

COVID-19: BUYING AND SELLING PPP BORROWERS

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INTRODUCTION

More than 4.5 million U.S. businesses have received loans through the Paycheck Protection Program (PPP), which was created under the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act). PPP loans have been a lifeline to many businesses, but also create complications for future M&A, investment, and financing transactions involving PPP borrowers. Those complications vary during the life cycle of a PPP loan and, unfortunately, some survive forgiveness or even repayment of such loan.

This alert discusses some of these key issues, primarily in the context of an M&A transaction, including:

- purchase price considerations, including whether an outstanding PPP loan is treated as debt in arriving at a “cash-free, debt-free” equity value;
- tax, employment, and other considerations resulting from being a PPP borrower that may impact valuation and transaction structures;
- legal, regulatory, and reputational risks arising out of a transaction involving PPP borrowers, and the new methods of due diligence needed to assess such risks; and
- key terms that should be addressed in transaction documents relating to a current or prior PPP loan of a target.

Although these issues are new, the tools that M&A parties can use to deal with them are similar to the tools used to deal with many existing business, legal, regulatory, and tax issues.

BASIC PPP BACKGROUND

The CARES Act has been amended by two subsequent laws¹ and has been implemented through a dizzying array of regulations issued primarily by the U.S. Small Business Administration (the SBA). In simplest terms, as of the date of this alert, PPP loans:

- are available only to borrowers who, together with their affiliates, meet certain size and other eligibility requirements;
- are capped at 2.5X the borrower's LTM (or 2019) average monthly payroll costs, subject to an individual cap of \$10 million per borrower and an aggregate cap of \$20 million for such borrower and other members of its “corporate group”;

- are subject to strict limitations on use of proceeds (with the bulk reserved for payroll expenses);
- are potentially wholly forgivable if the borrower properly uses the PPP proceeds and satisfies certain employment criteria during the applicable forgiveness covered period;
- eliminate the borrowers' ability to claim employee retention tax credits and to access certain other stimulus benefits;
- if not forgiven, will bear interest at 1% and have a term of two years or five years; and
- cause a borrower to be subject to review by the SBA and, perhaps, possibly subject to public disclosure.

For a more fulsome and detailed description of the PPP loan program, please see our firm's summary term sheet.

PPP LOAN LIFE CYCLE AND RELATED ISSUES

The first determination to be made in a transaction involving a PPP borrower is where the PPP borrower falls in the PPP loan life cycle, as the status of the PPP loan will dictate the issues to be addressed in the transaction. Highlights of the issues for each period of the life cycle are set forth below, and the issues are discussed in greater detail in the following sections of this alert.

Forgiveness Covered Period

The initial stage of a PPP loan is the “covered period”² during which the PPP borrower must use the PPP loan proceeds and maintain employment and salary/wage levels in accordance with the requirements of the CARES Act and the implementing regulations. The forgiveness covered period starts from the date the PPP loan is obtained and ends on (i) the earlier of 24 weeks after such date and 31 December 2020, or (ii) if elected by a PPP borrower whose loan was funded before 5 June 2020, eight weeks after such date.

- Primary business issues during the forgiveness covered period include (A) whether the PPP loan will remain outstanding post-closing (and potentially be partially or wholly forgiven), if the transaction should be structured to avoid the acquisition of a PPP loan, or if the PPP loan should be repaid in connection with the transaction; (B) if the loan will remain outstanding, whether the buyer will undertake any obligations to obtain forgiveness of the loan and who controls the forgiveness application process; and (C) which party bears the risk that forgiveness may not be obtained.
- Primary legal issues during the forgiveness covered period include: (A) review of the PPP borrower's eligibility for the loan; (B) the accuracy of its PPP loan application; (C) the PPP borrower's use of the loan proceeds; and (D) the PPP borrower's eligibility for forgiveness during the pre-closing period.
- Parties should also consider the reputational risks involved in buying or selling a business while it has an outstanding PPP loan, especially in light of the intended purpose of the CARES Act to support the operations of the business in its prior form and the intense media scrutiny of certain PPP borrowers that did not appear to require a PPP loan to remain in business.

