



Mergers and Acquisitions with PPP or EIDL Borrowers: Considerations for Buyers, Sellers, and Lenders

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By now, most small business owners and their lenders are acutely aware of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), enacted to provide emergency assistance and health care response for individuals and businesses impacted by the COVID-19 pandemic. Among its many provisions, the CARES Act established the Paycheck Protection Program (PPP) to be administered by the U.S. Small Business Administration (SBA), and modified SBA's pre-existing Economic Injury Disaster Loan (EIDL) program. Since March 27, 2020, when the CARES Act was signed into law, SBA has approved over 5 million PPP loans and roughly 3.5 million EIDLs.

Given the number of participating businesses, it is hardly surprising that some borrowers are evaluating strategic transactions ? including stock or membership interest sales, mergers, corporate or company reorganizations, stock or membership interest redemptions, asset sales and the like ? while their PPP loans or EIDLs are outstanding. The parties to such transactions should review the terms and conditions of the subject business's PPP loan or EIDL, as well as the applicable SBA rules and regulations, to determine if the transaction must be approved by either or both of the PPP lender and SBA.

PPP LOANS

Transactions affecting the ownership of a PPP borrower may require the PPP lender to request SBA's approval or to notify SBA of the transaction. These potential obligations warrant attention from buyers, sellers, and lenders alike, and should be regarded as an important diligence item.

Why is SBA's Approval or Notification Required?

PPP loans are an outgrowth of SBA's 7(a) business loan program, which is governed by Section 7(a) of the Small Business Act, SBA regulations, SBA Standard Operating Procedure (?SOP?) documents, and SBA Procedural Notices. While Congress and SBA established certain rules that are specific to PPP loans, many of the existing 7(a) rules also apply to the PPP loan program. SBA guidance continues to

highlight obligations found in the 7(a) rules that may not have been known to borrowers or lenders in the PPP's early days.

With regard to lenders' servicing requirements, for example, a recent SBA Procedural Notice states that "PPP Lenders are responsible for servicing PPP loans in accordance with SBA SOP 50 57, as amended." [1] The current version of this document, SOP 50 57 2, effective as of December 1, 2015, contains the loan servicing rules for 7(a) loans and applies to PPP loans in the absence of superseding or conflicting PPP-specific rules.[2] As discussed below, these rules may require the lender to notify SBA, or to seek SBA's approval, of certain PPP borrower transactions.

Transactions that Require SBA Approval

SOP 50 57 2 provides that certain actions after the full disbursement of loan proceeds require SBA's prior written approval, as set forth in the SBA 7(a) Lenders Servicing and Liquidation Matrix. One action that requires SBA approval is a "[c]hange in the ownership of a Borrower in the first 12 months after final disbursement." [3] This requirement applies to "any adjustment to or change in the ownership of a Borrower, including a change in percentage of ownership, for 12 months after final disbursement on any loan." [4] Given the breadth of this language, it is prudent to seek SBA's consent to a transaction that would change any or all of the ownership interests in a PPP borrower.

The assumption of a PPP loan with the release of the original borrower also requires SBA approval [5]

Transactions that Require SBA Notification

Other situations do not require SBA's prior approval, but do require lenders to notify SBA. For example, the lender must notify SBA of a "[c]hange in Borrower's legal structure." This requirement applies to changes in legal structure that result in a change to the Employer Identification Number or Social Security Number of any obligor.[6] Parties to transactions that contemplate the formation of new entities for existing PPP borrowers should evaluate whether this rule requires the lender to notify SBA of the transaction.

Transactions that Require Lender Consent

Irrespective of any SBA approval or notification that may be required, some events may require the PPP lender's consent. The events discussed above implicitly, if not explicitly, require the lender's consent. But there are several other events that may constitute a default if the lender's prior consent was not obtained. The particular events may vary by lender. Because some lenders used their own forms to document PPP loans, the restrictions on entity transfers or changes without lender consent are not uniform for all PPP loans.

