

COVID-19: UNDERSTANDING THE BORROWER CERTIFICATION REQUIREMENTS UNDER THE PAYCHECK PROTECTION PROGRAM

Date: 19 May 2020

U.S. Banking and Asset Finance Alert

By: Elizabeth H. Evans, John ReVeal

BACKGROUND

In order to obtain a Paycheck Protection Program (PPP) loan, Section 1102(G) of the Coronavirus Aid, Relief and Economic Security (CARES) Act, requires that an eligible recipient certify to the following four requirements in good faith:

- That the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient;
- That the funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments;
- That the eligible recipient does not have an application pending for a loan under this subsection for the same purpose and duplicative for amounts applied for or received under a covered loan;
- During the period beginning on 15 February 2020 and ending on 31 December 2020 that the eligible recipient has not received amounts under this subsection for the same purpose and duplicative of amounts applied for or received under a covered loan.

On 3 April 2020, lenders began processing applications that generally contained the certifications specified above.

Under the CARES Act, an “eligible recipient” was always a broader definition than the “small business concern” that is normally the standard needed to qualify for a loan guaranteed by the Small Business Association (SBA) under Section 7(a) of the Small Business Act.¹ Congress intended that the CARES Act would provide badly needed loans to a broad range of businesses, and even included special rules to make it easier for large restaurants and hotels to obtain the loans.

Nevertheless, after many of the loans were made in compliance with the above certifications, critical media reports focusing on certain of the larger recipients of the loans prompted Secretary of Treasury Mnuchin to say in a White House press briefing that there would be “severe consequences” for recipients who had made improper certifications.² He further noted that U.S. Department of the Treasury was “going to give people the benefit of the doubt” and signaled further regulation that would provide, “If you pay the loan back right away, you won’t have liability to the SBA and to Treasury.”³

The Paycheck Protection Program Loans Frequently Asked Questions (FAQs) were subsequently updated to provide that, notwithstanding the suspension by the CARES Act of the ordinary requirement that borrowers “must be unable to obtain credit elsewhere,”⁴ borrowers must still certify in good faith that their PPP loan request is “necessary.” Potential borrowers are now required, when making such certification, to 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.”⁵

These guidelines simultaneously provided a “return the money” safe harbor: “Any borrower that applied for a PPP loan prior to the issuance of this guidance and repays the loan in full by 7 May 2020 will be deemed by SBA to have made the required certification in good faith.”⁶ FAQ 47, released on 13 May 2020, further extended the deadline to 18 May 2020 in order “to give borrowers an opportunity to review and consider FAQ 46.”⁷

FAQ 46 provided a new monetary safe harbor for the necessity certification.⁸ Specifically, any borrower, that, together with its affiliates, received PPP loans with an original principal amount of less than \$2,000,000 “will be deemed to have made the required certification concerning the necessity of the loan request in good faith.”⁹ For purposes of this safe harbor, a borrower must aggregate the principal amount of any PPP loan received by its affiliates (to the extent defined under the SBA’s interim final rule on affiliates)¹⁰ with its own PPP loan.

FAQ 46 also gives some enforcement relief to borrowers outside of the \$2,000,000 monetary threshold. Even if the SBA determines that a borrower “lacked an adequate basis” for the necessity certification, the stated remedy is to “seek repayment of the outstanding loan balance” and “inform the lender that the Borrower is not eligible for loan forgiveness.” This clarifies that the only consequence of failing to meet the necessity certification standard (as determined by the SBA review) is to pay the loan back. While it is still not clear whether the repayment would be done in accordance with the existing tenor of the loan or be required all at once (an acceleration of the debt due), if the loan is repaid, the SBA will not “pursue administrative enforcement or referrals to other agencies based on its determination with respect to the certification concerning necessity of the loan request.”¹¹

Accordingly, there should be no False Claims Act (FCA) liability from a government-initiated suit in respect of the necessity certification.

FACTORS TO CONSIDER

The latest FAQs indicate that all PPP loans above a threshold of \$2,000,000 will each be reviewed prior to a forgiveness decision.¹² Additionally, PPP loans of any Borrower that, together with its affiliates’ PPP loans, aggregate to more than \$2,000,000 will not be eligible for the monetary safe harbor. Even though the chances of a governmental claim under the FCA have been practically eliminated by FAQ 46, there is still the possibility of private “whistleblower” claims under the FCA. Moreover, none of this will lessen public scrutiny and reputational risk in respect of these loans. It therefore is a good idea for all borrowers in this category to consider the factors listed below with respect to each of the borrower certifications:

Certification: “The uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient.”

- Determine how “current business activity” has been affected by COVID-19. This clearly is something more than the statutory standard of “future economic” uncertainty, but it is unclear how tangible the

current harm must be. Shutting and closing operations due to COVID-19 clearly should constitute current harm. Other factors to consider are:

- supply chain shortages,
- decreased employee productivity working from home, and
- decreased sales opportunities due to inability to travel.