Forgiveness Application Period

After the forgiveness covered period, the PPP borrower must apply to its lender for forgiveness. Currently, we expect that most PPP borrowers will apply for forgiveness within 10 months after the end of the forgiveness covered period.³

- The issues during this period are generally the same as those during the forgiveness covered period, except that the buyer will need to review the PPP borrower's compliance with the forgiveness requirements for the entire forgiveness covered period (rather than just the period prior to the closing of a transaction).

Forgiveness Review Period

This period begins when the PPP borrower applies to its lender for forgiveness of the PPP loan. A PPP lender must issue a decision on a borrower's application for forgiveness (including the borrower's calculation of the forgivable amount of its PPP loan) within 60 days of receipt and communicate such decision to SBA.⁴ SBA then has 90 days to review the lender's determination and to remit any approved forgiveness amount to the lender.

- In addition to the issues that are present in prior periods, a buyer should also review (A) the calculations of the forgivable amounts prepared by the borrower, (B) documentation supporting such calculations, and (C) the content of the borrower's forgiveness application.

Repayment Period

If a PPP borrower applies for forgiveness within 10 months after the end of its forgiveness covered period, then such borrower is not required to make any payments on its PPP loan until the SBA remits to the PPP lender the amount that is ultimately determined to be forgivable. If a PPP borrower fails to apply for forgiveness during this 10-month period, it must start making payments upon the expiration of the 10-month period.⁵ Most PPP loan forms provide for monthly amortization of any unforgiven amount during this repayment period through the end of the loan term.

- If a PPP borrower has commenced repaying its PPP loan, the economic issues are simplified and we expect many parties would treat the remaining loan amount as debt for purposes of the purchase price and (in many cases) pay the loan off at closing as they would other bank debt.
- However, the legal and reputational risks associated with a PPP loan can survive repayment, such that the diligence and risk allocation questions noted above, including with respect to the forgiveness application, would still remain.

Post-Termination Period

Borrowers are required to retain records relating to their PPP loan for a period of six years following forgiveness or repayment of the loan. SBA is authorized to review all loans at any time. Statements made by a PPP borrower in its loan application or forgiveness application could also be subject to claims under the False Claims Act, which has a statute of limitations of the longer of (A) six years from when a violation is committed and (B) three years after the United States knows or should know about the material facts of such a violation (capped at 10 years after such violation).

- Even after a PPP loan has been repaid and especially if any portion of a PPP loan has been forgiven, the parties should address the risks of any future governmental or third-party claims that the loan was improperly obtained or that the PPP borrower did not properly follow applicable PPP rules. This process will likely look and feel more like the traditional diligence and risk-allocation negotiation that M&A parties follow for other compliance matters.

STRUCTURAL CONSIDERATIONS

There are several PPP-related issues that impact the parties' decision whether to structure a transaction as an equity or asset deal, in addition to the traditional factors influencing such decision:

Limitation of Employee Retention Credit on Buyer and Affiliates

The most prominent issue is that affiliates of a PPP borrower, determined under tax aggregation rules that differ from the SBA affiliation rules, cannot take advantage the Employee Retention Credit (the ERC).⁶ Unfortunately, this applies even after a PPP loan has been repaid, subject to a limited safe harbor.⁷

- This means that a buyer who acquires the equity of a target who then has, or at any time has had, a PPP loan must determine the financial impact of the loss of the ERC that has then been, or would otherwise thereafter have been, claimed by the buyer and its aggregated control group. For private equity sponsors and their portfolio companies, it appears that all portfolio companies of the investing fund could be “infected” by the acquisition of such a PPP borrower.⁸ We are hopeful that the IRS or Congress will implement regulations or enact an amendment to the CARES Act that limits this exclusion to only the target company and its pre-acquisition affiliates or clarifies that there would be no backward-looking recapture of prior ERC amounts claimed by the buyer and its affiliates, but, until such changes are implemented, buyers should use caution in acquiring the equity of PPP borrowers.⁹
- To avoid the loss of the ERC, a buyer could acquire the business of the PPP borrower through an asset deal, which may result in additional transaction costs and create adverse seller tax consequences for which the seller may want to be compensated. Thus, buyers will need to weigh these transaction costs against the potential costs of any lost ERC amounts.

