

One Week Brings Big Changes to the Paycheck Protection Program

It's been a wild week (or so) for the Paycheck Protection Program (PPP). Is this really the same loan program that Congress adopted on March 27? Has the guidance over the past week increased our understanding of the program, or created more uncertainty? Let us walk you through the changes. We've linked to the official releases and other sources below.

April 23 – SBA publishes [FAQ 31](#)

What does the CARES Act require a PPP borrower to certify? Among other things, a PPP borrower must certify at the time of making its application that *“[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.”*

Does an applicant's liquidity matter when obtaining a PPP loan? Between March 27 and April 22, most thought that the answer was “no,” as Congress had excluded the SBA's “credit elsewhere” test from the PPP, and the certification noted above does not suggest that a liquidity analysis is required.

But on April 23, after the media focused attention on the return of PPP loan proceeds by Shake Shack and others, the SBA issued game-changing guidance: when making the required certification, applicants must take into account *“their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business.”* What does that mean? None of the terms in that sentence are defined. The SBA has issued no further guidance clarifying the April 23rd language, and has said only that *“it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification.”*

How does access to a line of credit or cash on hand affect my application? Should those considerations matter in the context of a program whose purpose is to keep workers working instead of on unemployment rolls? Does future “economic uncertainty” (i.e., after the 8-week period) matter? For example, may an applicant ensure that it has adequate capital after June 30 by securing other credit? Or, does the PPP require an applicant to expend all available resources before obtaining a PPP loan, with the result that it may have to furlough employees in order to ensure the survival of its business? FAQ 31 brings up, but does not answer, these questions. The SBA has stated that liquidity is relevant, but it has not explained how (and how much) liquidity affects eligibility under the PPP.

Does this guidance apply only to public companies? FAQ 31 does not clarify who is subject to the guidance; the only example provided relates to public companies. [FAQ 37](#), however makes clear that the SBA's position applies to private companies as well.

Why is May 7 important? FAQ 31 created what some are calling an “amnesty period.” It allows PPP borrowers to return their loan proceeds by May 7, 2020, without penalty. Any borrower that applied before April 23 and who fully repays its loan proceeds by May 7 will be deemed by the SBA to have made the “current economic uncertainty” certification in good faith. This implies that good faith will not be presumed for any borrower that does not repay its loan by May 7, and that the certification could be reviewed for any such loan. FAQ 31 does not indicate such a review will indeed occur, what the review process would be, or what consequences would result from a determination that the certification was not made in good faith. For example, would an adverse determination result in a loss of some or all forgiveness? Or could criminal penalties result?

Does the fact that my lender approved my application protect me? No. The text of the [CARES Act](#) and other guidance provided by the SBA (such as the SBA’s [PPP borrower application form](#)) provide that lenders are permitted to rely on borrower certifications. Treasury Secretary Mnuchin has noted that the responsibility for determining eligibility and whether the certification is made in good faith lies with the borrower, not the lender.

April 26 – The SBA publishes FAQ 37

As noted above, [FAQ 37](#) makes clear that a review of a borrower’s current business activity and access to other sources of liquidity will be made for all borrowers, not just public company borrowers, in determining whether the “current economic uncertainty” certification was made in good faith.

April 28 – Secretary Mnuchin announces that all PPP loans greater than \$2 million will be audited.

What did the Secretary say? A [Wall Street Journal article](#) relates Treasury Secretary Steve Mnuchin’s statement that PPP loans of more than \$2 million will face full audits, while loans for smaller amounts will be spot-checked. The audits will require not only a “*report that you actually spent the money on payroll and other items that qualify for forgiveness*” but also a determination of whether the “current economic uncertainty” certification was made in good faith. Secretary Mnuchin stated that borrowers, not banks, will face criminal liability for certifications that aren’t true.

What are the Treasury, SBA and DOJ doing in response? The Secretary speaks for the Treasury, so it is clear that Treasury will support prosecutions for certifications that aren’t true. The SBA has announced in [FAQ 39](#) that it will perform the audits announced by Secretary Mnuchin, and has separately stated that when appropriate, it will seek enforcement of the criminal provisions of the CARES Act. Separately, the Justice Department announced that it has opened an investigation into companies that applied for PPP loans. The CARES Act incorporates the [criminal penalty provisions](#) of the Small Business Act, including the potential for imprisonment of up to 30 years and fines of up to \$1,000,000.

Additionally, regardless of the potential for audit or criminal penalties, it is possible that the media could scrutinize any applicant, potentially resulting in reputational harm. All businesses should be concerned about reputational harm, but some businesses may be more at-risk than others (for example, faith-based organizations or nonprofits).

April 29 – The SBA publishes FAQ 39

Who will be audited? [FAQ 39](#) incorporates Secretary Mnuchin’s audit requirement, stating that it will “*review all loans in excess of \$2 million, in addition to other loans as appropriate, following the lender’s submission of the borrower’s loan forgiveness application.*” So, while only loans in excess of \$2 million are certain to be audited, all loans have the potential to be audited.

