

Client Alert

October 2020

Paycheck Protection Program: Loan Modifications, Changes in Ownership & Forgiveness

The Small Business Administration (“SBA”) has recently released a variety of new formal and informal guidance on the Paycheck Protection Program (“PPP”). The informal guidance was provided at an event hosted by the American Bankers Association on Wednesday, September 23, and at a House subcommittee hearing that same week. This past Friday, October 2, the SBA released a Procedural Notice on changes of ownership that includes information concerning the required procedures for changes of ownership of an entity that has received PPP funds.

At the ABA event, the SBA’s Chief of Staff, Bill Manger, specifically stated that the agency is working on additional formal guidance for loan modifications and forgiveness. Mr. Manger also noted that the SBA has been coordinating with the Government Accountability Office (“GAO”) and Congress more broadly to review the PPP as a whole. With the chances of congressional action continuing to fade, the US Department of the Treasury is supposedly focused on simplifying the forgiveness process for PPP loans of \$50,000 or less. This client alert summarizes the notable information provided by the SBA and Treasury on loan modifications, forgiveness and changes of ownership.

Please note that the information provided below may change as a result of additional formal guidance that the SBA expects to release soon, particularly with respect to loan modifications and forgiveness.

Loan Modifications

The PPP Flexibility Act created significant changes to the program after the first round of PPP funds had already been exhausted, leaving lenders with a large number of outstanding promissory notes with incorrect terms. On the ABA call, Manger acknowledged that typically loan modifications require a borrower’s signature to be effective, but many lenders have pushed back on this because the changes created by the PPP Flexibility Act were statutory and should serve to automatically change any conflicting terms in loan documents. As pointed out by Joe Brandon, President and CEO of the Georgia Bankers Association, most lenders (including those using the forms we provided) used notes that specifically contemplated changes in the law and should only be required to notify borrowers of the changes.

While the SBA continues to emphasize that lenders are responsible for determining how to handle loan modifications, the SBA has also informally acknowledged in various email communications that trying to modify promissory notes is problematic at best. The reason modifying notes is so challenging is that there is no possible way for a lender to unilaterally determine how a specific borrower’s payment terms may have changed as a result of the PPP Flexibility Act. It is important to add that the SBA did mention on the ABA call that lenders may modify promissory notes with advice from counsel without impacting the SBA guaranty.

There is no one size fits all approach for loans originated before June 5. In such cases, borrowers have the option to choose whether to use the initial 8-week forgiveness period or the extended 24-week forgiveness period. That decision provides the basis for calculating the 10-month deferment period and forgiveness application deadline. Even if it is assumed all borrowers will elect the longer 24-week

forgiveness period, which is certainly not the case, it is still impossible to calculate any payment start date as the borrower can submit the forgiveness application at any time within the 10-month period following the selected forgiveness period.

The PPP Flexibility Act modified various other loan terms, such as permissible expenses and the duration of the loan, but those changes generally should not directly affect terms in the promissory notes. Borrowers may not unilaterally change their loan maturity from two to five years as lenders have the discretion whether to grant such a modification. Considering borrowers and lenders are still expecting for most loans to be forgiven, unless a lender is seeking to sell its PPP loans, we encourage lenders to hold off on extending maturities at this time—this can be accomplished after the SBA’s forgiveness decision is made.

Changes in Ownership

There are an increasing number of businesses with PPP loans that are facing change of ownership scenarios. This past Friday, the SBA finally released guidance on how lenders are expected to evaluate proposed changes in ownership in the form of a procedural notice (“Procedural Notice”).¹

The Procedural Notice outlines what steps lenders must take in order to permit a change of ownership to occur and when explicit SBA approval is required. The SBA has clarified that for the purposes of the PPP, a “change of ownership” will be considered to have occurred 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, whether in one or more transactions; or
- (3) a PPP borrower is merged with or into another entity.

PPP borrowers are required to notify lenders in writing and provide copies of the proposed agreements or other documents that would effectuate any proposed change of ownership transaction. The Procedural Notice clarifies that there are no restrictions on a change of ownership if the borrower’s PPP note has been satisfied in full, either through early repayment or forgiveness of the loan by the SBA. SBA approval may be required if the PPP note has not been fully satisfied prior to the closing.

Prior SBA approval is not required where the change of ownership is structured as an asset sale, sale of common stock or other ownership interest or as a merger, provided the change of ownership is for less than 50 percent of the outstanding ownership interest in, or assets of, the PPP borrower or the PPP borrower has already completed and submitted a forgiveness application. In a change of ownership scenario where a borrower has submitted a forgiveness application, the SBA does require that the amount of the PPP loan be placed in escrow with the PPP lender until such time that the SBA issues its forgiveness decision.

The escrow requirement could be a significant burden for PPP borrowers that are needing to complete a change of ownership in order to stay in business and do not have the necessary funds to maintain such an escrow account.

If the PPP borrower has not yet exhausted the PPP loan funds and applied for forgiveness, then prior SBA approval is required and a PPP lender may not unilaterally approve the change of ownership. To request the SBA’s approval for changes of ownership, the PPP lender must first agree to the change of ownership and provide the SBA with the following information:

¹ [SBA Procedural Notice No. 5000-20057](#).

