

COVID-19 Coronavirus Business Impact Broadcast Series

PPP and UK Support Programs: M&A Considerations, Including the Strategic Use of a Special Indemnity Escrow

JUNE 5, 2020

On June 5, 2020, Dechert's Private Equity group, together with Citi Private Bank, presented "The PPP and UK Support Programs: M&A Considerations, including the Strategic Use of a Special Indemnity Using Escrow," an episode of the firm's COVID-19 Coronavirus Business Impact Broadcast Series. The episode was hosted by Derek Winokur, an M&A partner in the firm's New York office; David Miles, a leveraged finance partner in the firm's London office; and Doug Weaver, a director in Citi Private Bank's New York office.

After giving a brief summary of the U.S. and UK support programs, the presenters discussed consideration and risks that private equity professionals should take into account when acquiring a target company that has received a Paycheck Protection Program ("PPP") loan or a loan or grant from a UK government support program, and how a special indemnity escrow account can help remediate those risks.

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HIGHLIGHTS FROM THE EPISODE

M&A Considerations: Audits, Changing Guidance and Penalties

In the U.S., government authorities reserve the right to audit PPP loans and loan applications for their accuracy, eligibility, and appropriate use of proceeds. An acquirer of a loan recipient, such as a PE sponsor or portfolio company, inherits any risks associated with the target company's failure to comply with the applicable loan regulations. Similarly, in the UK, authorities can conduct retrospective audits of grant payments made to employers under the job retention scheme, which may lead to claw-back demands if grants were incorrectly made available. PE professionals should also understand that the PPP program was hastily written and put into effect. Accordingly, interpretation of the rules has continued to evolve, raising the risk that a reasonable interpretation made by a loan recipient at the time of the application could be contradicted by a later interpretation or guidance. The risk of retroactive change to the appropriateness of a loan under a UK scheme is likely lower.

Mitigation of Risk with Diligence and a Special Indemnity Escrow

PE professionals conducting due diligence on a target company should review: (i) whether the target received any government assistance under these loan programs; (ii) whether the target deferred tax payments or took advantage of any other deferral arrangements or, in the UK, whether the target participated in the job retention scheme; and (iii) in each case, whether the target complied with the relevant loan and grant regulations. Buyers can also protect themselves from the risks associated with a target company that received a loan or grant under these government programs with a special indemnity escrow.

Additional M&A Considerations

In addition to conducting due diligence on the appropriateness of the target company's PPP loan, buyers should also consider various post-signing mechanics regarding the loan, including how the loan and related cash will be dealt with for working capital purposes, whether the loan will be paid off at closing or retained, and whether the loan will qualify for forgiveness.

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