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CARES ACT: NAVIGATING PAYCHECK PROTECTION PROGRAM LOANS IN M&A TRANSACTIONS

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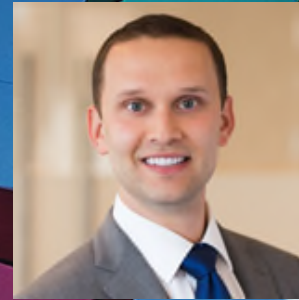
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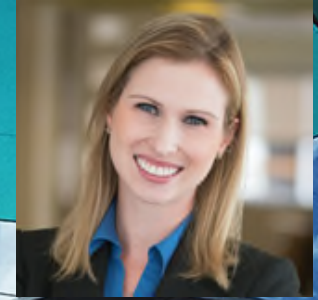
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A low-angle, upward-looking photograph of numerous colorful umbrellas against a bright blue sky with scattered white clouds. The umbrellas are in various colors including green, teal, purple, blue, and black. The perspective makes the umbrellas appear to be reaching towards the center of the frame, creating a sense of depth and upward movement.

EFFECT OF M&A TRANSACTIONS ON PPP ELIGIBILITY

Overview of Certain Eligibility Requirements

PPP eligibility based on size

- Is the business a “small business” concern within the size standard for its primary industry pursuant to 12 C.F.R. 121.301(a)?
OR
- Does the business, together with its affiliates, have no more than 500 employees (or higher for certain industries)?

Necessity certification

- “The uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient”

“Size” Eligibility Issues in an M&A Transaction

- Does the affiliation between the applicant and the buyer result in the applicant exceeding the threshold it is relying upon under SBA affiliation rules?
 - Analysis is as of the time of the application being accepted for processing by the SBA (but consider “present effect”)
- If the transaction has not yet occurred by the time of the application, consider:
 - Will the transaction be given present effect?
 - Is there another relationship between the buyer and the applicant (e.g., minority ownership and control rights)?

“Present Effect” Rule

- Under certain circumstances an acquisition agreement (including an agreement in principle) is given present effect in determining whether the buyer has power to control a target company

Likely to be given present effect as “agreements in principle”:

- Agreements that include a specific price and other definite terms;
- Proposals signed by the relevant parties that are only subject to confirmatory due diligence; and
- Offers that include exclusivity restrictions that are acknowledged and agreed to by the selling parties.

Not likely to be given present effect as “agreements in principle”:

- Mere agreements to negotiate or to continue negotiating;
- Agreements that are impossible or unlikely, speculative, or based upon material assumptions;
- Non-binding, tentative proposals that contain clear language as to the parties’ ability to withdraw from the transaction;
- No definitive price (or a mere range of price points);
- Offers that are subject to numerous conditions, including extensive financial and legal due diligence; and
- Unilateral indications of interests that have not been accepted by the other party.

Overview of Necessity Certification

- “The uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient”
- Need to consider ability to access other sources of liquidity sufficient “in a manner that is not significantly detrimental to the business”
- PPP borrowers with loans under \$2 million deemed to have made the necessity certification in good faith
- Timing considerations

Necessity Considerations for Borrowers/Sellers

- Is a transaction imminent, and will that transaction enhance the liquidity position of the applicant?
 - For example, does the transaction expressly contemplate an injection of working capital onto the applicant's balance sheet?
- How is the applicant's cash being used?
 - For example, are cash sale bonuses being diverted toward company executives?

Necessity Considerations for Buyers

- How will the deal affect the target's necessity certification both before and after the closing?
- Will the target have direct access to the capital of the buyer group or to other sources of liquidity as a result of the deal?
- Consider deal timeline and effect on necessity
 - Based on current guidance there does not appear to be a legal basis for the necessity certification made at the time of application to be re-evaluated to account for M&A activity arising after the date of the original certification (or brought down at the time of forgiveness, if any)
- If an applicant for a PPP loan is active in M&A, consider ability to make necessity certification if available liquidity is used for M&A activity

A low-angle shot of many colorful umbrellas against a blue sky with white clouds. The umbrellas are in various colors including teal, purple, green, and black. The text is overlaid on the left side of the image.

NEGOTIATING THE DEAL – TREATMENT OF OUTSTANDING PPP LOAN BALANCES AND REPAYMENT

To Repay or Not to Repay?

Parties must determine whether to repay or not repay a PPP loan at the closing of transaction



What are the terms of the loan?

