

Paycheck Protection Program Loans and Changes of Ownership

OCTOBER 7, 2020

On October 2, 2020, the Small Business Administration (the SBA) issued SBA Procedural Notice Control No. 5000-20057 (the Notice) providing information concerning the required procedures for changes of ownership of an entity that received a loan under the Paycheck Protection Program (PPP). A summary of the Notice and main points of note are set forth below.

Change of Ownership. The Notice requires notice and possibly SBA consent for any “change of ownership,” which is defined as the occurrence of any of the following:

- *Equity Transfers.* 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.
- *Asset Sales.* The PPP borrower sells or otherwise transfers at least 50 percent of its assets (measured by fair market value), whether in one or more transactions.
- *Mergers.* A PPP borrower is merged with or into another entity.

Notice to PPP Lender. Prior to the closing of any change of ownership transaction, the PPP borrower must notify the PPP lender in writing of the contemplated transaction and provide the PPP lender with a copy of the proposed agreements or other documents that would effectuate the proposed transaction. A PPP borrower must provide such notice and documentation regardless of whether the underlying PPP loan documentation requires it and regardless of whether consent from SBA is ultimately required, as discussed below.

SBA Consent. If a PPP borrower intends to consummate a “change of ownership,” the PPP borrower must then determine whether prior SBA consent is required for the transaction.

- *No SBA Consent Required.* Prior SBA consent is not required for a “change of ownership” under the following circumstances:
 1. **The PPP Note Is Fully Satisfied.** Prior SBA consent is not required for a change of ownership if, prior to closing the transaction, the PPP borrower has either (a) repaid the PPP note in full or (b) completed the loan forgiveness process in accordance with the PPP requirements, with either (i) SBA having remitted funds to

the PPP lender in full satisfaction of the PPP note or (ii) the PPP borrower having repaid any remaining balance on the PPP loan.

Note, however, that the Notice requires the PPP note to have been repaid or forgiven prior to the closing of a “change of ownership” transaction. It would be an unusual result to require SBA consent where a PPP note is satisfied out of transaction proceeds at closing instead of prior to closing, but PPP borrowers should consider whether to structure such transactions to provide for payments shortly before the closing of the remainder of the transaction.

2. **Certain Equity Sales and Mergers.** 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 either (a) the sale or other transfer, together with all other sales and transfers occurring since the PPP loan was approved, is of 50% or less of the common stock or other ownership interest of the PPP borrower; or (b) (i) the PPP borrower completes a forgiveness application reflecting its use of all of the PPP loan proceeds and submits it, together with any required supporting documentation, to the PPP lender, and (ii) an interest-bearing escrow account controlled by the PPP lender is established with funds equal to the outstanding balance of the PPP loan. Such escrow must be used first to repay any PPP loan principal and interest after the forgiveness process, including any appeals of SBA’s decision, is completed.

Note that where a PPP borrower relies on filing a forgiveness application and funding an escrow account to close without SBA consent, the forgiveness application must reflect the borrower’s use of all the PPP loan proceeds. It is unclear why a borrower must use all of the PPP loan proceeds when it is required to escrow the entire PPP loan amount and would still be required to repay any unforgiven portion. However, absent SBA guidance to the contrary, any PPP borrower relying on this portion of the Notice to close without prior SBA consent should be sure that its forgiveness application reflects use of all the PPP loan proceeds.

3. **Certain Asset Sales.** A PPP borrower may sell 50 percent or more of its assets (measured by fair market value) without the prior approval of SBA only if both (a) the PPP borrower completes a forgiveness application reflecting its use of all of the PPP loan proceeds and submits it, together with any required supporting documentation, to the PPP lender, and (b) an interest-bearing escrow account controlled by the PPP lender is established with funds equal to the outstanding balance of the PPP loan. As with an escrow for an equity sale or merger, such escrow must be used first to repay any PPP loan principal and interest after the forgiveness process, including any appeals of SBA’s decision, is completed.

As with PPP borrowers relying on forgiveness applications and escrows to close without prior SBA consent, any PPP borrower relying on this portion of the Notice to close without prior SBA consent should be sure that its forgiveness application reflects use of all of the PPP loan proceeds.

- ***SBA Consent Required.*** If a change of ownership of a PPP borrower does not fall within one of the three categories above, prior SBA approval of the change of ownership is required and the PPP lender may not unilaterally approve the change of ownership. SBA will provide a determination within 60 calendar days of receipt of a complete request that must include the following information:
 1. the reason that the PPP borrower cannot pay off the existing PPP loan or escrow funds as required to qualify as an excluded transaction in paragraph 3(a) above;
 2. the details of the change of ownership 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;
 6. a list of all owners of 20 percent or more of the purchasing entity; and

7. if deemed appropriate, SBA may require additional risk mitigation measures as a condition of its approval of the change-of-ownership transaction.

Failure to Obtain SBA Consent. The Notice does not specify what would be the penalty for failure to comply with the notice requirement or failure to obtain a required SBA consent for a change of ownership. Failure to comply with the Notice could constitute an event of default under the PPP loan documentation for any individual PPP borrower. In addition, SBA may refuse to grant forgiveness where a PPP borrower fails to obtain a consent required by the Notice. The Notice also does not specify whether it will be given retroactive effect, but SBA's general practice has been to apply PPP-related guidance only on a go-forward basis.

Other Conditions. Regardless of whether SBA approval is required for an equity sale or merger of a PPP borrower, that PPP borrower (and its successor by merger) remain subject to all requirements of the PPP loan. If any of the new owners or the successor by merger resulting from such change of ownership has its own PPP loan, then each PPP borrower must segregate and delineate its PPP funds and expenses and provide documentation to show compliance with PPP requirements.

For additional information regarding any of the above, please contact [Alan Roth](#), [Christopher Douglass](#), or your Winston & Strawn relationship attorney.

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