BRACEWELL

INSIGHTS

New PPP Rules Governing M&A Transactions

October 5, 2020

*By: **David A. Shargel**, **David J. Ball**, **Rachel B. Goldman**, and **Thomas F. Kokalas***

The Small Business Administration issued ***long-awaited rules*** governing lender and borrower obligations when there is a change in ownership of an entity that has received a Paycheck Protection Program ("PPP") loan. The new guidance, issued on October 2, 2020, eliminates the need for SBA approval for many merger or sale transactions, but injects a host of additional procedural and compliance requirements—including that the outstanding balance of the PPP loan be placed in escrow—that could create pitfalls for borrowers, purchasers and lenders.

By way of background, the SBA's standard PPP note provides that any change of ownership without lender consent constitutes an event of default. The SBA's servicing rules for 7(a) loans, which include PPP loans, require SBA approval before a lender consents to a change in ownership if the change occurs within 12 months of loan disbursement.

Under the new guidance, SBA approval is *not* required where:

1. the PPP loan has been repaid in full prior to the merger or sale transaction;

2. the borrower has completed the loan forgiveness process *and* the SBA has remitted funds to the PPP lender in full satisfaction of the PPP Note (and the borrower has repaid any unforgiven balance);

3. less than 50% of common stock or other ownership interest is being transferred;

4. more than 50% of common stock or other ownership interest is being transferred and the borrower completes and submits a forgiveness application and required documentation, and also establishes an interest-bearing escrow account controlled by the PPP lender containing funds equal to the outstanding balance of the PPP loan; or

5. the transaction involves a change in ownership of 50% or more of a borrower's assets, in which case the borrower must meet the escrow and other requirements in (4) above.

PPP Lenders are required to notify the SBA of the location and amount of escrowed funds within 5 business days of the transaction, and in the case of transfers of stock or other ownership interests, must also provide the SBA with information concerning the identity of the new owners. Once the forgiveness process is completed, the escrowed funds must be disbursed to repay the remaining PPP loan balance (if any), plus interest.

If the relevant conditions set forth above are not met, either because the borrower has not yet submitted a forgiveness application or is unable to escrow an amount equal to the outstanding balance of the loan, the PPP lender must seek SBA approval for the transaction. To seek approval, lenders must submit a request to the appropriate SBA Loan Servicing Center explaining the reason that the borrower cannot escrow the loan balance, the details of the proposed transaction and a copy of the PPP note, as well as letter of intent or purchase and sale agreement "setting forth the responsibilities of the PPP borrower, seller (if different from the PPP borrower), and buyer." The request for approval must also disclose whether the buyer has an existing PPP loan, together with a list of all owners of 20 percent or more of the purchasing entity. The SBA has committed to providing a determination within 60 days of receiving a completed request.

Importantly, the SBA's approval of a sale of 50% or more of a borrower's assets will be conditioned upon the buyer assuming the PPP borrower's obligations under the PPP loan, including responsibility for compliance with the PPP loan terms. Similarly, for stock or other ownership interest transfer agreements—regardless of whether SBA approval is needed—the successor entity will be subject to all obligations under the PPP loan, including the obligation to use PPP funds only for authorized purposes. Additionally, if the successor entity has a separate PPP loan, the PPP borrower and the new owner are required to keep separate records and segregate the PPP funds in order to demonstrate compliance with the PPP requirements for each borrower.

Finally, regardless of the nature of change in ownership transaction, the SBA's new guidance makes clear that the borrower remains responsible for all PPP obligations, as well as the certifications made with the PPP loan application. This includes the certification of economic necessity, which has been addressed in ***Bracewell's prior client alerts***.

Bracewell's cross-disciplinary COVID-19 task force is actively helping numerous clients navigate the many and evolving issues they are facing, including potential access to stimulus programs. Your Bracewell point of contact can help you learn more.