Impact on Forgiveness Calculations; Applications

In some transactions that happen prior to final determination of the forgiveness amount, it is possible that the PPP lender may consent to the change of control occurring as a result of the buyer's acquisition of the PPP borrower's equity.

- In such a transaction, the parties will want to ensure that the target remains a separate employer and continues to use the PPP proceeds solely for its own permissible expenses and not any expenses of the buyer.
- It does not appear that lenders would be permitted under current SBA 7(a) regulations to consent to a transfer of assets by a PPP borrower without SBA consent. Even if a lender were to consent to an asset transaction, such a transaction during the forgiveness covered period would have a significantly detrimental impact on the borrower's ability to obtain forgiveness because the borrower would, as of closing, cease incurring forgivable expenses and would also suffer a reduction (to zero in most cases) in its number of full-time equivalent (**FTE**) employees, thus reducing (if not eliminating) the forgivable amount of its PPP loan. Theoretically, the parties could enter into some sort of TSA whereby the borrower would retain its employees (and the related expenses) for the purpose of providing services to buyer, but this may be impractical and render lender consent to the transaction even more unlikely.

Impact on PPP Eligibility and SBA Affiliation

Although a buyer acquiring the equity of a PPP borrower will also become an “affiliate” of the PPP borrower under SBA regulations, such acquisition will not render the PPP borrower ineligible because SBA regulations provide that the applicable affiliation and size determinations were to be made as of the time of the loan. In situations where the buyer itself has a PPP loan outstanding, the target should remain eligible to retain its own PPP loan, as long as it remains a separate employer after closing of the acquisition. Such a buyer should also consider whether the aggregate amount of loans obtained by its “corporate group” would exceed \$20 million, although it is not clear whether such limitation would apply in this context.¹⁰

Risk Allocation

In an equity acquisition, the buyer is acquiring an entity that retains all pre-closing liabilities, including any liabilities arising out of non-compliance with the CARES Act and its implementing regulations. The parties would thus need to determine (a) how to allocate the risk for any such non-compliance, through appropriate representations, warranties, and indemnities and (b) if the PPP loan is to remain outstanding after closing, how to allocate control over the post-closing operations of the business (to the extent it impacts PPP forgiveness) and control over the PPP forgiveness application process.

Treatment under Buyer Credit Facilities

As in any transaction where a target is retaining an indebtedness, a buyer that has existing credit facilities or that is using new credit facilities to acquire a PPP borrower where the PPP loan will remain outstanding should ensure that its credit facilities would permit the PPP loan and understand how such loan will be treated for covenant purposes.

Reputational Risk

Some buyers, in particular private equity funds, have made a determination that their controlled companies will not have any PPP loans due to the reputational and other risks associated with the program. Such buyers will likely require that PPP loans be repaid at or prior to closing even in an equity acquisition.

Practical Results

- In equity acquisitions that occur prior to final determination of the forgiveness amount, we expect that many M&A parties will seek the lender's consent to leave the PPP loan outstanding, subject to reaching an agreement on the economic and points noted elsewhere in this alert.
- In asset acquisitions that occur prior to final determination of the forgiveness amount, we would expect that the parties will most often expect to have the PPP loan repaid, which will require agreement on the purchase price impact of such repayment.
- In both stock and asset deals during the repayment period, we expect the buyer to require repayment of the loan prior to closing, with the outstanding unforgiven amount treated as debt.

PURCHASE PRICE CONSIDERATIONS

Most transactions value the target on a “cash-free, debt-free” basis. For targets with outstanding PPP loans, both the “cash-free” and “debt-free” aspects of a transaction can present issues.

Treatment of PPP Loan as “Debt”

In transactions occurring prior to final determination of the forgiveness amount, a key negotiation point will be whether such PPP loan should be treated as “debt” of the target (and thus reduce the “debt-free” purchase price) or if it should instead be treated in whole or in part as a forgivable obligation that does not reduce purchase price.

