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# PPP in M&A: How Paycheck Protection Program Loans Could Affect Your Deal

Christopher J. Pippett, *Partner*

Matthew R. Kittay, *Partner*

Madison S. Clemens, *Associate*

Jamie Wilkerson, CPA, CGMA, *VP Finance, Velocity Clinical Research*

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# Dealing With PPP Loans in M&A Transactions

- New guidance from the Small Business Administration (SBA) sheds light on questions that arise in the context of M&A transactions **where one of the companies has a potentially forgivable loan through the Paycheck Protection Program (PPP)**
- Parties must be prepared for increased scrutiny during due diligence, transaction timeline delays and certain valuation implications



# SBA Loan Servicing Guidelines

- Under its longstanding Loan Servicing Guidelines, the SBA must be notified of a change in a borrower's legal structure if it results in a **change to EIN or SSN of any obligor**
- The Guidelines further provide that lenders may not unilaterally approve any adjustment to or change in the ownership of a borrower, **including a change in percentage of ownership, for 12 months after final disbursement on any loan**



# Procedural Notice 5000-20057

- In a Procedural Notice issued on October 2, 2020, the SBA clarified what constitutes a “**change of ownership**” of a PPP borrower and when (and if) SBA approval is needed in connection with the same
- A “change of ownership” takes place when any of the following occurs:
  - The PPP borrower sells or otherwise transfers **at least 50% of its assets** (measured by fair market value), whether in one or more transactions
  - A PPP borrower is **merged** with or into another entity
  - **At least 20% 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
- Note that in the final scenario, all sales and other transfers occurring since the PPP loan approval must be aggregated to determine if this 20% threshold has been met



# Procedural Notice 5000-20057

- The Procedural Notice outlines situations in which the SBA's prior approval is needed (and not needed) in conjunction with a change of ownership of a PPP borrower
- The situations are conditioned on the specific circumstances of the change of ownership



# The PPP Note is Fully Satisfied

There are no restrictions on a change of ownership if, prior to closing the sale or transfer, the PPP borrower has:

1. Repaid the PPP note in full
2. Completed the loan forgiveness process in accordance with the PPP requirements and:
  - SBA has remitted funds to the PPP Lender in full satisfaction of the PPP Note
  - The PPP borrower has repaid any remaining balance on the PPP loan



# PPP Note Is Not Fully Satisfied and SBA Approval Is Not Required

- **(i) Change of ownership is structured as a sale or other transfer of common stock or other ownership interest or as a merger**
- 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:
  - The sale or other transfer is of **50% or less of the common stock or other ownership interest** of the PPP borrower
  - The PPP borrower completes a forgiveness application (together with required supporting documentation), to the PPP Lender, **and an interest-bearing escrow account controlled by the PPP Lender is established with funds equal to the outstanding balance of the PPP loan**. After the forgiveness process (including any appeal of SBA's decision) is completed, the escrow funds must be disbursed first to repay any remaining PPP loan balance plus interest



# PPP Note Is Not Fully Satisfied and SBA Approval Is Not Required

- **(ii) Change of ownership is structured as an asset sale**
- A PPP borrower may sell **50% or more of its assets** (measured by fair market value) without the prior approval of SBA only if the PPP borrower completes a forgiveness application (together with required supporting documentation), to the PPP Lender, **and an interest-bearing escrow account controlled by the PPP Lender is established with funds equal to the outstanding balance of the PPP loan**
- After the forgiveness process (including any appeal of SBA's decision) is completed, the escrow funds must be disbursed first to repay any remaining PPP loan balance plus interest



# SBA Prior Approval Procedure

- If a change of ownership of a PPP borrower does not meet the aforementioned conditions, **prior SBA approval of the change of ownership is required and the PPP Lender may not unilaterally approve the change of ownership**
- To obtain prior approval of the SBA, lenders must submit a request to the appropriate Loan Servicing Center that includes:
  - The reason that the PPP borrower cannot fully satisfy the PPP Note
  - The details of the requested transaction
  - A copy of the executed PPP Note
  - 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
  - Disclosure of whether the buyer has an existing PPP loan and, if so, the SBA loan number
  - A list of all owners of 20% or more of the purchasing entity
- The SBA will review and provide a determination **within 60 calendar days** of receipt of a complete request



