

SBA Consent Requirements for M&A Transactions with PPP Loans

A Practical Guidance® Article by
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This article discusses the implications of guidance issued by the Small Business Administration (SBA) regarding SBA consent requirements for M&A transactions that involve SBA guaranteed loans under the Paycheck Protection Program. This article illuminates the following key points: (1) pending and potential M&A transactions need to address the existence of a target company's currently outstanding PPP Loan (as defined below); (2) the SBA has issued guidance on the types of transactions for which PPP Lenders (as defined below) must obtain the SBA's consent prior to consummating the proposed transaction; (3) asset deals and equity transactions with less than 50% of the business being conveyed likely do not require SBA consent; (4) mergers and transactions conveying more than 50% of a company's assets or equity will require the consent of the SBA, unless the PPP Borrower (as defined below) has (a) used all of the PPP Loan proceeds, (b) submitted a complete loan forgiveness application, and (c) established an escrow account with the PPP Lender to hold the PPP Loan proceeds until such time

as the forgiveness application is granted/denied; and (5) regardless of whether SBA consent is required or obtained, PPP Borrowers should review their loan documents with the PPP Lender and comply with notice and other provisions.

Background

On March 27, President Trump signed the Coronavirus Aid, Relief and Economic Security Act (CARES Act) which established, among other things, the Paycheck Protection Program (PPP). Under the PPP, the SBA guaranteed loans (PPP Loans) made by SBA Lenders (PPP Lenders) to small and medium-sized businesses (typically, those with 500 or fewer employees). Businesses that obtained PPP Loans (PPP Borrowers) were required to make numerous certifications regarding eligibility to participate in the program, including one related to the applicant's employee count calculation and one that stated that the loan was "necessary to support [the applicant's] ongoing operations" because of "economic uncertainty." Approximately 5.2 million PPP Loans totaling \$525 billion were issued to PPP Borrowers across the country.

For more information on the Paycheck Protection Program, see [First Analysis: CARES Act Paycheck Protection Program Summary](#).

Loan Forgiveness

The most attractive feature of PPP Loans was the potential for full loan forgiveness: up to 100% of the amount borrowed can be forgiven if the PPP Borrower uses the loan proceeds for eligible purposes in eligible amounts (i.e., at least 60% of the proceeds are used for "payroll costs," as defined in the

CARES Act) within 24 weeks of the loan's origination. The PPP Lender, after receipt of a complete PPP loan forgiveness application, has 60 days to provide its forgiveness decision to the SBA, whereafter the SBA has 90 days to review the loan forgiveness materials and make the final forgiveness determination. The SBA has separately announced that PPP Loans above \$2 million will receive heightened scrutiny in connection with loan forgiveness determinations.

While the SBA opened its portal for PPP Lenders to submit PPP forgiveness applications on August 10, a number of PPP Lenders are not yet accepting PPP loan forgiveness applications. Even where PPP Lenders are accepting such applications and are posting their forgiveness determinations to the SBA portal, the SBA has been slow to issue final forgiveness determinations. Specifically, as of October 1, even though the SBA had more than 96,000 pending loan forgiveness applications, none had been approved.

In the context of M&A transactions, outstanding PPP Loans have created a number of issues. For PPP Borrowers that have used all of their PPP funds and believe they are eligible for full forgiveness, the delay in obtaining a forgiveness determination from their PPP Lender and/or the SBA has created significant consequences. In addition, in transactions where the 24 week period to use the PPP proceeds has not lapsed so the necessary forgiveness calculations cannot be made, there are even more significant issues for both sellers and buyers given that the forgiveness calculations cannot yet be computed.

PPP Loan Interplay with M&A Transactions

For those PPP Borrowers who are in the middle of (or starting) an M&A process, PPP Loans are significantly impacting the negotiations, mechanics and, ultimately, closing of their transactions. Most PPP Borrowers expect their loans to be fully forgiven, so they do not view this liability as "debt" and, accordingly, do not agree that it should result in a reduction to the purchase price. Buyers of companies with PPP Loans, though, have no certainty of the ability of the seller to achieve full forgiveness and are therefore unwilling to accept the risk of having to repay a PPP Loan, especially when the proceeds of those loans were used by the PPP Borrower prior to the closing.