- During the forgiveness covered period, such negotiations may be challenging because the parties will not know the amount of the PPP loan that may be forgiven. If the loan is to remain outstanding, sellers would have to rely on an agreement from the buyer to continue to operate the business in accordance with such projections and to apply for forgiveness.
- During the forgiveness review period, this negotiation may become easier because the maximum forgiveness amount is known, and any remaining balance can safely be treated as debt. However, we expect that a seller may be unwilling to agree to any structure requiring such seller to repay the PPP loan in full, unless such seller receives close to full credit for the applied-for forgiveness amount of such PPP loan.
- Sellers will likely object to a PPP loan being treated as debt in a transaction where the parties expect such PPP loan to remain outstanding. However, this is also an issue if the buyer cannot allow, or will not agree to allow, the PPP loan to remain outstanding because the seller may demand compensation for the portion of the PPP loan that is projected to be forgivable even though the full PPP loan amount will be repaid to the lender, which will effectively increase the purchase price paid by a buyer above the otherwise “debt-free” price.
- As noted above, in both stock and asset deals during the repayment period, we expect that the buyer will require repayment of the loan prior to closing with the full outstanding unforgiven amount treated as debt.

Treatment of PPP Loan Proceeds as “Cash”

Because PPP loan proceeds may only be used for limited purposes, the parties in a transaction should take care in drafting the funds flow to clearly indicate that amounts being distributed to stockholders as sale consideration do not include any funds from a PPP loan.

- In deals where the PPP loan will be repaid at or prior to closing, the parties will want to ensure that these remaining PPP proceeds are used for such purpose.
- In deals where the PPP loan will remain outstanding, this may require the buyer to essentially “pay for” the PPP loan proceeds that will remain in the target's bank accounts following closing. Also, even if the PPP loan is to be paid off, it would be a best practice for the borrower to use any such remaining PPP loan proceeds for permissible purposes and to carefully document such usage.
- If a transaction will result in a reduction to the target's operations such that the remaining PPP loan proceeds cannot be used for such purposes, the buyer should consider how to value such cash, but we expect that in most cases the buyer will simply require such proceeds to be repaid to the lender prior to closing.

Practical Results

- In transactions where a buyer is willing to allow a PPP loan to remain outstanding, we may see a portion of the purchase price equal to the expected forgivable portion of the PPP loan net of any remaining PPP cash proceeds placed in escrow or held back by the buyer. The escrow or holdback could be released to

the seller to the extent the PPP loan is ultimately forgiven (perhaps less any expenses incurred by buyer in seeking such forgiveness).

- This construct would be similar to a transaction with a contingent payment or earn-out payment. The parties may consider whether any post-closing covenants would be appropriate to provide assurances to the seller that the buyer will operate the business to maximize forgiveness and then seek the maximum forgivable amount. A list of potential covenants appears below.
- We expect that M&A parties in many transactions that close prior to final determination of the forgiveness amount will negotiate some middle ground where only a portion of the total PPP loan amount would be treated as “debt” that reduces the purchase price, permitting the seller to receive credit for a mutually agreeable estimate of the forgivable portion of the PPP loan.

DUE DILIGENCE CONCERNS

PPP loan related risks do not end when the loan is repaid. As such, PPP-loan-specific diligence is advisable for any target that has ever obtained a PPP loan, even if such loan has been repaid or forgiven. All PPP borrowers have the legal burden to ensure that they obtained the PPP loan and used the PPP loan funds in accordance with all applicable laws. Such obligations survive the repayment or forgiveness of the PPP loan. SBA may review all PPP loans at any time, and statements made by a PPP borrower in its initial application or forgiveness application could be subject to claims under the False Claims Act. Penalties for inaccuracies or fraud may include immediate repayment of all loan amounts (if any amounts are still outstanding) and criminal and civil penalties.

Risk Indications

Buyers of PPP borrowers should consider several factors that enhance the risk of audit of that borrower. Even if the borrower is found to have complied with all requirements, such an audit will, at a minimum, create expenses for a buyer in terms of responding to such audit.

