

April 24, 2020

Carefully Documenting Your Eligibility for a PPP Loan

On April 23 and 24, the Small Business Administration (SBA), apparently responding to reports of large publicly traded companies accepting the Paycheck Protection Program (PPP) loans, issued additional guidance through an interim final rule and in its Q&As on the “necessity” criteria for qualifying for PPP loans. Specifically, the CARES Act indicates that recipients must make a good faith certification that “... the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations...” of the recipient. With respect to this “necessity” standard, the SBA has now indicated that it expects applicants with large company owners to take into account: “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.” The SBA explicitly called-out publicly traded companies with an example of a (i) publicly-traded company, (ii) with substantial market value and (iii) access to public markets as a company that would be likely ineligible to meet the necessity criteria for a PPP loan. The SBA also noted that if such a company paid the loan back by May 7, 2020, the company will be deemed to have made the initial certification in good faith.

The additional guidance provided by the SBA is clearly directed towards larger public and private companies. As such, we do not believe this additional guidance materially alters the eligibility analysis of smaller private companies. That said, venture backed companies, which may be deemed companies “with larger owners that have access to capital,” should also take heed of this additional guidance. The facts and circumstances applicable to an individual applicant are controlling. Thus, each applicant will want to carefully consider and reasonably document its determinations (even if they were perhaps already made) on eligible necessity for a PPP loan.

In all events, companies applying for a PPP loan must certify that they meet the necessity standard. We continue to recommend that companies carefully document the factors that they use in their analysis on whether they meet this

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standard. Factors that the company will want to consider may include the following:

- What has been the financial impact of COVID-19, directly or indirectly, on the company's sales, margins, expenses or other financial metrics? Are there other nonfinancial metrics that have materially changed?
- Have the company's prospects, such as forecasted budgets and projections, materially adversely changed due to the impact of COVID-19?
- Is the company able to continue operations substantially as before or is it required to make significant changes?
- Will the company need to lay employees off and/or significantly cut salaries to maintain its ongoing operations?
- Has a sale or financing transaction been delayed due to economic uncertainty that places the company's ongoing operations in jeopardy?
- Whether alternative sources of capital (debt or equity) are available to the company? What steps have been taken to acquire such other capital?

If capital is available, whether capital is available on terms that are not significantly detrimental to the business, including likelihood of closing, the dilutive effect on existing owners and additional preference overhang or onerous terms that would negatively affect future financings?

Each applicant's analysis will be quite different. Undertaking the review and documenting efforts – with counsel involved as attorney client privilege may be relevant – is the important point to remember.

Aside from the law, applicants may want to carefully consider broader business and external factors. We think there will be businesses within (possibly well within) the Act's coverage that choose to decline funds or return the money because managers make the determination that negative public or government perception is more costly than the negative impact on operations. As seen with the first round of PPP loans, companies will want to consider and should be prepared for public relations factors and related issues that may arise when customers and the general public learn such business has received the PPP funds.

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