



PPP Borrowers and Mergers & Acquisitions – New Requirements and Clarity from the SBA

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The Small Business Administration (SBA) issued [guidance](#) on October 2, 2020 on when SBA approval is necessary for a change of ownership involving a Paycheck Protection Program (PPP) borrower. Sellers with PPP loans and buyers of targets with PPP loans should refer to this new guidance before structuring any merger and acquisition activity.

For purposes of the PPP, a “change of ownership” means:

- The sale or transfer of at least 20% of the common stock or other ownership interest of a PPP borrower (in one or more transactions to one or more persons for private companies,^[1] with all sales and transfers since the date the PPP loan was approved being aggregated);
- The merger of a PPP borrower with or into another entity; or
- The sale or transfer of at least 50% of the assets (measured by fair market value) of a PPP borrower.

The guidance sets forth different procedures depending on whether the PPP loan has been paid in full (by forgiveness or otherwise) prior to the closing of the change of ownership transaction.

If the PPP loan is fully satisfied:

There are no restrictions or special steps to take with respect to a change in ownership if (1) the PPP has been paid in full or (2) the borrower has completed the forgiveness process and the SBA has remitted the full amount of the PPP loan or any partial amount of the PPP loan, and the borrower paid the remaining balance. If you are considering timing your closing to take advantage of the forgiveness process being completed, remember that the PPP lender has 60 days to review a forgiveness application and the SBA has an additional 90 days to review the application, if the file is not being audited. We understand the SBA started to issue forgiveness

determinations in the first days of October.

The PPP loan is not fully satisfied:

If the PPP loan is not fully satisfied prior to closing, there are two possible courses of action:

Changes of ownership where the PPP lender can unilaterally approve (SBA prior approval is not required)	• Structured as a <u>sale/transfer of 50% or less of the common stock</u> or other ownership interest of the PPP borrower (again aggregating all sales/transfers since the approval date of the PPP loan).
	• Structured as a <u>sale/transfer of greater than 50% of the common stock</u> or other ownership interest of the PPP borrower and: • the PPP borrower completes a forgiveness application reflecting its use of all the PPP loan proceeds, AND • the outstanding balance of the PPP loan is escrowed in an interest-bearing account controlled by the PPP lender.

- Structured as a **merger** and:
 - the PPP borrower completes a forgiveness application reflecting its use of all the PPP loan proceeds,
AND
 - the outstanding balance of the PPP loan is escrowed in an interest-bearing account controlled by the PPP lender.

- Structured as an asset sale of 50% or more of the assets (measured by the fair market value) of the PPP borrower and:
 - the PPP borrower completes a forgiveness application reflecting its use of all the PPP loan proceeds, **AND**
 - the outstanding balance of the PPP loan is escrowed in an interest-bearing account controlled by the PPP lender; **AND**

Changes of ownership where SBA prior approval is required (PPP lender cannot unilaterally approve)	Any change of ownership not meeting the above conditions. To obtain the SBA's prior approval, the following must be submitted to the SBA by the PPP lender: • the reason the PPP borrower cannot fully satisfy the PPP loan prior to closing or escrow the funds as described above; • details of the requested transaction; • copy of the PPP promissory note; • any letter of intent and the purchase agreement setting forth the responsibilities of the parties (including those of the seller if the seller is not the PPP borrower); • disclosure of whether the buyer has a PPP loan; and • a list of all 20% or greater owners of the buyer. Conditions: • The SBA may require risk mitigation measures as a condition of approval. • SBA approval of any asset sale involving 50% or more of the assets (measured by fair market value) will be conditioned on the purchaser assuming all the PPP borrower's obligations under the PPP loan. The purchase agreement must include appropriate language in this regard. NOTE: The SBA indicates it will review and decide within 60 calendar days of receipt of a complete request.
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With respect to the establishment of an escrow account for the outstanding PPP loan balance, the escrowed funds can only be paid out after the completion of the forgiveness process, including any appeals, and must first be disbursed to pay any remaining PPP loan balance plus interest. The new guidance makes clear that the escrow account only needs to be controlled by the PPP lender, and not necessarily held at the PPP lender as may have been indicated in prior informal communications from the SBA.

Requirements for all changes of ownership by merger or sale/transfer of common stock or other ownership interests

The following requirements apply to all changes of ownership involving a merger or sale/transfer of common stock or other ownership interests, regardless of whether SBA approval is required:

- The PPP borrower (and the successor by merger of any PPP borrower) remains subject to all PPP loan obligations.
- The SBA will have recourse against the new owners if they use PPP funds for unauthorized purposes.
- If the new owners in a sale/transfer of common stock or other ownership interests has a separate PPP loan, the PPP borrower and the new owners must segregate and delineate PPP funds and expenses to demonstrate compliance by each PPP borrower. In the case of a merger with a successor with a separate PPP loan, the successor must similarly segregate and delineate PPP funds and expenses to demonstrate compliance for both loans. In other words, PPP loans are not to be combined for purposes of authorized uses or forgiveness.
- The PPP lender must provide the SBA specific information concerning the new owners of the common stock or other ownership interest in addition to the location of any escrow account if applicable within five business days of completion of the transaction.

Considerations when entering into merger and acquisitions activity involving a PPP borrower

Our SBA Lending Team is advising borrowers and lenders on merger and acquisition transactions to comply with the new guidance and the PPP loan documents. Below are some considerations for PPP borrowers and PPP lenders involved in a change of ownership transaction.

- Unless the PPP loan will be satisfied in full before the closing of the transaction, the PPP lender is expected to be engaged in any of the change of ownership scenarios under the guidance. 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 purchase agreements or other documents relating to the proposed transaction before the closing even if the PPP Loan has been satisfied in full. Notice is required even if the PPP loan documentation does not expressly require PPP lender consent in these transactions. The guidance is silent as to whether PPP lenders are required to review the proposed purchase agreements other than to provide the requested information in a change of ownership requiring SBA approval.
- If you have an agreement for a change of ownership transaction that has not yet closed, consider reviewing the agreement for any required changes, particularly with respect to the required assumption of the PPP obligations for any asset deals involving 50% or more of the assets of a PPP borrower if the PPP loan amount is not being escrowed. If less than all of a PPP borrower's assets are being sold parties may want to make sure they reach an agreement on how they are calculating fair market value and what percentage of assets are being sold compared to the PPP borrower's total assets.
- If the transaction has closed and an escrow was established or there was a holdback, consider if any modifications to the escrow or holdback are appropriate to comply with the specific escrow requirements to avoid obtaining SBA consent. It seems unlikely the SBA will apply the new requirements to changes of ownership transactions that already closed. However, the guidance is silent as to the impact of not following the guidance and whether or not

following the guidance impacts loan forgiveness or the SBA guaranty.

Not every consideration is listed above so it is important to engage legal counsel as early in the process as possible to comply with the SBA guidance.

For more information, contact [Shannon Kuhl](#) or any attorney on Frost Brown Todd's [Financial Services](#) industry team.

[\[1\]](#) For publicly traded borrowers, only sales or other transfers that result in one person or entity holding or owning at least 20% of the common stock or other ownership interest of the borrower must be aggregated.

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