Size of PPP Loan

SBA has stated that PPP borrowers who, together with their affiliates, received more than \$2 million in PPP loans will be subject to review and greater scrutiny, including a review of whether such PPP borrowers made the “necessity certification” in good faith. Consequently, any PPP borrower with a PPP loan in excess of \$2 million should also be subject to heightened diligence. In making this determination, buyers will need to understand not only the target’s PPP loan, but also whether it had any affiliates (under the SBA affiliation rules) who obtained PPP loans.

Nature of the Target and its Owners

SBA has specifically mentioned that public companies and portfolio companies of private equity funds may have a harder time making the “necessity certification” in good faith, and thus such borrowers may be more likely to be subject to a higher level of scrutiny, even if their loans are less than \$2 million.

Timing and Announcement of Transaction

PPP borrowers who are acquired in a publicized transaction or a transaction that results in significant proceeds to the target or its owners shortly after taking a PPP loan (particularly if the target was in negotiations to be acquired while it was applying for a PPP loan) may likely be subject to greater scrutiny.

Equity Acquisitions

As noted above, in a transaction where the buyer acquires the equity of the target, the buyer is effectively buying all PPP risks within the target.

Risk Mitigants

In addition to review of the substantive areas of diligence discussed below, a PPP borrower that has kept clear and complete records of its PPP borrowing process, including all supporting documentation with respect to its eligibility determinations, its rationale for obtaining a PPP loan, and its use of the PPP loan proceeds, will be less likely to incur PPP loan-related liability. Similarly, a PPP borrower that engaged a competent third-party advisor regarding the process for applying for a PPP loan may be less likely to have PPP compliance issues. Buyers should review all documents related to the loan application as well as any records regarding the PPP borrower's rationale for obtaining a PPP loan (including review of internal communications and memos) and potentially discussions with any third-party advisors that were engaged by the PPP borrower in applying for the PPP loan.

Key Diligence Areas

Buyers may seek to focus diligence in the following key areas of concern:

Eligibility & Loan Amounts

- ***Borrower Eligibility.*** In order to have been eligible for a PPP loan, the borrower must have met certain size requirements, based on its employees, revenues, or net income and tangible net worth. Such size requirements are determined on an aggregate basis with the borrower's affiliates (subject to certain exceptions under the CARES Act). A buyer's due diligence efforts should include a review of a PPP borrower's size determination, including whether it appropriately included all "affiliates."
- ***PPP Loan Amount.*** The permitted amount of a PPP loan is based on the borrower's payroll costs for 2019 or the LTM period when it applied for the loan. A buyer should review the borrower's calculations both for accuracy and for compliance with the CARES Act and applicable regulations.
- ***Corporate Group Limit.*** PPP borrowers that belong to a "single corporate group" can only receive a maximum of \$20 million in the aggregate, even if they otherwise satisfy one or more of the exemptions from aggregation. Businesses are part of a "single corporate group" if they are majority owned, directly or indirectly, by a common parent.
- ***Affiliate Diligence.*** The affiliation and corporate group issues may present diligence challenges. Sellers may be unwilling to provide diligence on affiliates of the target who are not part of the business being acquired. Thus, if the target has affiliates under SBA regulations or is a part of a corporate group, the buyer will need to determine what if any diligence information it will require relating to such other entities it requires. Buyers may need to rely on limited or no diligence information on such entities and to instead rely on the seller's representations as to such compliance matters. As noted below, in other contexts, RWI insurers have been reluctant to cover representations that they cannot diligence, so this remains a key open question as to the scope of available RWI insurance for PPP-related representations and warranties.

Necessity Certifications

Each PPP borrower is required to make certifications on its PPP loan application, including the “necessity certification,” which requires the PPP borrower to certify that “current economic uncertainty makes this loan request necessary to support the ongoing operations of the” borrower. This issue presents special diligence concerns because it is a subjective standard and presents significant reputational risk in addition to the traditional legal risks for non-compliance. As noted above, this is of special concern for public companies and portfolio companies of private equity funds.

- Such review should be made by buyer prior to agreeing to treat any outstanding PPP loan as forgivable in determining the purchase price as the PPP loan will not be forgivable if the SBA determines that the borrower lacked an adequate basis for the necessity certification.
- Buyers should carefully review a PPP borrower's reasons for obtaining its PPP loan and ensure that there was a reasonable (and ideally well-documented) basis to conclude that the PPP borrower had a “need” for such loans in order to maintain operations. These concerns survive, and are in fact enhanced, after a PPP loan has been forgiven.