How will the audits be conducted? The SBA stated only that the audits will be performed “*following the lender’s submission [to the SBA] of the borrower’s loan forgiveness application.*” The exact procedures for such audit were not laid out – FAQ 39 stated that additional guidance would be forthcoming. Presumably, this guidance would be part of the forgiveness guidance previously promised by the SBA and which was expected (under the provisions of the CARES Act) by April 26. As of May 2, that guidance has yet to be issued.

April 30 – The SBA issues its [Interim Final Rule](#) limiting loans to Corporate Groups

What is a corporate group? In its rule, the SBA defined a corporate group as businesses that are “majority owned, directly or indirectly, by a common parent.”

What is the limit? The rule provides that corporate groups may not obtain PPP loans in an aggregate amount exceeding **\$20 million**.

Who is not affected? Individual borrowers and corporate groups that applied for/received PPP loans in an aggregate amount less than \$20 million are not affected by the rule. Nor are corporate groups who received all their loan proceeds as of April 30, 2020.

Who is affected? Any corporate group having at least one member that has not received all its loan proceeds by April 30, 2020, is potentially affected by the rule. If any member of a corporate group receives loan proceeds after April 30, 2020, it should check to confirm that its disbursement would not cause the corporate group to exceed the \$20 million cap. If the disbursement would cause the corporate group to have received more than \$20 million of PPP loan proceeds, it will violate the rule. Failure of an applicant to withdraw or request cancellation of a pending PPP loan application or approved PPP loan not in compliance with the rule will be regarded by the SBA as a use of PPP funds for unauthorized purposes, with the result that the loan will not be eligible for forgiveness.

If the affiliation rules were waived with respect to my business, am I protected? The SBA noted that businesses are subject to this limitation even if they have received a waiver of

the affiliation rules (e.g., hospitality businesses and restaurants, certain franchises and businesses receiving SBIC financial assistance).

What does all this mean?

For many borrowers, particularly larger borrowers or borrowers that have cash on hand or access to a line of credit or other loans (whether originated or available if applied for), the government's actions over the past week have added to the uncertainty surrounding the program. Some would say that the ground rules have changed significantly, and that the program is a different program than then one rolled out by Congress on March 27.

In particular, the government's stated requirement that an applicant must consider its ability to access "other sources of liquidity" seems to contradict the CARES Act's elimination of the "credit elsewhere" test with respect to the PPP program. Does the SBA's requirement impermissibly override the law, or is it a permitted interpretation? It's unclear at this point, but borrowers who face the possibility of losing their forgiveness or face criminal prosecution are certain, in litigation, to argue the former.

What can a borrower do to show its good faith?

The current guidance indicates all borrowers, but especially those who have loans exceeding \$2 million, should be prepared to demonstrate the following in a formal audit:

- (1) They fit within the eligibility criteria for the PPP loans (i.e., the 500 employee limit (or alternative limits), as may be affected by the SBA's affiliation rules);
- (2) They conducted objective analysis in writing that supports their "current economic uncertainty" certification; and
- (3) They can provide evidence of payment, such as receipts and reports from payroll providers, of eligible costs to support their forgiveness application.

In order to satisfy any potential agency review, ideally, the "current economic uncertainty" analysis (a) will have been made at or around the time of application, (b) relies upon both internal projections and independent, third-party projections (whether to the economy generally or specifically relating to the borrower's industry), and (c) supports the decisions made with respect to the borrower's personnel. The SBA has not released its guidance, but it may be necessary to show how personnel decisions would have been different without the PPP loan. (I.e., would the borrower have furloughed more employees or cut wages or hours?) Care should be taken to evaluate other sources of risk and uncertainty for the business, such as decreases in sales and orders, loss of customers or projects, unavailability of resources, health concerns of employees, and effects of any of the foregoing on covenants contained in existing credit facilities, bond arrangements and other contracts. Ideally, this analysis has been / should be presented to the board of directors or other governing body for the borrower.

Hopefully the forthcoming forgiveness and audit guidance will shed more light on how to evaluate borrowers' cash on hand and access to credit. Should the written analysis show a relationship between how the PPP funds are used in the short term (the 8-week period) and how the other sources of liquidity are used in the long-term? Will the SBA find that analysis relevant?

Will the forgiveness and audit guidance be provided by May 7, 2020? Although it would be ideal for the SBA's forgiveness and audit guidance to be provided in advance of May 7, 2020 so that borrowers can make educated decisions as to whether to return their funds and receive "amnesty," it is unclear whether the SBA will do so. The SBA has not stated the date by which it expects to publish such guidance, and the CARES Act's 30-day window for providing guidance ended on April 26, 2020. Therefore, Borrowers will have to make some difficult decisions:

- Do I keep the PPP funds under the belief that I am eligible and that I can in good faith make the "current economic uncertainty" certification, based on the current, limited guidance?
- Even if the PPP funds may be helpful to my business, should I return the loan proceeds by May 7, 2020, so that I can limit any liability I may have?
- Will returning the loan funds save me from reputational harm? Or might it expose me to public criticism, as with Shake Shack, the Los Angeles Lakers, and Harvard University?
- If I do not return the loan funds by May 7, 2020, will there be later guidance issued that makes me wish that I had done so?
- What are the effects on my business and my employees if I do not keep the loan proceeds?

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