Companies also should consider any positive effects that the COVID-19 crisis has had on their business through, for example, increased product demands, access to different markets or new governmental contracts (whether at the local, state, or federal level).

- Consider if the business has “access to liquidity in a way that is not significantly detrimental to the business.” Companies that have existing working capital loan facilities may not be able to utilize the PPP loan for up to \$10,000,000 just because it is a “forgivable” and low-priced loan. Factors that should be considered include:
 - the size of the existing loan facility (the larger the facility, the less likely that a PPP loan will be considered necessary),
 - the number of layoffs and workers that will be terminated should the company borrow against the facility (recognizing that companies may not want to borrow (and pay interest) solely to keep workers employed), and
 - the timing on accessing the facility (longer times to receive disbursements could result in greater need for the PPP loan). If a facility is not available due to a default (even if undeclared) resulting from application of financial covenants during the COVID-19 crisis, this could be a factor justifying an application for a PPP loan.
- Consider if the business has “access to liquidity” through their equity investors or a prior equity raise. A well-capitalized company holding a significant amount of cash (perhaps greater than two years of operations?) should not keep or seek a PPP loan over \$2,000,000 (as aggregated in accordance with FAQ 46).
- From a headline risk perspective, the source of the capital should also be examined. Is it from a recent public offering (after 15 February 2020)? Is the company tied to a largely well-known individual, family wealth fund, venture fund or private equity fund?

Certification: “The funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments and utility payments.”

- 75% of the PPP loan proceeds need to be used for “payroll costs” (as defined under the CARES Act).¹³ The other permitted uses of PPP loan proceeds are interest on mortgage payments (but not principal), lease payments, and utility payments. Under the CARES Act, all lease, mortgage, and utility contracts must have been in effect prior to 15 February 2020.

Certification: “The eligible recipient does not have an application pending for a loan under this subsection for the same purpose and duplicative for amounts applied for or received under a covered loan.”

- The PPP loan program is very focused on nonduplication. If Economic Injury Disaster Loans (EIDL) have been disbursed prior to 26 April 2020, they must be refinanced with the PPP loan, and they count against the \$10,000,000 limit.¹⁴ Any EIDL grant received under Section 1110 of the CARES Act does not need to be refinanced because it is an emergency grant.
- Do not apply to more than one lender, even if you plan to accept only one loan, contrary to some suggestions that we have seen to be made.

Certification: "During the period beginning on 15 February 2020 and ending on 31 December 2020, the eligible recipient has not received amounts under this subsection for the same purpose and duplicative of amounts applied for or received under a covered loan."

- Only one PPP loan is allowed per eligible recipient. This is in addition to the \$20,000,000 cap on loans to the same corporate group.
- The single-loan rule applies to each borrowing entity and not to a corporate group as a whole. It is for this reason that the \$20,000,000 cap on loans to a corporate group was issued.

There are a variety of factors to consider in determining whether or not to apply for, or utilize the proceeds of, a PPP loan. We recommend all companies document the factors involved in taking action to apply for and accept PPP loans in anticipation of an SBA and Treasury audit.

If you have any questions, do not hesitate to contact counsel. In light of the ongoing release of guidelines in respect of the PPP loan program, many companies are weighing the risks and benefits in light of the aforementioned enforcement risks. For further insight into enforcement risk, please see our thinking, *Federal Stimulus Today: Federal Investigation Tomorrow and Looming False Claims Act Liability for Paycheck Protection Program Loans*.

FOOTNOTES

¹ 15 U.S.C. § 636 (a) (1953).

² Graham Rapier, *Treasury Secretary Warns There Will Be 'Severe Consequences' for Large Companies That Took Bailout Loans Intended for Small Businesses*, Business Insider (22 April 2020).

³ *Id.*

⁴ 15 U.S.C. § 636(a) (1) (A) (a).

⁵ U.S. DEP'T OF THE TREASURY, FAQs, Question: 31 (13 May 2020).

⁶ *Id.*

⁷ U.S. DEP'T OF THE TREASURY, FAQs, Question: 47 (13 May 2020).

⁸ U.S. DEP'T OF THE TREASURY, FAQs, Question: 46 (13 May 2020).

⁹ *Id.*

¹⁰ 85 Fed. Reg. 20,817 (15 April 2020).

¹¹ U.S. DEPT OF THE TREASURY, FAQs, Question: 46 (13 May 2020).

¹² U.S. DEPT OF THE TREASURY, FAQs, Question: 39 (13 May 2020).

¹³ U.S. DEPARTMENT OF THE TREASURY, PAYCHECK PROTECTION PROGRAM (PPP)_INFORMATION SHEET: BORROWERS (3 April 2020).

¹⁴ CARES Act § 1102(a) (19 March 2020).

KEY CONTACTS



ELIZABETH H. EVANS
PARTNER
NEW YORK
+1.212.536.3958
ELIZABETH.EVANS@KLGATES.COM



JOHN REVEAL
PARTNER
WASHINGTON DC
+1.202.778.9055
JOHN.REVEAL@KLGATES.COM

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.