

PPP Loans and M&A Transactions: Lender and Borrower Considerations

by Kenneth Logsdon and Cort Hoge

The Paycheck Protection Program (PPP) created under the CARES Act has provided much needed assistance to millions of businesses and other organizations operating in the United States that have been impacted by the COVID-19 pandemic. This program, however, continues to be fraught with snares for the unwary and the mergers and acquisitions space is no exception.

It is important to highlight that PPP loans are included among what are known as Small Business Administration (SBA) “7(a) loans” and are therefore subject to the same regulatory guidelines that apply to 7(a) loans generally. Among such guidelines are situations when a lender must obtain SBA consent before a borrower is permitted to perform or allow certain activities. One such activity is permitting a “change of ownership” (with no threshold specified) of a borrower within 12 months of the final disbursement of a 7(a) loan, including PPP loans. This has obvious implications for PPP borrowers that are the target of a merger or an equity acquisition. Nevertheless, and though the SBA regulations do not expressly address asset acquisitions, the SBA has recently been informing PPP lenders that the SBA does not distinguish between an asset acquisition and a “change of ownership” and therefore will expect PPP lenders to obtain SBA consent prior to approving any such transaction. It is important to note that the requirement to obtain SBA consent for an acquisition of a PPP borrower is the *PPP lender’s* obligation and failure to obtain consent can result in such lender losing the SBA guaranty backing the applicable PPP loan. As a result, the only way for a PPP lender to be sure it can control the process is to require a PPP borrower to obtain such lender’s consent before a merger or an acquisition of such borrower is effectuated. To that end, the SBA form PPP loan promissory note contains certain restrictions regarding changes in the business and ownership without lender consent (the specific default language are cases where a borrower “reorganizes, merges, consolidates, or otherwise changes ownership or business structure without Lender’s prior written consent”). That said, PPP lenders were not required to use such form and were expressly permitted to use their own form instrument. In cases where a PPP lender opted to use its own form it is possible that such lender’s PPP loan promissory note is silent on the question of “change

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of ownership” of borrower or other similar restriction. If so, there is nothing under SBA regulations or guidance preventing a PPP borrower from allowing a change of control without PPP lender consent and the consequences for a PPP lender with such a form promissory note remain unclear. In light of the above, PPP lenders should review their respective form PPP loan promissory note to confirm whether or not there are any prohibitions contained therein that would require the consent of the lender prior to a “change of ownership” of the borrower. To the extent a PPP lender’s form promissory note does not require lender consent for a “change of ownership”, it may be prudent for such lender to contact the SBA for further guidance on how such lender can best protect itself.

As for PPP borrowers, failure to obtain its PPP lender’s consent to a merger or an acquisition when it is the target and required to do so under the terms of a PPP loan promissory note could result in the denial of PPP loan forgiveness and may result in immediate repayment of the PPP loan. As discussed above, a PPP borrower in such a situation will need not only its PPP lender’s consent, but approval from the SBA as well. As for timing, a PPP borrower should expect anywhere from 2 to 6 weeks following the PPP lender’s request to the SBA for approval of a merger or an acquisition of the borrower and consent by the SBA is not necessarily guaranteed.

In any event, if PPP lender consent proves impractical or will be difficult to obtain (or if SBA consent could be delayed), it may be preferable to delay the transaction timeline in order for forgiveness to be obtained prior to closing. Even in cases in which consent isn’t required under the applicable PPP loan promissory note, it may be prudent to allow for the borrower to submit the forgiveness application prior to closing (which could be at the end of the 8 week or 24 week period commencing when the PPP loan was funded) and setup an escrow with the expectation that the funds be released upon forgiveness. As for timing around PPP loan 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) and such period is in addition to the 60-day period a PPP lender has to approve the forgiveness application prior to submitting to the SBA. Lastly, even if a PPP loan has been fully forgiven prior to consummation of a merger or an acquisition of a PPP borrower, the SBA retains the right to review the underlying PPP loan for eligibility issues. With the above in mind, PPP borrowers should review their PPP loan promissory note to confirm whether or not there are any prohibitions contained therein that would require the consent of the lender prior to the consummation of a merger or an acquisition of the borrower and work with their PPP lender in cases where consent is required.