# PPP Borrower Liability

- Regardless of any change of ownership, the PPP borrower remains responsible for:
  - Performance of all obligations under the PPP loan
  - The certifications made in connection with the PPP loan application, including the certification of economic necessity
  - Compliance with all other applicable PPP requirements
- Additionally, the PPP borrower remains responsible for obtaining, preparing, and retaining all required PPP forms and supporting documentation and providing those forms and supporting documentation to the PPP lender or to SBA upon request
- Note that if the new owner(s) use PPP funds for unauthorized purposes, the SBA will have recourse against the owner(s) for the unauthorized use



# Underlying PPP Loan Documents

- Some lenders are using their own form loan documents (different from the Section 7(a) SBA form loan documents) that do not address and/or provide less stringent change of control restrictions
- The Procedural Notice explicitly provides that, 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**



# Sale of Assets

- Previously, the SBA Loan Servicing Guidelines did not contain a reference to a sale of assets
- Buyers should be cognizant of compliance with the Procedural Notice as well as the underlying loan document, including any limitations on the use of PPP loan funds (e.g., permitted uses, certification of economic necessity, 60% payroll costs, etc.)
  - SBA approval of any change of ownership involving the sale of **50% or more** of the assets (measured by fair market value) of a PPP borrower will be conditioned on the purchasing entity assuming all of the PPP borrower's obligations under the PPP loan, including responsibility for compliance with the PPP loan terms
  - The purchaser must include appropriate language in the purchase or sale agreement regarding the assumption of the PPP borrower's obligations under the PPP loan



# Outstanding PPP Loans

- Should the PPP loan be repaid or assumed in connection with the closing?
- The answer is complicated by the fact that, absent such a transaction, PPP loans may be forgiven and even further complicated by the SBA's timeline in processing such forgiveness or approval of the change in ownership



# Outstanding PPP Loans

- Recent SBA guidance on PPP loan forgiveness references a **90-day period** for the SBA to approve and disburse the loan forgiveness amount (subject to additional time for further SBA review)
- This 90-day period is in addition to the **60-day period** a lender has to approve a forgiveness application prior to its submission to the SBA – thus collectively bringing the forgiveness turnaround time to a possible **150 days**, which may not include the time it takes for the SBA to approve the transaction (e.g., **60 additional days**)
- Buyers and sellers should take these periods into account when considering the timing for a transaction



# Key Takeaways

- Conduct thorough diligence on the nature of any change of control restrictions contained within the loan documents and consider any restrictions found therein are consistent with SBA change of ownership requirements
- Assess the borrower's compliance with the SBA requirements and the terms of the PPP loan (e.g., necessity certificate, use of proceeds, eligibility for funds received, etc.) and conduct heightened scrutiny as needed
- Consider the timeframe for prior approval from the lender and SBA in combination with the projected transaction timeline
- Consider how to treat the PPP loan (e.g., is forgiveness sought prior to closing, repayment, etc.) at the onset of proposed transaction
- Depending on how the PPP loan will be treated, consider supplementing the purchase agreement with more robust representations, warranties and covenants. In addition, consider what (if anything) must be included in the purchase agreement per various SBA requirements



# Thank you!

**Christopher J. Pippett**

610.458.6703

[cpippett@foxrothschild.com](mailto:cpippett@foxrothschild.com)

**Matthew R. Kittay**

212.878.7978

[mkittay@foxrothschild.com](mailto:mkittay@foxrothschild.com)

**Madison S. Clemens**

610.458.6180

[mclemens@foxrothschild.com](mailto:mclemens@foxrothschild.com)

**Jamie Wilkerson**

[jwilkerson@velocityclinical.com](mailto:jwilkerson@velocityclinical.com)



**Fox Rothschild** LLP  
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