Before October 2, most M&A practitioners have been advising their clients that (1) the PPP Lender likely has a consent right to a change of control of the PPP Borrower

(through the underlying PPP Loan documentation), (2) the PPP Lender likely would require as a condition to its consent the consent of the SBA (as is required for all SBA 7(a) loans, of which the PPP is one type; if SBA consent is not obtained in connection with the change in control transaction, the PPP Lender risks losing the SBA's guarantee of that PPP Loan per the SBA's Standard Operating Procedures applicable to all 7(a) loans), and (3) buyers should require 100% plus accrued interest (or more) of the amount of the PPP Loan to be placed into a separate escrow account to protect the buyer in the event the PPP Loan ultimately is not forgiven (the escrow amount requirement was also typically imposed by the PPP Lender in connection with obtaining its consent to the change in control; proceeds typically cannot be released until forgiveness amounts, plus any amounts not forgiven, are paid, and the PPP Loan is fully satisfied). Asset Sale transactions (e.g., where the buyer does not acquire the equity of the PPP Borrower) were sometimes easier to negotiate as the PPP loan agreements often did not specifically require PPP Lender consent; in a number of cases, however, PPP Loan provisions that required consent for a "change in business or business plan" included such transactions.

New Guidance

On Friday, October 2, the SBA issued a procedural notice (SBA PPP Consent Notice) that formally implements the process for determining when SBA consent is required for certain M&A transactions being undertaken by PPP Borrowers. (Note that this agency issuance does not negate existing notice and consent provisions in the underlying PPP Loan agreements between PPP Lenders and PPP Borrowers.)

Importantly, it should be noted that the SBA PPP Consent Notice addresses both asset and equity transactions notwithstanding the fact that the subject heading is limited to "changes of ownership." According to the SBA PPP Consent Notice, a "change of ownership" is 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, including to an affiliate or an existing owner of the entity, (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 a **PPP borrower is merged with or into another entity**" (emphasis added) (collectively a "significant sale"). For purposes of determining whether the 20% common stock transfer threshold has been met, all sales and other transfers since the PPP Loan was approved must be aggregated.

Notice to PPP Lender

Prior to closing any significant sale, the PPP Borrower must notify the PPP Lender in writing and provide the PPP Lender with copies of the proposed transaction documents. Note that an equity transfer more 20% of the ownership is a “significant sale” requiring notice to the PPP Lender but does not trigger the 50% threshold described below for SBA consent requirement.

No SBA Restrictions

If, prior to closing a significant sale, the PPP Borrower has repaid the PPP Loan or has had the PPP Loan forgiven (e.g., the SBA has remitted the funds to the PPP Lender and/or the PPP Borrower has repaid any remaining balance after the SBA’s final forgiveness determination) (such PPP Loan, a “satisfied loan”), there is no requirement to seek the consent of the SBA.

No SBA Consent Required

Equity Transaction or Merger

The PPP Lender may approve of a significant sale, and the SBA consent is not required, if the significant sale is an equity transfer or merger and either (1) the equity transferred is 50% or less of the ownership interests of the PPP Borrower (note all equity transferred since PPP Loan application must be aggregated for purposes of determining whether the threshold has been exceeded) or (2) the PPP Borrower has (a) used all of its PPP Loan funds, (b) submitted to the PPP Lender a complete loan forgiveness application, and (c) established an interest-bearing escrow account controlled by the PPP Lender with an amount of funds equal to the amount of the PPP Loan outstanding. This escrow account must provide that any funds therein go to repay any remaining PPP Loan balance, plus interest, if any amounts under the PPP Loan are not forgiven. If the significant sale includes acquisition finance from a 7(a), those loan proceeds cannot be used to fund the above-mentioned escrow account. Even if SBA consent is not required, the Continuing Obligations (described below) remain in effect.