Is lender consent required?

Is SBA consent required?

Timing considerations?

Consent Requirements

Is lender consent required?

- SBA's form Section 7(a) note requires lender consent if borrower "[r]eorganizes, merges, consolidates, or otherwise changes ownership or business structure"
- Lender may use own form with different consent provisions

Is SBA consent required?

- Change in ownership of borrower in first 12 months after final disbursement
- Sales of assets

Borrower/Seller Perspective

- Should the PPP loan be treated as indebtedness?
 - In a debt-free transaction, indebtedness typically reduces the purchase price
 - Borrower/seller may argue that PPP loan should not reduce purchase price given potential forgiveness
- When to seek forgiveness?
 - Prior to transaction ensures borrower/seller benefits from forgiveness but may jeopardize timing
 - Buyer may seek to repay PPP loan at closing and forgo benefits of forgiveness

Buyer Perspective

Benefits of Repayment

- Ensure target company is acquired on a debt-free basis
- Avoid optics and potential scrutiny associated with acquiring a PPP borrower
- Avoid potential headaches of seeking forgiveness

Costs of Repayment

- Lose favorable terms of PPP loan (low interest, grace period for payments, unsecured)
- Lose potential benefits of forgiveness

Buyer Perspective

- What is the timeline for forgiveness?
 - 60-day period for PPP lender to approve forgiveness application
 - 90-day period for SBA to approve and disburse loan forgiveness amount
- Does PPP loan conflict with existing credit facilities or other agreements?