Use of PPP Loan Proceeds; Compliance With Terms of Loan Documents

PPP loan proceeds must be used only for documented and eligible payroll costs and certain permitted expenses for rent, utilities, and payment of interest on mortgages and other debt obligations. Any due diligence effort should include a review of the records kept by a PPP borrower showing the use of the PPP loan proceeds and a review of PPP loan documents to ensure that the target has complied both with applicable laws and any additional requirements in its loan agreements.

Forgiveness Application and Amount

Under the PPP rules, the total forgivable amount is the least of (i) the full PPP loan amount, (ii) the sum of all Forgiveness Eligible Costs (described below) incurred by the PPP borrower, and (iii) total payroll costs during the forgiveness covered period divided by 0.60. For most PPP borrowers, the key determination will be the amount of “Forgiveness Eligible Costs,” which includes eligible payroll costs, interest payments on mortgages, rents, and utilities paid in the forgiveness covered period. However such amount is reduced by both salary cuts made during the forgiveness covered period and by reductions in the number of FTE employees during the forgiveness covered period, subject to certain safe harbors for restoring such cuts and exceptions due to an inability to do so for specified reasons. While the rules on forgiveness continue to change and we are awaiting further updated rules on forgiveness, buyers will want to closely review the target's books and records regarding forgiveness and its forgiveness application (if previously filed) both for accuracy and for compliance with the CARES Act and the final regulations.

M&A TRANSACTION DOCUMENT PROVISIONS

PPP Loan Representations and Warranties

Buyers should request representations covering the key areas of diligence, including with respect to (i) the PPP application process and the accuracy of loan documents, (ii) certifications made with respect to eligibility and loan amount, (iii) use of the PPP loan proceeds, and (iv) forgiveness eligibility and the forgiveness calculation if an application for forgiveness has already been determined.

Scope of MAE

Buyers should consider whether the definition of “Material Adverse Effect” in a transaction document should allocate risks associated with changes in PPP loan laws and regulations, especially in light of known need (as of today) for further implementing forgiveness regulations, the frequent changes to such laws and regulations since the original passage of the CARES Act and “HEROES Act,” and other pending legislative proposals in Congress. Typically, the definition of “Material Adverse Effect” would shift the risk of changes in law between signing and closing to the buyer, such that if a target’s financial position is adversely changed solely as a result of a change in law, the buyer would accept such risk. With respect to PPP loans, and more generally in light of the shifting legal landscape for COVID-related laws, parties may want to specifically address the allocation of risk regarding changes to COVID-related laws and regulations.

Pre-Closing Covenants

If a sale transaction has a delayed closing and the PPP loan is in the forgiveness covered period, a buyer may consider including specific pre-closing covenants requiring a PPP borrower to (i) comply with all laws with respect to using any PPP loan proceeds, (ii) keep thorough records of the use of PPP loan funds, and (iii) ensure that the PPP borrower takes all appropriate actions with respect to obtaining the maximum amount forgiveness. If the PPP loan is in the forgiveness application period, forgiveness review period, or repayment period, a buyer may consider requesting additional pre-closing covenants requiring a PPP borrower to expend efforts to obtain the maximum amount of forgiveness with respect to the PPP loan, to withdraw such application if the PPP loan will be paid off in connection with closing, or to make repayments on a timely basis.

Post-Closing Covenants.

If the PPP loan will remain outstanding and the forgiveness determination has not yet been made with respect to such PPP loan, M&A parties may need to add post-closing covenants with respect to obtaining forgiveness of such PPP loan if the seller economically bears the risk of non-forgiveness. Specifically, such a seller may request a buyer to include specific covenants to:

- use best efforts to make the forgiveness application and to appeal any decisions from lenders and SBA that would grant forgiveness to less than the whole amount of the applied for forgiveness amount of the PPP loan (including by initiating litigation to seek such forgiveness);
- maintain the number of FTE employees and/or salaries and wages of all employees for the applicable forgiveness covered period and/or cause the borrower to meet one of the safe harbors;
- ensure compliance with all PPP loan requirements, including using at least 60% of the PPP loan funds for eligible payroll expenses; and/or
- permit the seller to participate in the forgiveness application process or to control the forgiveness application process.

