP borrowers had fully used the proceeds of their PPP loans and 30% expected to deplete their cash reserves by the end of 2020. PPP loans are forgivable if the proceeds were used for certain purposes (primarily payroll expenses). Many PPP borrowers are currently engaged in the process of applying for forgiveness of the loans; however, some PPP Lenders have not yet begun to accept forgiveness applications.

The new guidance provides as follows:

Definition of a "change of ownership." A change of ownership of a borrower is defined as (i) a sale or transfer of at least 20% of the PPP borrower's common stock or other ownership interest (whether in one or more transactions and including transfers to affiliates or existing owners); (ii) a sale or transfer of at least 50% of the PPP borrower's assets (measured by fair market value, and whether in one or more transactions); or (iii) a merger of the PPP borrower with or into another entity. To determine if the relevant threshold has been met, all sales and other transfers occurring since the date of approval of the PPP loan must be aggregated. For publicly traded borrowers, only sales or transfers that result in one person or entity holding or owning at least 20% of the common stock (or other ownership interest) of the PPP borrower must be aggregated.

Notice of any change of ownership transaction is required. Prior to the closing of a change in 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." (The PPP Lender will have to continue to submit the required monthly reports ("1502 reports") until the PPP loan is fully satisfied.)

Under certain circumstances, prior approval by the SBA will <u>not</u> be required for a change of ownership transaction involving a borrower with an outstanding PPP loan. The guidance newly provides that, if there is an outstanding balance under a PPP loan, prior approval by the SBA of a change of ownership transaction involving the borrower will *not* be required (and the PPP Lender unilaterally can provide such approval) *if*, prior to the closing of the transaction, (i) the PPP borrower submits to the PPP Lender a completed application for forgiveness of the PPP loan, together with all required supporting documentation, and (ii) an amount equal to the outstanding balance of the PPP loan is deposited into an escrow account for the purpose of fully satisfying the loan. The escrow account must be interest-bearing and controlled by the PPP Lender; and, after the forgiveness process is completed (including any appeal of the SBA's decision), the escrow funds must be disbursed to repay any remaining PPP loan balance plus interest before being disbursed to the PPP borrower. We expect that in most cases the PPP borrower will, at the closing of the change of ownership transaction, have the buyer divert part of its payment of the purchase price in order to fund the escrow account. The guidance states that only a change of ownership transaction involving the sale or transfer of more than 50% of the PPP borrower's common stock (or other ownership interest), or the sale

or transfer of 50% or more of the PPP borrower's assets (by fair market value), is subject to prior approval by the SBA.

The SBA will make a determination within 60 calendar days of receiving a request from the PPP Lender for approval of the borrower's change of ownership transaction. To obtain approval for a PPP borrower's change of ownership transaction, the PPP Lender must submit the request to the appropriate SBA Loan Servicing Center. The request must include (i) the reason the PPP borrower cannot fully satisfy the PPP loan or have the escrow account established (either of which would eliminate the need for the SBA's prior approval); (ii) the "details" of the proposed change of ownership transaction; (iii) a copy of the executed PPP Note; (iv) any letter of intent and the purchase or sale agreement setting forth the responsibilities of the PPP borrower, the seller (if different from the PPP borrower), and the buyer; (v) disclosure as to whether the buyer has an existing PPP loan (and, if so, the loan number); and (vi) a list of all owners of 20% or more of the buyer. Further, the guidance states that, if the SBA deems it appropriate, it may require "additional risk mitigation measures" as a condition of its approval. Also, the guidance states that approval of an asset sale will be conditioned on the purchasing entity assuming all of the PPP borrower's obligations under the PPP loan.

The following requirements apply to all sales or transfers of common stock (or other ownership interest) or mergers, whether or not prior SBA approval is required:

- ***Segregation of any PPP loan of the buyer.*** If any new owner(s) or the successor in a merger has a separate PPP loan, then, after closing of the change of ownership transaction, the PPP loans must be "segregated" and documentation submitted demonstrating compliance with PPP requirements with respect to each PPP loan.
- ***Continuing responsibility of the PPP borrower.*** Notwithstanding a change of ownership transaction involving a PPP borrower, the PPP borrower (and, in the event of a merger of the PPP borrower into another entity, the successor to the PPP borrower) "will remain subject to all obligations under the PPP loan." In addition, "[i]f the new owner(s) use PPP funds for unauthorized purposes, SBA will have recourse against the new owner(s) for the unauthorized use."
- ***Post-closing notice to Servicing Center.*** Within five days of "completion" of a change of ownership transaction, the PPP Lender must notify the appropriate SBA Servicing Center of (i) "the identity of the new owner(s) of the common stock or other ownership interest" and the new owner(s)' ownership percentage(s), (ii) the tax identification numbers for any owner(s) holding 20% or more of "the equity in the business," and (iii) the location of and amount of funds in an escrow account if one is required.

Prior approval of a borrower's change of ownership transaction will not be required if the PPP loan has been fully satisfied. Prior approval (by the SBA or the PPP Lender) will not be required if the PPP loan has been fully repaid or if the forgiveness process has been completed and any unforgiven amount has been fully paid.

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