



The SBA's Evolving Guidance on PPP Loan

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As the impact of COVID-19 was rippling through the American economy, business owners saw the PPP as a lifeline. The promise of a quick infusion of capital to keep their businesses operational and the opportunity to have these debts forgiven were understandably enticing. In fact, to have declined these needed funds to keep employees on the job and rents paid would have seemed a dereliction of duty for many. However, the SBA's guidance continues to evolve, and the political pressure mounts as several companies were criticized for accepting the funds. Press accounts note several large (and highly visible) companies decided to return funds already accepted. Given the facts known at the time and the paucity of guidance regarding eligibility, who should and shouldn't accept these funds?

On April 28, 2020 the Small Business Administration issued the latest iteration of its FAQs, adding Question 37.[1] The question posed was: "Do businesses owned by private companies with adequate sources of liquidity to support the business's ongoing operations qualify for a PPP loan?" The Answer: "See response to FAQ #31."

FAQ Question 31, which was previously issued on April 23, 2020, in turn asked:

Question: Do businesses owned by large companies with adequate sources of liquidity to support the business's ongoing operations qualify for a PPP loan?

Answer: In addition to reviewing applicable affiliation rules to determine eligibility, all borrowers must assess their economic need for a PPP loan under the standard established by the CARES Act and the PPP regulations at the time of the loan application. Although the CARES Act suspends the ordinary requirement that borrowers must be unable to obtain credit elsewhere (as defined in section 3(h) of the Small Business Act), borrowers still must certify in good faith that their PPP loan request is necessary. Specifically, before submitting a PPP application, all borrowers should review carefully the required certification that "[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant." **Borrowers must make this certification in good faith, taking 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. For example, 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.**

(Emphasis Added.)

The SBA inserted an "amnesty" or "safe harbor" provision for those businesses that returned funds promptly:

Lenders may rely on a borrower's certification regarding the necessity of the loan request. Any borrower that applied for a PPP loan prior to the issuance of this guidance and repays the loan in full by May 7, 2020 will be deemed by SBA to have made the required certification in good faith.

SBA offered no guidance on the amnesty or safe harbor provision, nor did it do so regarding the "ability to access other sources of liquidity to support their ongoing operations." With no clarity as to "other sources of liquidity," companies were forced to look to subsequent additions to the FAQs.

The impact of Secretary Mnuchin's April 21, 2020 warning of "severe consequences" for companies that fail to meet the criteria and don't return the funds, combined with the lack of SBA guidance, sent shockwaves through the business community. Thousands of well-intentioned business owners were in reasonable fear that their good faith applications for assistance would be questioned and that a subsequent review could expose them and their companies to significant civil and criminal exposure. For some, the risk was too great, and many companies returned funds before the May 7, 2020 deadline, despite their intent to use the funds for permissible expenses like salaries and rent. Some businesses recognized the limits of the PPP based on IRS guidance that expenses paid using the proceeds of Paycheck Protection Program (PPP) loans (Covered Loans) are not deductible expenses for income tax purposes if those loans subsequently are forgiven, see **IRS Denies Deduction for Forgiven PPP Loan Amounts Used for Business Expenses**.

Companies considering whether to return PPP funds were given some much needed relief when, late on May 5, 2020 the SBA extended the amnesty deadline until May 14, 2020 and promised additional guidance. Observers anticipate that the SBA will issue additional guidance in order to assist companies in determining whether their applications were "necessary to support the ongoing operations of the Applicant" and whether there were other sources of liquidity, in the eyes of the SBA.

Considerations Before and After the May 14, 2020 "Amnesty" Deadline

a. How big is too big?

As reported by the *ABA Banking Journal*, on April 28, 2020 Secretary Mnuchin promised a "full audit" of any company that received more than \$2 million in funds before the obligation to repay is forgiven. He added, "It's the borrowers who have criminal liability if they made this certification and it's not true," responding to recent reports of large firms—including professional sports franchises—that have sought and received PPP funding. Mnuchin added that the PPP "was a program designed for small businesses—it was not a program designed for public companies that had liquidity. The certification was very clear in saying that, if people had other sources of liquidity, they could not take this loan."²

b. Document your rationale and available information.

Whether in response to an SBA audit or a False Claims Act investigation, it is critical to document a company's actions. The people most involved with this process now may no longer be with your company at the time of an audit or investigation, or their recollections may fade with the passage of time. It is important to take the time now to thoroughly document your application process, including the underlying information and guidance that informed your application. Accessing, relying on and preserving good economic data, forecasts for your company's specific sector, public health information and other analysis are critical. Likewise, thoroughly document the uses of these funds. Keep these documents specially identified and keep them for at least seven years after the later of the use of the funds or the loan forgiveness so that, if an audit or investigation were to occur, it would be easy to locate them. This could save valuable time and money when responding to an inquiry years later.

c. Stay current with PPP interpretations from the government and your bank.

Because the passage of the CARES Act and the implementation of the PPP occurred so suddenly, the Department of the Treasury and other federal entities have been issuing near-daily clarifications and interpretations to guide banks and borrowers. Just because your company already has applied for or received funds does not mean that your obligation to comply with subsequently-issued guidance has terminated. Continue monitoring guidance and rules as they are issued. As noted, additional guidance is expected before May 14, 2020, presumably in time for applicants to respond in a timely fashion.

d. Considering the current and anticipated guidance, analyze whether alternative funding would be available or "significantly detrimental" to your business. Companies should consider all available streams of funding and the conditions placed on each of them. Even if financing is available, the terms may be such that declining them in favor of PPP funds is appropriate. In those cases, companies should consider and document their decision in anticipation of a later inquiry. This is especially true for recipients of more than \$2 million in PPP loans.

e. In conducting a risk assessment, consider public relations, civil liability and criminal liability, each of which will warrant analysis.

These considerations, and others, will be critical in responding to later inquiries, particularly where economic forecasts, political considerations and enforcement priorities may be very different than they are today. For now, stay abreast of evolving guidance and respond accordingly, before and after the "amnesty" period. With the assistance of competent counsel, prepare now for future scrutiny.

There will be significant government oversight of the PPP loan program. As discussed in the alert, **Strings Attached: Preparing for and Mitigating Risk Associated with COVID-19 Stimulus** accepting taxpayer money comes with strings attached. PPP borrowers should be prepared for an audit. Moreover, federal investigations of PPP loans may occur years down the road. And as discussed in the alert, **Paycheck Protection Program: After the Pay Comes the Chase**, now is the time for borrowers to take steps to address the risk of government scrutiny in the future.

[1] PPP FAQs have been issued multiple times, including April 6, 8,13,14,15,17,23,24,26, 28 and 29 and May 3 and 5.

[2] <https://bankingjournal.aba.com/2020/04/mnuchin-sba-to-review-ppp-loans-over-2m/>

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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Related People

- Anthony H. Anikeeff ? 703.760.5206 ? aanikeeff@williamsmullen.com
- Charles E. "Chuck" James, Jr. ? 804.420.6529 ? cjames@williamsmullen.com
- Caitlin M. Poe ? 919.981.4085 ? cpoe@williamsmullen.com

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