However, from the buyer perspective, each of these potential covenants would have implications for the buyer in its post-closing operations and may hinder the operational success of the acquired business.

Control of Audits, Investigations, and Claims.

Parties negotiating a transaction should include covenants describing the rights of the parties in the event of an audit, investigation, or third-party claim relating to a PPP loan. These will likely be similar to the rights negotiated

around the process for filing tax returns and/or indemnification for third-party claims, with the party not controlling such process having customary rights like reasonable consent rights to any settlements and the ability to participate or to be kept informed.

R&W INSURANCE/INDEMNITY

The market has not yet clearly settled on the extent to which representations and warranties insurance (RWI) will cover COVID-related representations generally, or in particular, PPP-related representations. If the parties intend to use RWI in the sale transaction, they will need to carefully review the RWI indication letters and policies for such exclusions. Buyers may need to negotiate with brokers to try to limit or exclude such exclusions with the provision of further diligence. However, if the RWI underwriter insists on excluding some or all PPP-related representations from coverage, a buyer may wish to consider requesting a special indemnity relating to the PPP-related risks noted above.

CONCLUSION

M&A activity during and following the COVID-19 pandemic, especially of targets that are PPP borrowers, will require enhanced diligence and may require additional tools to address new and unique concerns introduced by the pandemic and related government programs. Please also note that the rules, regulations, and statutes referenced in this alert continue to evolve and we expect new rules and FAQs to be issued, which may impact the positions taken in this alert. We are continuing to monitor the impact of COVID-19 and related legislation on M&A transactions and are working closely with clients to offer practical solutions to the unique challenges brought on by COVID-19. If you have questions regarding how to navigate this new environment, please do not hesitate to reach out to any of us at K&L Gates.

FOOTNOTES

¹ The Paycheck Protection Program and Health Care Enhancement Act, enacted on April 24, 2020 and the Paycheck Protection Program Flexibility Act of 2020 (the PPPFA), enacted on June 5, 2020.

² The CARES Act confusingly uses the term “covered period” for two different purposes and time periods, so we will refer to the “covered period” used in determining forgiveness as the “forgiveness covered period.”

³ There does not appear to be a specific deadline by which a borrower must apply for forgiveness, but as noted below, a borrower who fails to apply for forgiveness within 10 months of the end of the forgiveness covered period must begin making repayments of the applicable PPP loans.

⁴ If a lender determines to reject any portion of the requested forgiveness amount, the lender must also notify the borrower of such decision.

⁵ Under the current rules, it appears that a borrower could thereafter still apply for forgiveness, but it would be required to start making and continue making payments.

⁶ The ERC is a 50 percent credit against up to a maximum of \$10,000 in qualified wages (including allocable health care benefits) per employee paid after March 13, 2020 and before January 1, 2021. Many significant eligibility determinations for this credit are made applying complex aggregation rules to treat the claimant and its

affiliates as a single employer. Please see “*COVID-19: CARES Act Employer Payroll Retention Tax Credit*” for more details about this credit.

⁷ There is a safe harbor exception for a PPP borrower who repaid its PPP loan prior to May 18, 2020. The ERC guidance treats such a borrower as if it never had a PPP loan for this purpose.

⁸ Please see “[COVID-19: Affiliation & Aggregation Considerations for the Paycheck Protection Program and the Employee Retention Credit](#)” for more details about the loss of the ERC.

⁹ The “HEROES Act” passed by the House would have corrected this issue by removing the PPP loan limitation to ERC claims in general, but faced opposition in the Senate.

¹⁰ In rare circumstances, the parties may be looking to sign an acquisition agreement for a company that is considering a PPP loan or that has a pending PPP application. Note that a buyer will become an affiliate of the target upon signing a definitive agreement (but not most letters of intent) to acquire the equity of the target, which could create PPP size and eligibility issues because SBA regulations consider “agreements to merge (including agreements in principle) to have present effect.”

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