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## SALE OF BUSINESS, EQUITY TRANSFER OR MERGER AND THE PAYCHECK PROTECTION PROGRAM

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On October 2, 2020, the U.S. Small Business Administration (“**SBA**”) published an SBA Procedural Notice (the “**SBA Notice**”) that establishes certain requirements if a borrower with an outstanding loan under the Paycheck Protection Program (“**PPP**”) undergoes a “change of ownership” transaction. The SBA Notice defines a “change of ownership” broadly; it includes many sales, transfers or issuances of equity and sales or transfers of assets, as well as mergers and most sale of business transactions. **Generally, a PPP borrower is now required to notify its PPP lender prior to the closing of any “change of ownership” transaction and submit a copy of the transaction documents to its lender.**

In some circumstances involving a sale of a PPP borrower’s business or a transfer of control of a PPP borrower, a PPP borrower may also need to receive prior approval from its PPP lender and deposit an amount equal to the balance of its PPP loan into an escrow account controlled by the PPP lender (an “**Escrow Deposit**”). The time frame for obtaining lender approval is not specified in the SBA Notice.

The key terms of the SBA Notice and our takeaways are summarized below. If you have or are planning to enter into a “change of ownership” transaction (see #1 below), we strongly encourage you to read this Client Alert and the SBA Notice and consult with our office or your legal counsel. A copy of the SBA Notice can be found here:

<https://www.sba.gov/sites/default/files/2020-10/5000-20057-508.pdf>.

1. **How “change of ownership” is defined.** The SBA Notice applies to any PPP borrower that enters into a “change of ownership” transaction. A “change of ownership” is broadly defined as any of the following:
  - a. The sale or transfer of 20% or more of the common stock or other ownership interest of a PPP borrower (including a publicly traded entity if the sale was to one person or entity), whether in one or more transactions since the approval of the PPP loan.
  - b. The sale or transfer of 50% or more of the assets of a PPP borrower (measured by their fair market value), whether in one or more transactions.
  - c. The merger of a PPP borrower with or into another entity.

Note that a change of ownership may arise in a variety of contexts, some of which may be unexpected, including a venture capital or private equity financing, a business combination or restructuring, an equity transfer to an affiliate or to an existing owner of the PPP borrower or transfers in connection with estate or financial planning by equity owners of a PPP borrower. In addition, all transfers from the date a PPP borrower’s loan was approved appear to be aggregated for purpose of the 20% threshold. This appears to mean aggregation of transfers made by the PPP

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borrower itself and by its equity holders, even if individual transactions are unrelated to one another, were undertaken for different purposes and involve different classes of equity interests. In addition, the SBA Notice appears to apply retroactively to transactions that occurred prior to the date the SBA Notice was published. PPP borrowers should track issuances and transfers of their equity interests and monitor compliance with the threshold.

2. **PPP lender approval requirement.** A change of ownership requires the prior approval of the PPP lender unless, at the time of such transaction, the PPP borrower has either (a) repaid the PPP loan in full, or (b) completed the loan forgiveness process and repaid any part of the PPP loan that remains unforgiven. A PPP borrower that plans to enter into a change of ownership transaction should submit a loan forgiveness application to its lender as soon as possible, as the loan forgiveness process could take up to 150 days to complete. For more information about loan forgiveness applications, see our Client Alert:

<https://bswlaw.com/wp-content/uploads/2020/06/Client-Alert-New-PPP-Loan-Forgiveness-App.pdf>

3. **Escrow Deposit.** If a PPP borrower undergoes a change of ownership that involves the sale or transfer of more than 50% of either (a “**Business Sale**”) (a) the common stock or other ownership interests of the PPP borrower, or (b) the fair market value of the assets of the PPP borrower, the PPP borrower is required to make an Escrow Deposit and submit a loan forgiveness application and supporting documentation to its PPP lender, unless the PPP loan has been confirmed to be discharged through repayment and/or loan forgiveness. The escrow continues until the loan forgiveness process is complete (including any appeal) and the escrowed funds are first used to pay off the remaining balance of the PPP loan. We expect that this escrow requirement will have a significant impact on M&A and other transactions that are in process as well as transactions going forward.
4. **SBA approval requirement.** If the Escrow Deposit is not made in connection with a Business Sale (e.g. there may not be available cash from the transaction to fund the escrow), the prior approval from the SBA for that transaction is required. The SBA has up to 60 days to decide to issue an approval, and the SBA can condition its approval including on the buying entity assuming the PPP borrower’s obligations under the PPP loan.
5. **Practical impacts of non-compliance.** The SBA Notice does not identify the consequences of a failure to comply with the notice, approval or escrow requirements associated with a change of ownership transaction. For example, it does not indicate if loan forgiveness would be affected by non-compliance. Even if there was non-compliance with the SBA Notice (or similar provisions under the PPP loan documents), the SBA lender and the SBA may not incur any financial loss or damage if the PPP loan is otherwise forgiven or paid off. However, non-compliance may result in acceleration of the PPP borrower’s obligation to repay its PPP loan. A PPP borrower should review their credit and other material agreements to determine if any of those agreements might be cross-defaulted or cross-accelerated with any default or acceleration of the PPP loan.

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As with many circumstances involving PPP loans and the rules and guidance that have been issued previously, there are questions and concerns, many with no clear answer. We hope that the SBA issues further guidance to answer some of these questions and concerns.