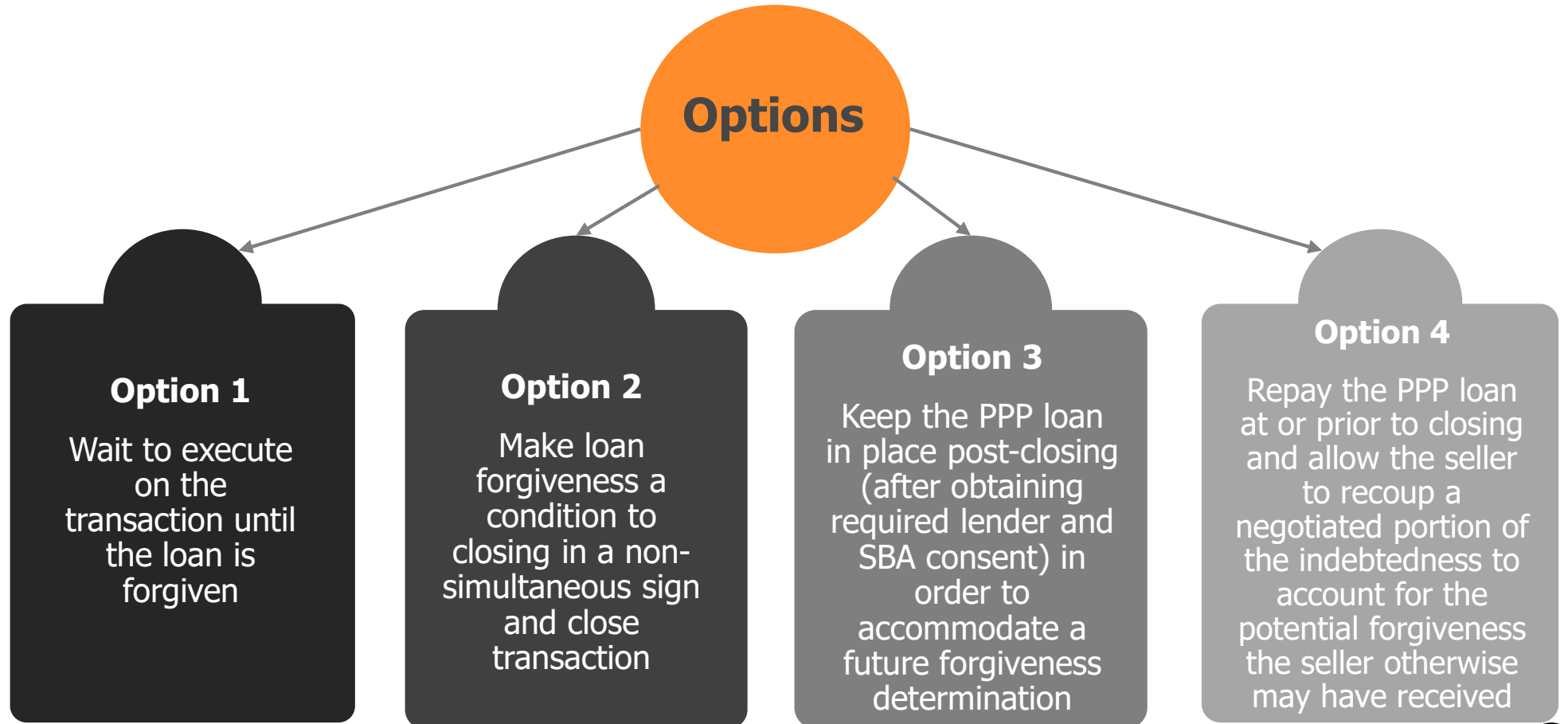
Lender Perspective

- Mixed market practice regarding requiring repayment
- Requiring repayment allows lender to redeploy capital on more market terms and avoid uncertainty regarding PPP loans and forgiveness
- Consenting to M&A transaction may lead to more creditworthy borrower and preserve relationship with borrower

TRANSACTION STRUCTURING AND PPP FORGIVENESS



4 Options for Handling PPP Forgiveness



Illustrative Timeline – Option 3

April 1: PPP application for \$1,000,000

April 15: PPP loan funded

8-week forgiveness period

June 1: Borrower signs LOI to be acquired

- Borrower applies for forgiveness amount (\$800,000)

July 15

- Signing and closing of definitive acquisition agreement promptly following filing of forgiveness application

December 12: Outside date for forgiveness determination (assuming no SBA review)

Illustrative Timeline – Option 3

April 1: PPP application for \$1,000,000

June 1: Borrower signs LOI to be acquired

September 30: Borrower applies for forgiveness amount (\$800,000)

April 15: PPP loan funded

24-week forgiveness period

July 15: Signing and closing of definitive acquisition agreement promptly following filing of forgiveness application

February 27, 2021: Outside date for forgiveness determination (assuming no SBA review)

Treatment of Forgiveness Amount

Baseline: PPP Loan Balance will be treated as indebtedness.

Buyer Covenant to Remit Forgiveness: Buyer agrees to pay to seller the forgiveness amount if and when the borrower receives a favorable forgiveness determination.

Escrow Forgiveness Amount: Buyer places the maximum potential forgiveness amount in a third party escrow account to be released to seller if and when the borrower receives a favorable forgiveness determination.

Credit for Forgiveness at Close and Adjust Post-Closing: Buyer gives seller credit for the expected forgiveness benefit, potentially discounted for the risk of denial and/or tax adjustments. If and when the PPP loan is forgiven, such amount is paid to Buyer. Acquisition agreement provides for post-closing adjustment to true-up the forgiveness benefit if the maximum forgiveness amount is not approved.

Pro-Buyer

Pro-Seller

Considerations in Asset Sales

- Is lender consent required under the terms of the PPP note?
- Have the PPP loan proceeds already been utilized?
 - If PPP loan proceeds are utilized prior to the asset sale, the seller/borrower's eligibility for forgiveness should not be impacted.
 - If a borrower has not utilized all of the PPP loan proceeds and sells substantially all of its assets and transfers its employees, it is unlikely that the borrower will be able to utilize the loan proceeds for permitted uses following the asset sale.

Effect of PPP Loans on Net Working Capital

- Buyers should consider the effect of any PPP loan proceeds on working capital balances
- Highly deal- and fact- specific
- Buyer-favorable approach: Target net working capital to reference a “pre-COVID-19” level and exclude the PPP proceeds from current assets
- Seller-favorable approach: Target net working capital to refer to trailing 12 months (including effects of COVID-19) and include PPP loan proceeds

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DUE DILIGENCE, RISK IDENTIFICATION AND RISK MITIGATION

Areas of Diligence and/or Additional Representations

- Concerns apply whether or not loan is being repaid at closing
- Was the borrower eligible?
- Was the loan amount properly calculated?
- Has the loan been properly administered since its issuance?
- Have any directors, officers, or other employees have been debarred or otherwise prohibited from engaging in any government contracting activities?
- Bolstering “Compliance with Laws” representations and any representations pertaining to Indebtedness

NOTE: All under backdrop of potential False Claims Act enforcement (criminal penalties for false statements and/or civil liabilities such as treble damages)

