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PPP Loans and M&A Transactions: Considerations for Lenders and Buyers

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Hinshaw Alert

Paycheck Protection Plan (PPP) loans are Small Business Administration (SBA) Section 7(a) loans. Consequently, they are subject to the same regulatory guidelines that generally apply to Section 7(a) loans.

Lender Considerations

These regulatory guidelines include several provisions directing lenders to obtain consent from the SBA before allowing a borrower to perform certain activities.

Notably, one guideline requires a lender to secure the SBA's permission before approving a change of ownership of a borrower that occurs within 12 months of the final disbursement of the Section 7(a) loan, including PPP loans. This guideline applies to a change of ownership, but it does not specify any minimum threshold that would trigger a change of ownership.

One would not expect that an asset sale would fall within the purview of this guideline as the selling company continues in existence following an asset sale. Thus, no change of ownership of the selling company would have occurred.

The SBA regulations do not expressly address asset acquisitions. However, the SBA has recently been informing PPP lenders that the agency does not distinguish between an asset acquisition and a change of ownership. Consequently, the SBA has been advising PPP lenders that they must obtain consent prior to approving an asset sale, merger, or equity acquisition (Business Combination).

The obligation to obtain SBA consent for a Business Combination involving a PPP borrower falls on the PPP lender. Failure to obtain such consent can result in the lender losing the SBA guaranty covering the PPP loan.

The SBA's form PPP promissory note contains certain restrictions regarding changes in the business and ownership that cannot be made without the lender's consent (the specific default language concerns transactions where a borrower "reorganizes, merges, consolidates, or otherwise changes ownership or business structure without Lender's prior written consent"). This language clearly obligates a PPP borrower to secure the lender's consent before proceeding with a Business Combination.

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Where a PPP lender uses its own note form, the note may be silent on the question of whether a Business Combination must be approved by the lender. To the extent that the note does not require lender consent for a Business Combination, the lender should consider advising its PPP borrowers that the lender must secure SBA consent before a borrower can complete a Business Combination.

PPP Borrower Considerations

As for PPP borrowers, the failure to obtain their PPP lender's consent to a Business Combination or the failure of the lender to secure SBA approval of a Business Combination could result in the denial of PPP loan forgiveness. It may also result in a demand for immediate repayment of the PPP loan.

Buyer Considerations – Due Diligence

When conducting due diligence of a PPP borrower, a buyer should review several items, including whether:

- the borrower needed the loan funds. The SBA has a needs certification requirement which requires the borrower to certify that the loan was necessary to support its ongoing operations. The buyer should review the target's records at the time the loan was made to satisfy itself that the target can satisfy the certification test;
- the target was eligible to receive the loan. The SBA rules require that a borrower must be eligible under the SBA rules to receive a PPP loan. These rules include affiliation tests that should be reviewed;
- the amount of the loan proceeds was proper. The buyer should review the documentation prepared by the target to support the amount of the PPP loan.
- the target complied with all of the PPP program rules; and
- the target spent the PPP loan proceeds on expenses that can be forgiven under the program. The buyer should review the records with respect to the expenses that are to be forgiven to make sure they qualify for forgiveness.

Buyer Considerations – Definitive Agreement

When negotiating a definitive agreement, a buyer should address a number of issues, including the impact that the PPP loan and loan forgiveness could have on the purchase price and taxes.

The definitive agreement should also contain additional representations related to the PPP loan, including that the target:

- was eligible to receive the loan;
- met the need certification requirements;
- complied with the PPP program rules; and
- spent the PPP loan funds on expenses that could be forgiven under the program.

The definitive agreement should also include covenants requiring the target, for example, to comply with PPP rules and to spend loan proceeds on forgivable expenses.

Finally, the agreement should include indemnification provisions designed to address the PPP post-closing issues, as well as breaches of PPP representations and covenants.

Buyer Considerations – Consents

A buyer targeting a PPP borrower should review and ensure compliance with the consent rules discussed above.

It can take anywhere from two to six weeks to secure the SBA's approval of a Business Combination. Furthermore, SBA consent is not necessarily guaranteed. And, if given, a consent may contain restrictions on future operations that might cause a buyer to terminate a deal.

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In any event, if PPP lender or SBA consent will be difficult to obtain—or if SBA consent could be delayed—the buyer should consider delaying the closing in order that forgiveness may be obtained prior to closing. However, if the buyer wishes to proceed with the closing without forgiveness being obtained, consideration should be given to setting up an escrow so that the funds will be released upon forgiveness.

It can take up to five months to secure forgiveness. The SBA has up to 90 days to approve a loan forgiveness application (subject to any additional time if the SBA elects to review an application). This period is in addition to the 60 days that a PPP lender has to approve the forgiveness application prior to submitting it to the SBA.

Even if a PPP loan has been fully forgiven prior to or after the consummation of a Business Combination, the SBA retains the right to review the underlying PPP loan for eligibility issues. In addition, the SBA and the U.S. Department of the Treasury have stated that all PPP loans in excess of $2 million will be reviewed. With that in mind, the buyer should ensure that the post-closing indemnification obligations of the target also apply to the PPP loan.

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