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## **SBA Issues Guidance on Change of Ownership Transactions and PPP Loans**

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by Karen P. Wackerman

On October 2 the U.S Small Business Association (“SBA”) issued a Procedural Notice outlining the requirements for the closing of change of ownership transactions for those borrowers who have loans under the Paycheck Protection Program (“PPP”).

Most PPP borrowers are about to apply, or have only recently submitted their applications, for forgiveness of their loans. The forgiveness process involves both the PPP lender and the SBA and can take up to 150 days – much longer than the usual cycle of a merger or acquisition transaction. Moreover, many banks have not yet opened their portals to receive forgiveness applications. As a result, most PPP borrowers still have outstanding loans.

The PPP loans are a form of Section 7(a) loans, which require SBA consent for a borrower’s change of ownership. Obtaining that consent can take up to 60 days, and it is not clear that the SBA would consent. Without the SBA’s consent, an outstanding PPP loan would be in default upon the closing of a change of ownership transaction. This situation has led to uncertainty as to how to proceed in these transactions. If the acquirer were to also have a PPP loan the consequences of having the transaction result in two PPP loans in one entity were unclear.

The Procedural Notice provides answers to many of these uncertainties.

As an initial matter, the Notice makes clear that if PPP borrower has completed the forgiveness process with the SBA by either remitting the funds back to the PPP lender or being granted forgiveness by the SBA, then the parties to the sale transaction need not concern themselves with the PPP loan process because the

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loan has been fully forgiven.

The Notice defines “Change of ownership” as (1) the sale or transfer of at least 20% of the common stock or other ownership interest of a PPP borrower, whether in one or more transactions, (2) the sale or transfer of at least 50% of the assets (measured by fair market value) of a PPP borrower, or (3) the merger of a PPP borrower with or into another entity.

If the PPP loan has not yet been forgiven or satisfied, prior to the closing of any change of ownership transaction, the PPP borrower must provide written notice of the planned transaction to the PPP lender as well as a copy of the proposed agreements that will effectuate the transaction.[1] The PPP lender is now permitted to approve the change of ownership, and the prior approval of the SBA is not required, if either (i) the transaction is the sale or other transfer of less than 50% of the equity interest of the PPP borrower or (ii) the transaction is a sale or other transfer of more than 50% of the equity interest of the PPP borrower, the merger of the PPP Borrower with or into another entity, or the sale or other transfer by the PPP borrower of 50% or more of its assets, *and* -

- the PPP borrower completes a forgiveness application and submits it to the PPP lender, together with any required supporting documents, *and*
- an interest-bearing escrow account controlled by the PPP lender is established with funds equal to the outstanding balance of the PPP loan.[2]

If a PPP borrower cannot meet the conditions above, it must obtain prior SBA approval of the change of ownership and the PPP lender may not unilaterally approve the transaction. The SBA has 60 days from its receipt of the request for approval to provide a decision.

### Ongoing Obligations of PPP Borrower with Respect to its PPP Loan

Whether or not the transaction requires SBA approval, if the change of ownership involved the sale or transfer of equity or was a merger, the PPP borrower (or the resulting entity, in the event of a merger) remains responsible for performing the PPP borrower’s obligations under the PPP loan. If the change of ownership involved the sale of 50% or more of the assets of the PPP borrower and SBA approval was not required, the PPP borrower remains responsible for performing all of its obligations under the PPP loan. If SBA approval was required for the sale of 50% or more of the assets of the PPP borrower, SBA approval will be conditioned on the purchaser assuming all of the PPP borrower’s obligations under the PPP loan and such obligations must be assumed in the purchase agreement or a separate assumption agreement.

After the forgiveness process for a PPP borrower relying on the safe harbor, including any appeal, is completed, the escrow funds must first be disbursed to repay any remaining PPP loan balance plus interest before being distributed as provided in the escrow agreement.

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### *If the Resulting Entity has Multiple PPP Loans*

If the new owner(s) of stock or other ownership interest of the PPP borrower or the entity into which the PPP borrower is merged has a separate PPP loan, after the closing the new owner(s) and the PPP borrower (or the merged entity, as the case may be) are responsible for segregating and delineating PPP funds and expenses and providing documentation to show compliance with PPP obligations for each entity.

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[1] The PPP borrower might consider requesting confidential treatment by the PPP lender of the transaction documents.

[2] The PPP lender and/or the purchaser in the transaction may require that the escrow account also include the interest on the PPP loan that could be due if the loan is not forgiven plus some funds to cover the expenses of the PPP lender and/or the purchaser in connection with the escrow account. In addition, the funds in the escrow account may not include the proceeds of any SBA Section 7(a) loan that the purchaser is using to acquire the PPP borrower's equity interests or assets or for the merger, as the case may be.

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