Recourse

- Treatment of PPP related reps and/or “Compliance with Laws” rep as fundamental (e.g. extended survival, “first dollar” recovery, no cap).
- Consider specific indemnity related to PPP non-compliance (particularly where issues have been found)
- Consider specific indemnity in respect of forgivable amount (depending on whether buyer has “paid” for the value thereof)
- Definition of “Losses”
- Note: R&W Insurers likely to seek exclusions related to PPP liabilities

Covenants

- Covenants related to “forgiveness” element
 - Binding seller during interim period **or** binding buyer post-closing if seller remains “on the hook” for the forgiveness amount (via indemnity or escrowed sale proceeds)
- Control of Audits / Cooperation
 - Six-year audit period for PPP loans – all loans in excess of \$2mm will be audited

FINANCING CONSIDERATIONS AND LENDER INSIGHTS



Financing Considerations

- Impact of PPP loan on buyer's existing credit facilities
 - Consent of buyer's other lenders may be required for both M&A transaction and assumption of PPP loan
 - Buyer's other lenders may prefer for PPP loan to be repaid to avoid time and costs
 - If PPP loan remains outstanding, PPP lender and buyer's other lenders may need to coordinate and enter into an intercreditor agreement
- PPP-specific representations in financing arrangements for M&A transactions

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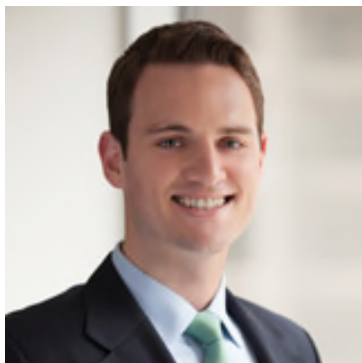
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Andrew Budreika is a Partner in the Finance practice. He advises clients on private equity transactions, domestic and cross-border public and private mergers and acquisitions, debt financings, strategic investments, and other corporate transactions. Andrew also regularly counsels clients on securities law, corporate governance, and other general corporate and finance matters.

Consistent with Morgan Lewis's core principles, Andrew is committed to providing exceptional client service and building long-term strategic relationships with clients focused on communication and collaboration. Andrew seeks first to listen and understand a client's goals and the business context and then to provide insightful, creative, and tailored solutions that enable the client to achieve those goals within the client's defined parameters for success. Andrew endeavors to bring together Morgan Lewis's intellectual and global talent and resources to construct elite legal teams that deliver the best overall results and experience to clients.

Andrew is also passionate about using technology, knowledge management, legal project management, and other innovations in legal practice to provide fast, reliable, and consistent service in a cost-effective and efficient manner.

Andrew has practical experience handling a full spectrum of transactions including buyouts; platform acquisitions; exit transactions; mergers; add-ons and roll-ups; carve-outs and spin-offs; leveraged recapitalizations; and management rollovers and equity incentive structures. He also regularly works on matters involving growth equity, minority, and strategic investments; co-investments; corporate restructurings and reorganizations; and founder liquidity transactions. Additionally, Andrew advises on acquisition financings; syndicated bank loans; investment grade and high-yield bond offerings; asset-based loans; mortgage loan warehousing and repurchase facilities; and capital call lending transactions.

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Jacquelynne Hamilton is part of a team that focuses on diverse transactions, including mergers and acquisitions, joint ventures, spin-offs, and strategic alliances. Other areas of work include matters involving finance, restructuring, tax, and securities, including public and private equity and debt offerings. Clients range from Fortune 500 companies and investment banks to emerging market companies. While attending law school, Jacquelynne participated in the Entrepreneurship Legal Clinic and served on the board of Lambda Law.

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Mehar Jagota focuses his practice on mergers and acquisitions, private equity, venture capital, securities, and general corporate matters. He primarily advises buyers, sellers and investors on acquisitions, dispositions, restructurings, joint ventures, and other types of transactions. Before joining Morgan Lewis, Mehar worked for a large, international law firm in New York, where he focused on mergers and acquisitions, financial institutions, and general corporate matters.

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Andrew Rocks focuses his practice on public and private mergers and acquisitions (including private equity transactions, joint ventures, spin-offs, and strategic alliances) and general corporate and securities law matters (including public and private equity and debt offerings). Prior to joining Morgan Lewis, Andrew was an associate in the New York office of another major international law firm.

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Benjamin Stango is an Associate in the Corporate Business Transactions practice. He works with a team to counsel clients in business law matters, including mergers and acquisitions, joint ventures, financings, restructurings, and compliance with securities laws. He advises clients ranging from emerging and high-growth businesses to Fortune 500 companies. Ben also has experience in government, nonprofits, and political campaigns. With an M.B.A. from The Wharton School, Ben brings a unique perspective on business, law, and government to serve his clients' needs.

