

Paycheck Protection Program: Change of Ownership of Borrower

The Paycheck Protection Program, created on March 27, 2020 under the Coronavirus Aid, Relief, and Economic Security (CARES) Act (H.R. 748), established a temporary loan program under Section 7(a) of the Small Business Act (the “Act”), empowering authorized Small Business Association (the “SBA”) lenders to provide up to \$659 billion of loans to businesses and not-for-profit organizations to help cover payroll costs and certain eligible non-payroll costs (the “PPP Loans”). As the COVID-19 pandemic continues to disrupt economic activity, many small business owners are struggling despite having received PPP Loans and are considering alternatives to keep their businesses alive, including mergers, asset sales and equity sales. The SBA’s Standard Operating Procedure 50 57 2 (7(a) Loan Servicing and Liquidation), and the form of SBA note, on which many PPP Loans rely, require the lender’s and the SBA’s consent to any change of ownership that occurs within one year of disbursement of a loan provided under the Act, including a PPP Loan. On October 2, 2020, the SBA published a Procedural Notice providing guidance regarding what constitutes a change of ownership and announcing what procedures are required for borrowers planning to undergo a change of ownership and when prior approval of the change of ownership by the SBA is required.¹ This memorandum outlines these important new procedures and approval requirements.

I. Change of Ownership

The Procedural Notice states that a “change of ownership” occurs when one of the following takes place: (1) an aggregate of 20% or more of the common stock or other ownership interest of the borrower (including publicly traded stock) is sold or otherwise transferred, including to an affiliate or existing owners of the borrower, since the date of approval of the PPP Loan; (2) the borrower sells or transfers 50% or more (based on fair market value) of its assets since the date of approval of the PPP Loan; or (3) the borrower is merged into another entity. The borrower must notify its lender with a copy of the proposed agreements or other documents that would effectuate the proposed transaction prior to the closing of any change of ownership transaction.

II. SBA Approval

The Procedural Notice delineates instances when a change of ownership does not require SBA approval. Regardless of whether approval is required, the borrower must comply with the responsibilities discussed below.

a. Instances in which SBA prior approval is not required

If the PPP Loan has been repaid in full or the SBA remitted the forgiveness amount to the lender and the borrower has repaid any remaining balance on the PPP Loan prior to the closing of the sale or transfer, the PPP Loan is considered fully satisfied, and no SBA approval is required for a change of ownership. However, if the PPP Loan is not fully satisfied prior to closing of the sale or transfer, the borrower may need to seek prior approval of the transaction from the SBA.

Prior approval of the SBA is not required if (1) the sale or other transfer is of no more than 50% of the common stock or other ownership interest of the borrower or less than 50% of the borrower’s assets; or (2) the borrower submits a PPP Loan forgiveness application and supporting documentation, demonstrating the use of all PPP Loan proceeds, to its lender and deposits an amount equal to the PPP Loan balance into an interest-bearing escrow account controlled by the lender. These funds will be disbursed after the forgiveness process is completed

¹ The Procedural Notice can be found [here](#).

to repay any remaining PPP Loan balance, including interest. Within five business days of the completion of the transaction, the lender must notify the applicable SBA Loan Servicing Center² of the location of and the amount of funds in the escrow account.

b. Instances in which SBA prior approval is required

If the change of ownership is structured as a sale or other transfer of more than 50% of the common stock or other ownership interest of the borrower or 50% or more of the assets of the borrower and the required escrow account is not established, or the transaction is structured as a merger of the borrower, prior approval from the SBA, not just the lender, is required. In such instances, approval is conditioned upon the buyer assuming all of the borrower's obligations under the PPP Loan. In the case of a change of ownership structured as an asset sale, the purchase or sale agreement must include language evidencing the assumption of the borrower's obligations under the PPP Loan or a separate assumption agreement must be submitted to the SBA. The borrower must submit the following materials to its lender with ample time for the lender to submit the approval request to the appropriate SBA Loan Servicing Center:

1. the details of the requested transaction;
2. any letters of intent and the purchase or sale agreement setting forth the responsibilities of the borrower, the seller (if different from the borrower), and the buyer;
3. disclosure of the buyer's existing PPP Loan, if applicable, and the SBA loan number;
4. the reason why the borrower cannot fully satisfy the PPP Loan or the reason for which the borrower cannot establish an escrow account as described above;
5. a copy of the executed PPP Note; and
6. a list of owners of the 20% or more of the buyer.

The SBA will conduct its review and provide a determination within 60 days of the receipt of the completed request.

III. Continuing Responsibilities Of The Borrower

In all instances of a change of ownership, the borrower (or, the successor to the borrower in the event of a merger) remains responsible for performance of all obligations under the PPP Loan. The borrower (or, the successor to the borrower in the event of a merger) also remains responsible for the certifications made in connection with the PPP Loan application, including the certification that the PPP Loan is necessary, and compliance with all other requirements under the Paycheck Protection Program. This includes obtaining and preparing all required forms and supporting documentation for the lender or the SBA upon its request. The SBA may exercise its rights and remedies available under the law in the event of any fraud, false statements, or unauthorized uses of the PPP Loan proceeds. If the buyer and/or the seller has an outstanding PPP Loan and the change of ownership transaction is financed by a loan pursuant to Section 7(a) of the Act, the SBA Loan Program Requirements (13 CFR 120.10) must be met.³

² A list of appropriate SBA Loan Servicing Centers can be found [here](#).

³ The SBA Loan Program Requirements can be found [here](#).

Importantly, if an escrow account is established, as described above, the 7(a) loan proceeds used to finance the transaction cannot be used to finance such escrow account.

The Procedural Notice provides notice requirements for all change of ownership transactions, regardless of whether the transaction requires SBA approval. The borrower must submit the following information to the lender with enough time so that lender may notify the SBA no later than five business days after the completion of the transaction:

1. identity of the new owner or owners of the common stock or other ownership interest;
2. new owner's or owners' ownership percentage(s);
3. tax identification number of any owner holding 20% 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 lender, if an escrow account is required.

IV. Conclusion

Borrowers and lenders have long awaited guidance regarding change of ownership requirements under the Paycheck Protection Program. While the SBA's Procedural Notice provides some much needed clarity to businesses and lenders alike, it leaves unanswered many questions that could complicate the ability of small businesses to promptly complete important transactions. For example, is SBA approval required where a change of ownership occurs indirectly through a transaction accomplished at a higher corporate level? How does a borrower calculate the 50% equity ownership (for example, does it include only outstanding common stock)? How is fair market value of assets determined (for example, is a third-party valuation necessary or is a board resolution sufficient)? Does the Procedural Notice supersede the SBA's rule that all changes in ownership require its consent within the first year after loan disbursement? Further changes and guidance are likely to provide businesses a clearer way forward as they navigate changes in ownership in these uncertain times.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email authors Helene R. Banks at 212.701.3439 or hbanks@cahill.com or Robyn Sablove at 212.701.3753 or rsablove@cahill.com; or email publications@cahill.com