Changing Control in the Time of COVID: Navigating 'Change of Ownership' Prior to PPP Loan Satisfaction

THE HYPOTHETICAL

Everyone loves a hypothetical, right? So let's begin with one about Billy Builder:

Billy Builder holds 55% of the equity in a construction business he founded way back when the fax machine was cutting edge. Billy wants to sell his stock to his son-in-law Sonny. Business is tiring – more so with COVID – and he wants to step away to spend more time with his grandkids. The problem: Billy's business took a $2.5 million PPP-1 loan. Billy has zero interest in repaying that loan because they expect to qualify for forgiveness. But forgiveness is likely a long way off. What do you, their trusted banker (and originator of their PPP-1 loan) do when they ask if Sonny can buy out Billy? To some extent, Billy is in luck – at least insofar as having an answer is concerned.

Note that our scenario does not apply to any PPP loan which is fully satisfied prior to closing a transaction that constitutes a "change of ownership." It should go without saying that in these cases, there are no restrictions on that transaction.

For reference, a PPP loan is fully satisfied if the PPP borrower has:

1. Repaid the PPP note in full; or
2. Completed the loan forgiveness process in accordance with the PPP requirements and:
    a. The SBA has remitted funds to the PPP lender in full satisfaction of the PPP note; or
    b. The PPP borrower has repaid any remaining balance on the PPP loan.

Now, back to Billy's desire to retire by selling his stock to Sonny.

THE GUIDANCE

Late last year, the U.S. Small Business Administration ("SBA") released a procedural notice ("Procedural Notice") related to changes of ownership in an entity that has received a Paycheck Protection Program ("PPP") loan – what we are now calling the PPP-1 loans. Many Maine bankers likely saw the release, or were at least aware of it. Most importantly, it clarified that borrowers with PPP loans which undergo a change of ownership will not forfeit the chance to have their PPP loan forgiven.

While the borrower's professional advisors should always be consulted, bankers will want to have at least a general sense of what the borrower is facing (and CROs and General Counsel internally will want their lenders at least familiar with the information below). Bear in mind that a change of control – as defined below – has implications for the bank's reporting requirements as well.

WHAT IS "CHANGE OF OWNERSHIP?"

For purposes of the PPP, the SBA will consider the following events to be a "change of ownership:"

1. At least 20% 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% 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.

Our friend Billy is going to be subject to change of ownership rules involving PPP. So what do you, as his lender, need to know to advise him about next steps?

SBA APPROVAL REQUIRED vs NOT REQUIRED

No SBA approval required

An individual or entity may sell or otherwise transfer common stock or other ownership interest in a PPP borrower without the prior approval of SBA only if:

1. The sale or other transfer is of 50% ***or less*** of the common stock or other ownership interest of the PPP borrower (or 50% ***or less*** of the borrowers assets, measured by fair market value); or
2. The PPP borrower submits its forgiveness application with all required supporting documentation to its PPP lender, and an interest-bearing escrow account controlled by the PPP lender is established with funds equal to the outstanding balance of the PPP loan.

After the forgiveness process (including any appeal of SBA's decision) is completed, the escrow funds must be disbursed first to repay any remaining PPP loan balance plus interest. Buyers and sellers will have to decide how to fund the escrow account and allocate the escrow amount (if any is left over after repaying any outstanding balance of the PPP loan).

SBA approval required

If a change of ownership of a PPP borrower does not meet the conditions described above (i.e., no escrow established), the PPP lender must obtain the SBA's prior approval. To obtain the SBA's prior approval of requests for changes of ownership, the PPP lender (this means you, my banking friends) must submit a request to the appropriate SBA Loan Servicing Center with the following:

1. The reason that the PPP borrower cannot fully satisfy the PPP note or escrow funds as described above;
2. The details of the requested transaction;
3. A copy of the executed PPP note;
4. Any letter of intent, and the purchase or sale agreement setting forth the responsibilities of the PPP borrower, seller (if different from the PPP borrower), and buyer;

5. Disclosure of whether the buyer has an existing PPP loan and, if so, the SBA loan number; and
6. A list of all owners of 20% or more of the purchasing entity.