- (1) the reason that the PPP borrower cannot fully satisfy the loan or apply for forgiveness and place the amount of the PPP loan in escrow until the SBA has issued its forgiveness decision;
- (2) details of the proposed transaction;
- (3) a copy of the executed PPP note;
- (4) any letter of intent and the change of ownership documents setting for the responsibilities of the PPP borrower and the buyer;
- (5) disclosure of whether the buyer has an existing PPP loan; and
- (6) a list of all owners of 20 percent or more of the purchasing entity.

The SBA reserves the right to require additional risk mitigation measures as a condition of approving any change of ownership request. Requests for approval will be reviewed and decided upon within 60 calendar days of receipt of a complete request.

Regardless of whether prior SBA approval is required, the PPP lender must notify the appropriate SBA Loan Servicing Center within five business days of completion of the transaction with information on the new business structure—this includes the identities of new owners, the ownership percentages, any new tax identification number, and the location and details of the escrow account under the control of the PPP lender, if an escrow account is required.

The Procedural Notice emphasizes that the surviving entity remains responsible for compliance with all requirements of the PPP. If any of the new owners already has a separate PPP loan, the Procedural Notice requires the PPP borrower to carefully segregate and delineate PPP funds and expenses while providing documentation to demonstrate compliance with the PPP requirements for each loan.

Lenders are also reminded to comply with any notifications or other requirements of the PPP Liquidity Facility for PPP loans pledged to the Federal Reserve. Unless other changes occur alongside the change of ownership, such as a change in maturity, any notification is likely limited to informing the Federal Reserve of a change to the name of the PPP borrower, if applicable.

It is important to note that the Procedural Notice does not address indirect changes of ownership, where, for example, the owner of a PPP borrower is a corporate entity that is itself going through a change of ownership. We have reached out to the SBA and are seeking further guidance on indirect changes of ownership.

So long as lenders take prudent steps to follow the requirements outlined in the Procedural Notice and communicate with the SBA regarding changes in ownership for PPP borrowers, it is reasonable to expect that the changes will not impact the SBA guaranty absent other material issues. It remains to be seen how accommodating the SBA will be for changes in ownership that require prior SBA approval.

Forgiveness

What comes as no surprise to lenders or borrowers, a GAO report found that the forgiveness process was substantially more time consuming than originally expected. As of last Wednesday, the SBA has received over 100,000 forgiveness applications from lenders (approximately 2% of all PPP loans), but no forgiveness decisions have been made. Addressing the incredibly complex forgiveness process continues to be a top priority for lenders and borrowers alike.

Borrowers have ten months from the end of the covered forgiveness period to apply for forgiveness without having to make any payments on PPP loans.² If a borrower does not submit a forgiveness

² "Covered forgiveness period" refers to either the 8-week or 24-week forgiveness period.

application within the ten month deferral period, the borrower must begin making payments on the loan. However, borrowers may still submit a loan forgiveness application at any time on or before the maturity date of the loan.³ As a result, lenders may want to be prepared for the forgiveness process to potentially last until all PPP loans are off their books.

The House Small Business Committee also heard concerns from borrowers and lenders on various problems with the PPP forgiveness process at a recent hearing. Witnesses emphasized support for legislative changes to the PPP, including allowing certain businesses to take a second loan and to simplify the forgiveness process for loans under \$150,000.⁴ As the likelihood of imminent congressional action continues to diminish, lenders may be left with figuring out how to navigate an unwieldy forgiveness process for the foreseeable future.

Secretary Mnuchin indicated last week that he will continue to work with the SBA on finding ways to streamline the forgiveness process even without congressional action. Mnuchin specifically stated that the agency can create a more streamlined approval process for loans under \$50,000, perhaps without any forgiveness application at all, and that it will improve the forgiveness process for loans ranging from \$50,000 to \$150,000. While an increasing number of lenders have collectively submitted thousands of forgiveness applications and not a single response has been reported from the SBA to date, Mnuchin promised the SBA will begin issuing forgiveness in a matter of days.

Closing Thoughts

We continue to emphasize that the SBA and Treasury's official position is that a lender's actions will not be challenged if the lender complies with the guidance and rules in effect at the time the specific action is taken.⁵ This may appear straightforward, but our [PPP timeline](#) shows that there have been over 93 distinct official announcements or changes to the terms of the PPP. Lenders are encouraged to continue carefully documenting all PPP actions as well as their compliance with available rules and guidance so that actions cannot be questioned later by the government applying guidance retroactively.

Please feel free to contact any of the authors if you would like assistance with preparing a general notice to PPP borrowers on changes in loan terms, the forgiveness process or anything else PPP related.

Contacts

Peter G. Weinstock
pweinstock@HuntonAK.com

Heather Archer Eastep
heastep@HuntonAK.com

Patrick J. Boot
pboot@HuntonAK.com

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³ This is based on the witness statement of Bill Manger, SBA Chief of Staff, at the House Small Business committee hearing, available at: <https://docs.house.gov/Committee/Calendar/ByEvent.aspx?EventId=111032>.

⁴ Recently, more than 100 trade groups, including the American Bankers Association, the Independent Community Bankers of America and the Consumer Bankers Association, sent a letter to lawmakers last week urging automatic forgiveness for PPP loans of \$150,000 or less.

⁵ As stated in the introduction to the [PPP Frequently Asked Questions](#) issued by the SBA and Treasury, which were last updated on August 11, 2020.