

New Government Guidance Clarifies PPP Loan Eligibility, Promises Enforcement

Legal Alert
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More guidance has raised new issues and concerns. Given the criticisms that some large businesses with alternative access to capital received a CARES Act Paycheck Protection Program (“PPP”) loan they perhaps did not need, the U.S. Government has issued new (some may say tardy) guidance on who is eligible for a PPP loan – and what will happen if the U.S. Government later determines a PPP loan recipient was not small and/or had an insufficient financial need under the program.

The takeaways:

- The U.S. Government has focused on financial need as a key element of PPP eligibility.
- Clearer rules and regulations are being applied retroactively for the review and perhaps future audit of PPP loans.
- The laws governing the PPP provide for penalties and fines for misuse of the PPP.
- The Small Business Administration (“SBA”) may review loan eligibility as part of the loan forgiveness process.
- Documentation of the steps you took to make a good faith determination of financial need are the keys to preparing your business for any Government review of your PPP loan.
- A safe harbor of repaying the PPP loan by May 14, 2020 (originally scheduled for May 7, 2020) is available for companies that want to avoid questions about their certification.

The full information is that the new guidance addresses multiple factors:

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Financial Need is a Key Element of Eligibility. Question 31 in the [SBA-U.S. Department of Treasury](#) (the “Treasury”) FAQs on PPP Loans states:

“[B]orrowers . . . 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.”

Safe Harbor: Repay PPP Loan in Full by May 14, 2020. FAQ 31 also states:

Note: The SBA extended the repayment date until May 14, 2020 from the originally scheduled May 7, 2020. Dates have been updated below. Borrowers do not need to apply for this extension and the extension will be promptly implemented through a revision to the SBA’s interim final rule providing the safe harbor.

“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 14, 2020 will be deemed by SBA to have made the required certification in good faith.”

Worried now that this new guidance – which applies retroactively – might make your company considered to be ineligible? There is a solution: a borrower that repays its PPP Loan in full by May 14, 2020 will be deemed to have made its certification in good faith. This “safe harbor” provision has been incorporated into a draft interim final rule to be published imminently.

Should your company use this safe harbor? Answering that question must be a fact-specific analysis tailored to your situation. The May 14 deadline creates a short timeframe, and the rules are not yet clear. Keep in mind that missing a safe harbor does not mean putting up the white flag. A borrower that does not use the safe harbor retains all its rights to make its case if ever questioned.

Possible Penalties. The PPP application and regulations set forth the penalties. The PPP application form contains the following certification:

“I understand that knowingly making a false statement to obtain a guaranteed loan from SBA is punishable under the law imprisonment of not more than five years and/or a fine of up to \$250,000; under 15 U.S.C. 645 by imprisonment of not more than two years and/or a fine of

not more than \$5,000; and, if submitted to a federally insured institution, under 18 U.S.C. 1014 by imprisonment of not more than thirty years and/or a fine of not more than \$1,000,000.”

A key word is “knowingly.” Given the rush and confusion surrounding the roll out of the PPP and the lack of guidance, there will likely be significant disputes over what “knowingly” means, and it will likely be a fact-specific analysis.

Audits of All Loans Over \$2 Million. On April 28, Secretary of the Treasury Steven Mnuchin stated that every loan for more than \$2 million given under the PPP will be subject to audit. This statement is consistent with the oversight and audit provisions of the CARES Act. However, it is unclear on how the audit process will work.

The Government May Review Eligibility and Need as Part of the Loan Forgiveness Process. Secretary Mnuchin further stated that “the [SBA] will be doing a full review of that loan before there is loan forgiveness.” Some bank loan documents now contain a statement such as the following: “The Administration has indicated it will conduct a full review of businesses for false representation of need and misuse of the funds as part of the loan forgiveness application. Businesses that do not adhere to these guidelines may face criminal investigations as described in the Payroll Protection Program application.”

As above, it is unclear of how the SBA can do a full review of every PPP loan as part of the loan forgiveness process. Additional regulations are likely forthcoming.

What to do? The key to preparing for a future review and perhaps audit of your PPP application and your request for loan forgiveness is documentation – documentation to support your determination of your financial need underlying your good faith certification and to support your eligibility for loan forgiveness:

- Prepare and retain financial records showing the financial harm to the company, including internal financial projections at the time you applied for the loan, and the use of funds for the required and permissible purposes;
- Memorialize that steps the company took to determine that the “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” It is helpful for the company to show that it took into account:
 - its current business activity;
 - projected impacts on future business activity; and
 - its ability to access other sources of liquidity sufficient to support its ongoing operations in a manner that is not significantly detrimental to the business; and
- Confer with your financial and legal advisors.

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For additional resources on how to navigate the business disruptions caused by COVID-19, please visit our [COVID-19 Resource Center](#) and reach out to the Foster Garvey team with any questions.