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To Keep The PPP Money or Not? Business Necessity and Eligibility According to Recent SBA and Treasury Department Guidance

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In mid-April, national news coverage began breaking that several public companies had received significant loans from the SBA's Payroll Protection Program. In response, officials in the Treasury Department urged companies with substantial market value and access to capital markets to return their PPP loans. Why? The argument was that current economic uncertainty resulting from COVID-19 did not make the PPP loans "necessary to support the applicant's ongoing operations." The result has been uncertainty and confusion among PPP loan borrowers. On April 23, 2020, SBA published additional guidance related to the Paycheck Protection Program ("PPP") in the form of Frequently Asked Questions ("FAQs"), which were most recently updated on May 6, 2020. This additional guidance provided a safe harbor of May 7, 2020 - now extended to May 14, 2020 - for companies that were ineligible based on a lack of necessity to return their loan proceeds.

The purpose of this blog post is to present an analysis that PPP borrowers and their advisors may use to determine whether to return their PPP loan proceeds before the May 14 deadline. The PPP application requires a borrower to make several good faith certifications at the time the application is submitted to their bank. One of the certifications is that "[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant." The SBA later provided new guidance on this certification resulting in a concern that the SBA and/or the Treasury might begin second-guessing whether an applicant really *needed* PPP money to support their ongoing operations at the time the application was submitted. Below are considerations that every PPP borrower should consider concerning loan eligibility and certification of necessity.

Q. The applicant must certify that "*Current economic uncertainty makes this loan necessary to support the ongoing operations of the applicant*." What facts, questions, and issues should be considered when making this certification?

- In this context, "current" means economic uncertainty as of the date the certification.
- What creates or evidences economic uncertainty? Some considerations include:
    1. What have been the drivers of your business? What has changed? When did those changes occur?
    2. What is happening to your industry? What is happening to your competition?
    3. What is happening to your customers and clients?

4. What is happening to your supply chain?
5. What is happening to your assets?
6. Are you an “essential business” as determined by federal, state, or local governmental regulations?
7. On the date of certification, did you anticipate that your assets would likely continue to be used consistent with historic levels?
8. Has there been a slow-down in transactions that drive your business?
9. Have your customers or clients notified you that the projects you have been working on for them are on hold or are likely to be put on hold or delayed?
   - What is your projected revenue for the next 8 weeks or longer?
   - What are your projected expenses for the next 8 weeks or longer?
   - Is it likely that those who pay your invoices will have a disruption in their business that prevents them from timely paying you?
10. Has there been a slow-down in existing business or new business? Has the slow-down in one area of your business been offset by areas where new business increased?
11. What will be the effect of a shelter-in-place order or other governmental restrictions in the geographic areas that your business operates?
12. As a result of shelter-in-place orders or other governmental restrictions in the geographic areas that your business operates, can your employees get to work? What will be the economic implications?
13. Did these factors predate “current economic uncertainty”?
14. But for the receipt of the PPP loan, how likely is it that the business will have to lay off employees?
15. If the PPP loan is received, is it more likely that the business will be able to retain its employees not only during the 8-week period following the date the loan is funded but also after the end of that 8-week period?
16. Are there any drawbacks to using other available lines of credit? What do the loan documents say? What conditions are there to a draw down on the line of credit? Assuming the business can get through the immediate time period, will drawing on the line of credit today hamper the business viability after the period of the lock down when the economy is starting up again?
17. Is the PPP loan necessary to keep the business going?

Q. If my company is not publicly traded and does not have access to capital markets but does have an existing line of credit and access to cash reserves, can it still qualify for a PPP loan?

It depends. The statute and SBA rules and FAQs do not categorically exclude any particular type of company nor do they categorically exclude companies with particular sources of existing funding. If a borrower has access to other sources of capital then that factor will be an important consideration in determining the “necessity” of the PPP loan, but the existence of cash reserves and access to existing credit, alone and together, are not determinative as to whether the PPP loan is necessary.

The SBA has specifically used the example of a public company with substantial market value and access to capital markets as one that is “unlikely” to be able to make the requisite certification in good faith. Even in this instance, however, the SBA’s position is pragmatic, recognizing that each borrower’s facts and circumstances are unique and require an independent determination. Note that there is nothing in the legislation or the SBA rules or FAQs suggesting that a borrower has to sell its assets instead of seeking a PPP loan.

Q. Is the PPP loan “necessary” to support the business’ ongoing operations?

It depends. The only real guidance is the SBA’s comment that prospective borrowers must “tak[e] 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.” This test depends entirely on the facts and circumstances of each borrower. In some situations a “but for” analysis may be appropriate. In other situations because of different facts, that analysis may not be appropriate. All of the facts and circumstances affecting each borrower are relevant in assessing that borrower's need.

Q. Should PPP loan borrowers be concerned about audit risks?

Yes. Treasury Secretary Steven Mnuchin publicly announced last week that any PPP loan exceeding $2 million will be audited. Since then, the SBA has updated its FAQs to add Question 39: "Will SBA review individual PPP loan files?" The SBA's answer to Question 39 states that "[t]o further ensure PPP loans are limited to eligible borrowers in need, the SBA has decided, in consultation with the Department of the Treasury, 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." It is no surprise that the PPP loans will be reviewed and may be audited. All loans in excess of $2 million will be reviewed. Loans in a lesser principal amount may also be reviewed. The audit will be triggered by an application for forgiveness certifying the use of the loan proceeds in accordance with the CARES Act. Although the implication is that if forgiveness of PPP loan indebtedness is not pursued then the audit risk will be lower, it is difficult to quantify the exact risk differential. Therefore, for planning purposes, a borrower should assume that if it seeks forgiveness of the PPP loan indebtedness, it will be audited.

Q. When should I get prepared for a PPP loan audit?

*Immediately***.** We suggest that all PPP borrowers proactively document the business necessity for their PPP loan at the time of origination, including the questions mentioned above right away, as well as carefully track how all PPP funds are spent during the covered period. We suggest that PPP loan funds be placed in a segregated account and that the money be accounted for from day one as part of a budget for the 8-weeks/56 days including the day the loan is funded. The amount that may be forgiven is not equivalent to the amount that a borrower is eligible to borrow. Get prepared from day one and have all documentation in pristine condition immediately following the end of the 8-week covered period. Thorough documentation of where the PPP funds are spent will be important for all borrowers in applying for forgiveness. We expect additional guidance from the SBA about the forgiveness process. Preparing from day one will assist in ensuring that (i) the borrower was an eligible borrower, (ii) the PPP loan funds are used solely for permitted purposes, and (iii) the PPP loan amount that may be forgiven is maximized.

Q. Should I return my PPP loan?

*Perhaps, but not necessarily***.** If, upon further reflection, a PPP borrower has determined that there was no business necessity for your PPP loan, you may return the money in full by **May 14, 2020** and you will be deemed by the SBA to have made the required certification in good faith and without any risk that you made a false certification. Although the safe harbor focuses on PPP borrowers that have "substantial market value and access to capital markets" the issue is a facts and circumstances test of "necessity" for each borrower and not a bright line test.

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