The parties contemplating a strategic transaction should carefully review the relevant PPP note, loan agreement, and any other certifications made to the PPP lender, to determine if that lender's consent or waiver of default should be obtained. While there is no formal guidance from SBA to this effect, there is a potential risk that a borrower would forfeit its ability to obtain loan forgiveness if its PPP loan goes into default, even if the lender does not call the loan.

ECONOMIC INJURY DISASTER LOANS

Unlike the PPP, the EIDL program has been in existence for decades. The EIDL program derives from Section 7(b) of the Small Business Act and carries a different set of regulations from the Section 7(a) rules that govern PPP loans, including SBA SOP 50 30 9, effective as of May 31, 2018. EIDLs are funded and administered by SBA, without the involvement of a private lender partner. Also, unlike the relatively short-term PPP loan, an EIDL can have a loan term of up to 30 years, making it more likely that a strategic transaction involving the borrower will arise during the life of the EIDL.

Why is SBA's Approval or Notification Required?

In short, SBA's approval of a strategic transaction involving an EIDL borrower is required because the EIDL loan documents say so. Specifically, the EIDL promissory note states that the borrower is in default if it "[r]eorganizes, merges, consolidates, or otherwise changes ownership or business structure without SBA's prior written consent."^[7] That language is broad enough to cover most, if not all, transfers of ownership interests.

With respect to asset sales, whether SBA's approval is required depends upon whether the EIDL is secured. SBA requires collateral to secure all EIDLs over \$25,000.^[8] Although SBA prefers real estate collateral, it often takes a blanket security interest in all of the borrower's tangible and intangible personal property to secure an EIDL. The security agreement states that the borrower "will not sell, lease, license or otherwise transfer (including by granting security interests, liens, or other encumbrances in) all or any part of the Collateral or Borrower's interest in the Collateral" without SBA's written approval.^[9]

Ownership or asset transfers also often involve a contemplated release or change of guarantors. Under SOP 50 30 9, the addition or deletion of a guarantor is a material change to an EIDL that requires SBA's approval, and possibly a loan document modification.^[10] Note, however, that CARES Act EIDLs under \$200,000 do not require personal guarantees.^[11]

Requesting Approval

The initial request for approval of any transfer or modification involving an EIDL should be made to the SBA loan officer who closed the loan. That officer may need authorization from a "Supervisory Loan Officer" for material changes, and even the SLO may need authorization from further up the chain of command at SBA.^[12]

SUMMARY

In a strategic transaction involving a small business with an outstanding PPP loan or EIDL, the buyer, the seller, the private PPP lender, and the lender financing the strategic transaction all have a stake in ensuring that SBA has been notified of and has approved the transaction, when required. As the COVID-19 crisis continues, common sense dictates, and our communication with SBA on behalf of clients has confirmed, that SBA is overwhelmed with PPP loan and EIDL requests. As such, contact with SBA on any contemplated strategic transaction cannot be an afterthought. It should be one of the first diligence

tasks undertaken by the parties to the transaction, and both borrowers and lenders can benefit from engaging advisors with experience interacting with SBA.

[1] SBA Procedural Notice No. 5000-20038, *Procedures for Lender Submission of Paycheck Protection Program Loan Forgiveness Decisions to SBA and SBA Forgiveness Loan Reviews* (July 23, 2020), at 3.

[2] *Id.*, at 3 n.3 (?Because PPP loans are 7(a) loans, the SOP applies to the servicing of PPP loans, to the extent that the SOP is not superseded by or in conflict with PPP-specific requirements.?)

[3] SBA Servicing and Liquidation Actions 7(a) Lender Matrix (Version 15, April 25, 2019), at 1.

[4] *Id.* at 3 n. 17.

[5] *Id.* at 1.

[6] *Id.* at 3 n. 8.

[7] SBA Form 147 B at §4.

[8] SBA SOP 50 30 9, *Disaster Assistance Program* (May 31, 2018), at 112.

[9] SBA Form 1059 at §5.

[10] SBA SOP 50 30 9, *Disaster Assistance Program* (May 31, 2018), at 136.

[11] CARES Act § 1110(c)(1).

[12] SBA SOP 50 30 9, *Disaster Assistance Program* (May 31, 2018),
at 154.

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