Asset Transaction

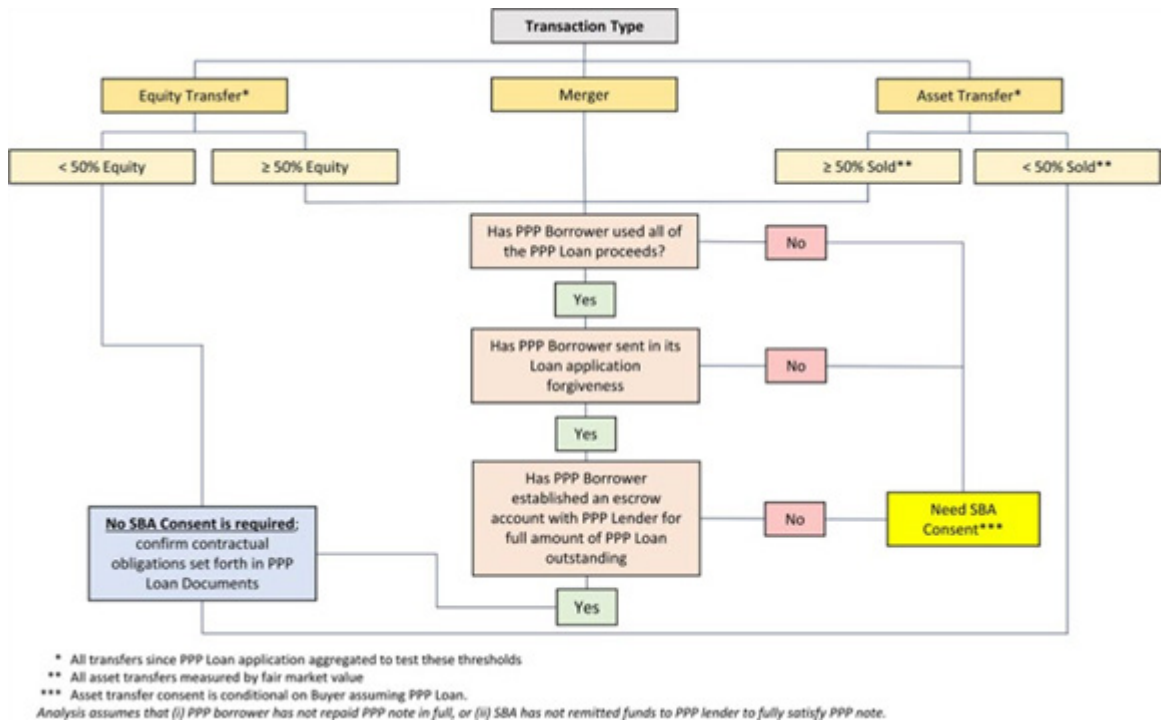
The PPP Lender may approve of a significant sale, and the SBA consent is not required, if the significant sale is structured as a sale of 50% or more of its assets (measured by fair market value) the PPP Borrower has (1) used all of its PPP Loan funds, (2) submitted to the PPP Lender a complete loan forgiveness application, and (3) established an interest-bearing escrow account controlled by the PPP Lender with an amount of funds equal to the amount of the PPP Loan outstanding. This escrow account must provide that any funds therein go to repay any remaining PPP Loan balance, plus interest, if any amounts under the PPP Loan are not forgiven. If the significant sale includes acquisition finance from a 7(a), those loan proceeds cannot be used to fund the above-mentioned escrow account. Even if SBA consent is received, the Continuing Obligations (described below) remain in effect.

SBA Consent Required

Any other significant sale that does not satisfy the conditions above requires the prior approval of the SBA. To obtain the SBA’s prior approval of requests for a significant sale, the PPP Lender must submit a request with the following information to the appropriate SBA Loan Servicing Center: (1) why the PPP Borrower cannot (a) take the actions necessary for the PPP Loan to be a satisfied loan or (b) escrow funds as required above, (2) a description of the proposed significant sale, (3) a copy of the promissory note for the PPP Loan, (4) a copy of the Letter of Intent or other transaction document describing the relevant parties’ identities and responsibilities, (5) whether the proposed buyer has an existing PPP Loan (and related SBA loan number) and (6) a list of the owners of 20% or more of the proposed buyer.