The SBA has discretion to require additional risk mitigation measures as a condition of its approval of the transaction. In order to obtain SBA approval of any change of ownership involving the sale of 50% or more of the assets of a PPP borrower, the buyer must assume all of the PPP borrower's obligations under the PPP loan, including responsibility for compliance with the PPP loan terms, and the purchase agreement must include appropriate language regarding the assumption of the PPP borrower's obligations under the PPP loan by the buyer, or a separate assumption agreement must be submitted to the SBA.

As of October, the SBA had given itself 60 calendar days from its receipt of a complete request to review and respond to such request – but it is not clear whether this is being followed (... and given their adherence to the forgiveness determinations, we rather doubt it). So, borrowers undergoing changes of ownership requiring SBA approval may wish to apply as soon as possible to make sure the SBA does not hold up the deal. Additionally, for these deals, it would be prudent to include SBA approval as a condition to closing. Unfortunately, there is no way to realistically estimate how long the SBA will take to issue approvals.

Requirements for all changes of ownership

Whether or not SBA approval is required, a PPP borrower undergoing a change of ownership must notify its PPP lender in writing of the contemplated transaction and provide its PPP lender with a copy of the proposed agreements or other documents that would effectuate the proposed transaction. Further, the PPP borrower (and the new owner of, or successor to, the PPP borrower) will remain subject to all obligations under the PPP loan.

If any of the new owners or the successor arising from such a transaction has a separate PPP loan, then, following the closing of the transaction:

1. In the case of a purchase or other transfer of common stock or other ownership interest, the PPP borrower and the new owner(s) are responsible for segregating and delineating PPP funds and expenses and providing documentation to demonstrate compliance with PPP requirements by each PPP borrower; and
2. In the case of a merger, the successor is responsible for segregating and delineating PPP funds and expenses and providing documentation to demonstrate compliance with PPP requirements with respect to both PPP loans.

The PPP lender must notify the appropriate SBA Loan Servicing Center, within five business days of completion of the transaction, of the:

1. Identity of the new owner(s) of the common stock or other ownership interest;
2. New owner(s)' ownership percentage(s);

3. Tax identification number(s) of any owner(s) 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 PPP lender, if an escrow account is required.

ONGOING REQUIREMENTS REGARDLESS

Regardless of any change of ownership, the PPP lender is still required to continue submitting monthly 1502 reports until the PPP loan is fully satisfied (as defined below), and the PPP borrower is still required to:

1. Perform all of its obligations under the PPP loan;
2. Remain responsible for all certifications made in connection with the PPP loan application, including the certification of economic necessity; and
3. Comply with all other applicable PPP requirements, such as using the PPP loan only for the authorized purposes.

The PPP borrower must also obtain, prepare and retain all required PPP forms and supporting documentation and provide those forms and supporting documentation to the PPP lender or lender servicing the PPP loan or to the SBA upon request. In the Procedural Notice, the SBA explicitly reserved all rights and remedies available under the law in the event of fraud, false statements, or unauthorized uses of PPP loan proceeds.

BILLY'S RESULT

So what about our friend Billy, and you, his banker? Poor Billy's PPP loan will not be fully satisfied prior to sale, so Billy will have to submit all forgiveness information to you, and will have to escrow for the balance. If he cannot escrow for the balance, he will have to obtain SBA approval.

If you, the lender, are financing Sonny's purchase (or a refinance of credit facility for the borrower as part of that buyout), it is probably worth establishing receipt of SBA approval as a condition of closing the loan (and the change of control). NOTE: Your monthly 1502 reports will have to continue until full satisfaction. Plan on at least 60 days for approval – but probably longer. Why? SBA in the time of COVID.

Lastly, while Billy already has his Margaritaville blender ready to roll, you will need to be sure he first preserves all PPP forms and supporting documents as part of his records – and yours.

Just like that, voila – Billy gets to retire, Sonny gets the business, and you dear banker, get to continue the lending relationship with the next generation.

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