

## SBA Consent Requirements for M&A Transactions with PPP Loans

October 5, 2020

### KEY POINTS

- Pending and potential mergers and acquisitions (M&A) transactions need to address the existence of a target company's currently outstanding PPP Loan;
- The Small Business Administration (SBA) has issued guidance on the types of transactions for which PPP Lenders must obtain SBA's consent prior to consummating the proposed transaction;
- Asset deals and equity transactions with less than 50 percent of the business being conveyed likely do not require SBA Consent;
- Mergers and transactions conveying more than 50 percent of a company's assets or equity will require the consent of the SBA, unless the PPP Borrower has (1) used all of the PPP Loan proceeds, (2) submitted a complete loan forgiveness application, and (3) 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
- 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.

### Loan forgiveness

The most attractive feature of PPP Loans was the potential for full loan forgiveness: up to 100 percent 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 percent 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 mergers and acquisitions (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 percent 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 (3) a **PPP borrower is merged with or into another entity**” (emphasis added) (collectively a **Significant Sale**). For purposes of determining whether the 20 percent 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 percent of the ownership is a “Significant Sale” requiring notice to the PPP Lender but does not trigger the 50 percent 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 percent 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*

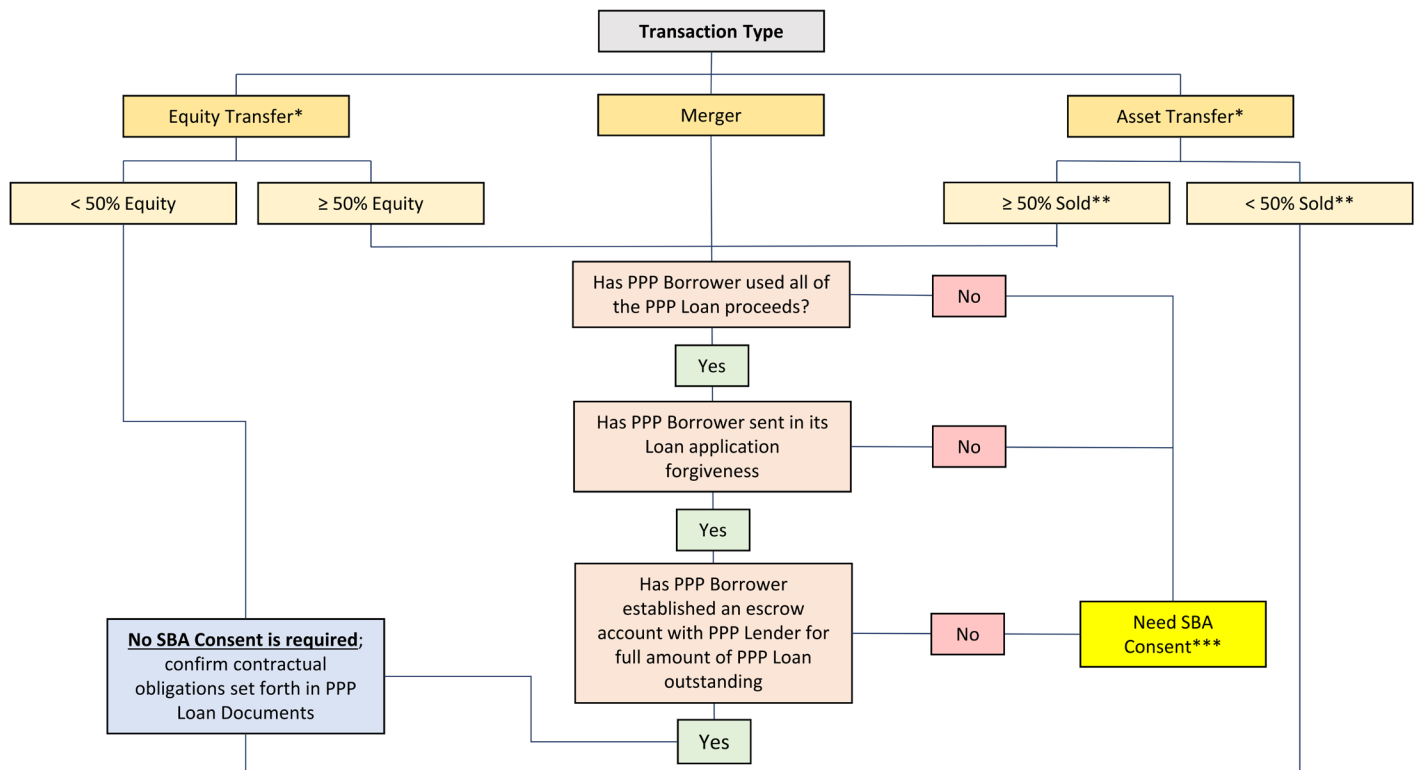
The PPP Lender may approve of a Significant Sale, and the SBA consent is not required, if the Significant Sale is structured as a sale of **50 percent or more of its assets** (measured by fair market value) the PPP Borrower has **(a) used all of its PPP Loan funds, (b) submitted to the PPP Lender a complete 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 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 percent 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 percent 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**.



\* All transfers since PPP Loan application aggregated to test these thresholds

\*\* All asset transfers measured by fair market value

\*\*\* Asset transfer consent is conditional on Buyer assuming PPP Loan.

Analysis assumes that (i) PPP borrower has not repaid PPP note in full, or (ii) SBA has not remitted funds to PPP lender to fully satisfy PPP note.

## 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 percent 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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## CONTACTS

For more information, please contact Katten’s [Corporate](#) group or any of the following attorneys.



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