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Lauren Galbraith focuses her practice on a broad range of corporate and transactional matters, including public and private securities offerings, mergers and acquisitions, corporate governance, and financial services regulatory matters. Prior to joining Morgan Lewis, Lauren was an associate in the New York office of another major international law firm.

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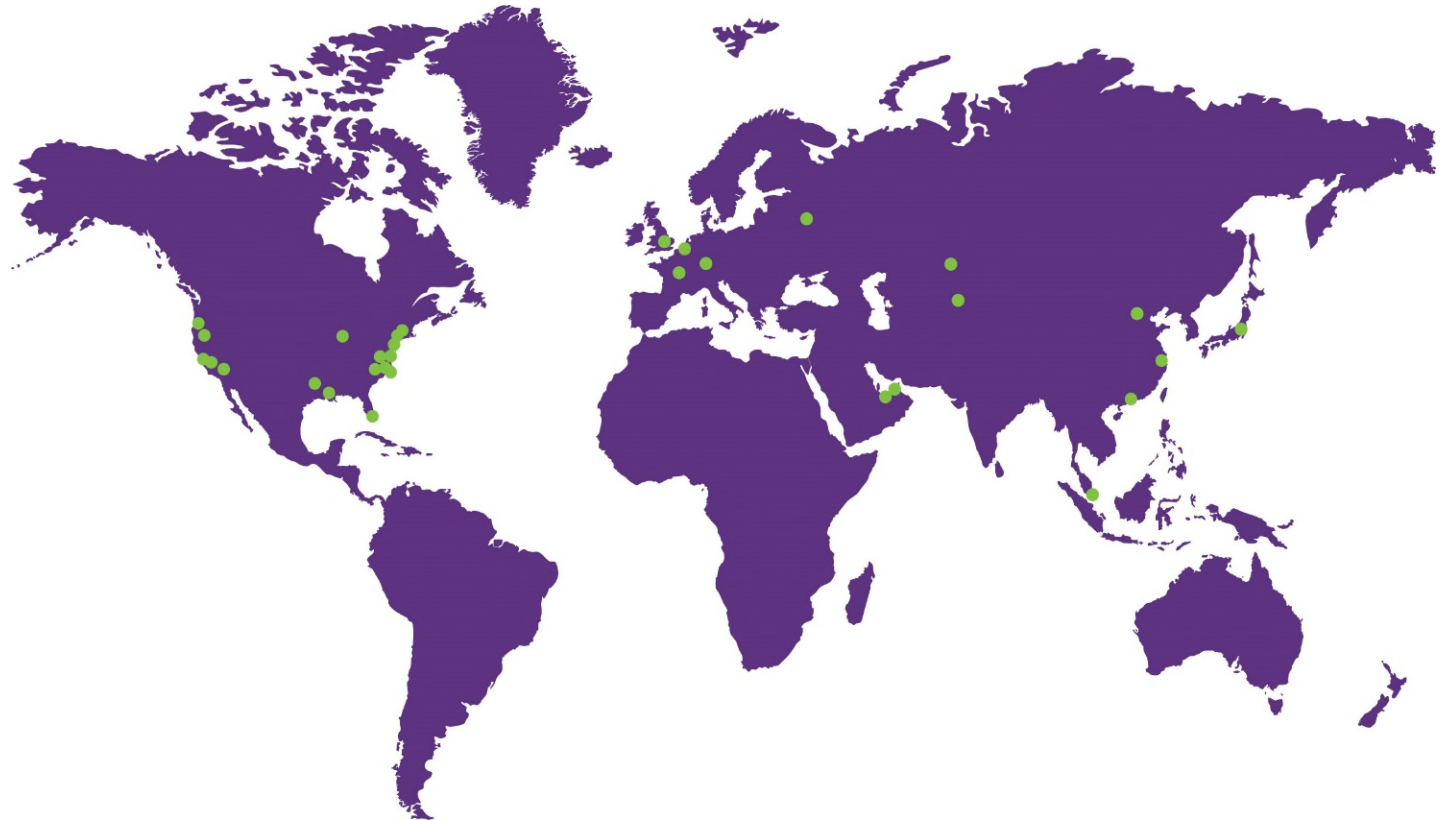
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