

## Top 5 PPP Pitfalls in M&A

In March 2020, Congress passed the CARES act to provide much needed economic relief to individuals and businesses injured by the economic shutdown. For over 5.2 million US small businesses, this relief came in the form of the SBA's \$525 billion Paycheck Protection Program (PPP) which provided a critical lifeline to weather this challenging time. If not for this stimulus, many of these businesses would have been forced to close their doors and fire many (if not all) of their employees.

The necessity to deploy these funds rapidly to boost the economy combined with the intention that many of these loans, if used properly, would be forgiven, many conditions typical of business "loans" were not required. As examples, no fees were paid, no collateral or personal guarantees were required, and some documentation typically required to receive loan approvals was not used. But like all things, there were some strings attached.

In our world, one of the most significant of those strings comes into play when the company that received the PPP loan is involved in a sale. In a standard business sale, any loans on the business are typically paid off prior to or at the time of the closing. Since PPP funds are structured as loans but intended to be forgiven, selling a business that is carrying a PPP loan creates a unique set of challenges. Yet, the SBA has provided no direct guidance on how to handle the sale of a company with a PPP loan.

**Here are the most important challenges and how to address them when selling a business:**

### 1. Lender Consent to the Sale

The sale of a business, whether a stock sale or an asset sale, is deemed an event of default under the terms of a PPP loan. In every instance, Sellers can expect that they will need to obtain consent to the business sale from their lender. We advise that business owners and their advisors engage in dialogue with the lender early on. This will allow the lender time to obtain the necessary approvals so that the deal is not hindered.

### 2. Escrow and Indemnification

It is very likely that the lender and the buyer will require that a portion of the sale proceeds equal to the amount of the PPP loan balance be put in escrow until such time as (and to the extent that) the PPP loan is officially forgiven. Buyers will likely want broad indemnifications to protect them from any future liabilities that could arise from the PPP loan such as audit expenses, penalties, or alleged fraud.



### 3. Control Over the Forgiveness Process

After the sale, particularly if it is in the form of a stock sale, the Buyer may want to have some say in the loan forgiveness application process. On the other hand, the Seller will likely want to have full control of the process. It will be important for the Buyer and Seller to agree on who will have control over the loan forgiveness application process after the sale of the business.

### 4. Public Relations and Deal Announcements

The haste with which the PPP program was put into effect has resulted in controversy. The existence of high-profile borrowers (some of whom returned the loans), public pressure resulting in further disclosure of many of the PPP recipients, and cases of fraud have created something of a cloud over the PPP program. Although the PPP program stipulate that borrowers of less than \$2 million are not required to prove their absolute need to borrow under PPP, Buyers and Sellers, concerned over public perception, may prefer to keep the deal under wraps in the near term rather than risk public misconceptions over the need for the loan.

### 5. Round 2 of PPP?

While the first round of PPP loans closed on August 8, 2020 and the measurement period for the use of those funds has passed, Congress is currently contemplating a second round of PPP loans in the HEALS Act. If a business obtains a PPP loan under the HEALS Act, and the business is sold during the measurement period, control over the use of the PPP funds will be critical. How those funds are used during the measurement period can significantly impact the forgiveness amount. Therefore, Sellers will want to retain control over spending until the end of the measurement.

The issues identified here are based on our experience in working with multiple sellers, conversations with top transactional attorneys, CPAs and other Investment Bankers, and our own research. These are but a few of the pitfalls that owners will face in the sale of their business. None of these challenges are deal breakers, but it is critical that business owners with a PPP loan who are exploring the sale of their business, avoid critical missteps. Additionally, with the SBA continually adjusting the rules and issuing updated guidance on the procedures for PPP loan forgiveness, there is an ever-changing landscape to navigate. We would be happy to have a conversation about these topics or any other issues that you might have.

Let's talk.