The SBA may require “additional risk mitigation measures” as a condition of its approval of the significant sale (but did not expand upon the conditions that may be required). The SBA’s approval of any significant sale involving the sale of 50% or more of the assets (measured by fair market value) of a PPP borrower will be conditioned on the proposed buyer assuming all of the PPP Borrower’s obligations under the PPP Loan. Evidence of such assumption should be established in the acquisition agreement or a separate assumption agreement which must be submitted to the SBA.

After receipt of the relevant documents, the SBA will review and provide a determination within 60 calendar days of receipt of a complete request.



Continuing Obligations

In the event of a significant sale or any other transfer of ownership interest in the PPP Borrower (even if such transfer does not rise to the level of a significant sale), the PPP borrower (and, in the event of a merger, the successor to the PPP Borrower) remains subject to all obligations under the PPP loan and if the new owner(s) improperly use the PPP proceeds, the SBA can seek recourse against the new owners.

The PPP Borrower (or successor) remains obligated, notwithstanding any change of ownership, for its obligations under the PPP Loan (documentary or otherwise). Further, the PPP Borrower (or successor) is responsible for the statements it made in its loan application and must continue to comply with its obligations under the PPP and the PPP Loan.

The PPP Lender will likely require the following information of the PPP Borrower for any transaction (even if it does not rise to the level of a significant sale so as to comply with its requirements with the SBA): (1) identity of the new owner(s) and their ownership percentage, (2) tax identification number(s) for any owner(s) holding 20% or more of the equity in the business, and (3) the amount (if any) and location of funds in an escrow account established pursuant hereto.

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As a Dallas-based partner in our Private Equity and Mergers and Acquisitions practices, Wade Glover regularly represents private equity firms, their portfolio companies and other privately held businesses in negotiating, structuring and executing complex and strategic transactions, including leveraged buyouts, acquisitions, divestitures, mergers, growth equity investments, restructurings, “tear-outs” and distressed transactions, including bankruptcy “363 Sales.” He has extensive experience in, and routinely provides corporate counsel to, boards and their management teams regarding growth initiatives and exits. His clients are acquisitive in diverse industries, including consumer products and retail, education, energy, manufacturing, and media.

For each matter, Wade seeks to understand the client’s immediate goals to determine what a “successful” transaction looks like. But beyond that, Wade uses his experience in representing private equity funds in the lifecycle of their holdings to think through not only how to address the issues currently in play, but also anticipate issues that may come up in the future (subsequent bolt-on acquisitions, dividend recaps, management incentives and, of course, the exit). He understands that no two deals are the same and that each purchase agreement requires a bespoke approach. Wade has significant experience in sophisticated “middle-market” transactions in North Texas, as well as throughout the rest of the United States.

Christina J. Grigorian, Partner, Katten Muchin Rosenman LLP

When leading lenders or their capital sources need regulatory advice about the lenders’ compliance or operations, they turn to Christina Grigorian. Clients rely on Christina’s thorough understanding of the complex regulatory environment in which lenders do business, as well as her practical approach to compliance and understanding of the broader credit market. Her clients include banks, bank holding companies, and state-licensed consumer and commercial lenders, as well as providers of capital to lending businesses.

Christina’s first priority when advising clients is to ensure that the products they offer or deals they fund comply with all applicable laws related to providing consumer or commercial credit in the US marketplace. For every client, she develops a thorough understanding of the operational, market and reputational challenges they face in order to provide the most actionable, practical compliance advice.

Christina finds solutions that allow her clients to finance transactions or conduct business with the assurance that all credit-related regulatory issues have been addressed. These are usually complex matters that demand painstaking attention to detail, while staying mindful of overarching business objectives and the market in which products will be offered.

One of Christina’s most complicated transactions required more than six bank regulatory applications before it closed. That persistence is typical of her work, but so is the creativity that she has shown in advising clients on complexities related to business relationships that bring new products to market. In addition to her extensive work for lenders, she also conducts third-party consumer and commercial lender audits on behalf of capital sources.

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