Unintended Impacts of PPP Loans Under Existing Credit Agreements

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Many businesses have joined the scramble that has taken place during the last weeks to secure a Paycheck Protection Program (PPP) loan. In many cases, such a loan will be key to being able to pay the wages and salaries of staff and certain other expenses during a period when cash flow may have been severely impacted by the shutdown of operations mandated in most states. The lucky companies that were able to secure a PPP loan will be congratulating themselves this week and in the weeks to come as the loan proceeds hit their bank accounts and they are able to meet payroll and keep their enterprises functioning.

However, there may be some unintended consequences of that success. Most businesses have focused on the fact that the PPP loans they receive are forgivable. Provided that the borrower complies with the criteria applicable to the PPP loan, the PPP loan will be forgiven and discharged, in whole or in part. However, until forgiven, and to the extent not forgiven, the PPP loan is a real loan that must be reflected as a true obligation on the books and records of the borrower. Many of the businesses that have secured PPP loans will be parties to existing credit arrangements. In the rush to secure that vital funding, the borrower may not have performed a complete review of its loan documents. Companies are well advised to review the terms of existing credit arrangements to determine whether receipt of the PPP loan will have any unintended but adverse consequences. The applicability of any of the following examples will depend on the exact wording of a borrower’s documents. Those can vary considerably depending on the type of loan, whether it is secured or unsecured, and the presence of industry-specific provisions.

- For example, certain loans will contain an outright prohibition on the borrower incurring any debt other than the amounts loaned under the existing credit agreement. Even though the PPP loans are not intended to be secured by any collateral or guaranteed in any way, a provision prohibiting any additional debt may be violated simply by the receipt of the PPP loan.
- In addition to outright prohibitions, a credit agreement may allow only certain categories of permitted indebtedness other than the original loan made under the existing credit agreement. A review of the terms would need to be made to ensure that the PPP loan fits into a permitted category of additional debt.
- Borrowers may also be subject to financial covenants that are implicated by changes in the aggregate debt load of the borrower. Such covenants may focus on the ratio of aggregate debt to total capitalization, or to the assets or a group of specified assets of the borrower. Since the PPP loan does not require any regularly scheduled payment over the next two years, the PPP loan may not increase the fixed charges or debt service of a borrower, but that would need to be verified.
- As existing mortgages, security agreements, and guaranties may be drafted in a broad way to

secure, guaranty or otherwise cover all obligations of the borrower to a lender, accepting a PPP loan from an existing lender may have the effect of putting collateral at risk or increasing a guarantor's obligations.

- Finally, since the amount of the PPP loan must be taken into account as an obligation of the borrower, and it is likely that the money will be spent within the next eight weeks, there is a possibility that the solvency of the borrower may be impacted when the PPP loan is reflected on the balance sheet of the recipient.

We are not seeking to turn the success of securing a PPP loan into a reason for concern, but wish to highlight for borrowers the fact that a detailed analysis of existing loan documents may not have been performed in the rush to secure vital funding. It would be a shame for any borrower lucky enough to have secured such financing to discover that its success has triggered a cash sweep provision under an existing credit agreement, or another provision that may affect operations. Borrowers would do well to be proactive in identifying any issues and resolving them with their lenders before they ripen into more serious problems, and while lenders remain under federal directive to work with borrowers adversely affected by COVID-19.

Please note: This alert contains general, condensed summaries of actual legal matters, statutes and opinions for information purposes. It is not meant to be and should not be construed as legal advice. Readers with particular needs on specific issues should retain the services of competent counsel.

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