

May 14, 2020

PPP: Changes in the Law May Require a Second Review; Be Prepared for More Change and Think About Your Brand and PR as Much, if not More Than, the Law

UPDATE (May 14, 2020). The SBA will be extending the repayment date for the safe harbor to May 18, 2020. Borrowers do not need to apply for this extension.

UPDATE (May 13, 2020). The SBA has released new guidance this morning, May 13, related to the certification that the borrowers must make that they meet the necessity requirement for a PPP loan (the changes to which are discussed below). Due to the change in the standard, the SBA allowed for repayment without consequences if the repayment occurred by the original deadline of May 7, and the deadline was then extended to May 14. Under the new guidance, borrowers (including all affiliates) that received PPP loans with an original principal amount of less than \$2 million will be *deemed to have made the required certification concerning the necessity of the loan request in good faith*. For borrowers with loans greater than \$2 million, the SBA has indicated that if they determine that a borrower lacked an adequate basis for the required certification concerning the necessity of the loan request, SBA will seek repayment of the outstanding PPP loan balance and will inform the lender that the borrower is not eligible for loan forgiveness. If the borrower repays the loan after receiving notification from SBA, 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. For those who borrowed in excess of \$2 million, we do not think this changes the fundamental analysis. For those who borrowed less than \$2 million and returned the money out of an abundance of caution, they may want to consider reapplying for a new loan. Keep in mind, however, that this is not regulatory guidance (it's an FAQ) and it only provides that

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the certification will be deemed to have been made in good faith. Accordingly, we advise that any borrower that returned the money and subsequently reapplies may want to ensure it still has an adequate basis for the required certification.

UPDATE (May 5, 2020). The SBA will be extending the repayment date for the safe harbor to May 14, 2020. Borrowers do not need to apply for this extension.

ORIGINAL (May 1, 2020)

Please be advised that new guidance under the Paycheck Protection Program (PPP) appears to effectively “walk back” express provisions under the law which may make it necessary for many applicants to re-evaluate their eligibility or face civil and criminal penalties.

- On March 27th the CARES Act (the “Act”) was signed in to law by President Trump which provided for emergency forgivable loans from the Small Business Administration (SBA) under the PPP. Under the Act, applicants needed to make a good faith certification “that the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient;” (the “Necessity Standard”). Although a normal requirement for SBA loans is that the applicant show that they cannot obtain credit elsewhere (the “No Credit Elsewhere” requirement), Section 1102(a) of the Act made clear that the No Credit Elsewhere requirement expressly did not apply to PPP loans. As a result, most of those seeking PPP loans did not read a No Credit Elsewhere requirement into the Necessity Standard.
- Lenders soon began processing the loans and the original \$349B in funding for the PPP was depleted on April 15th.
- On April 17th Shake Shack, a 6,000 employee publicly traded restaurant chain, released its Form 8-k which revealed that it had received PPP \$ on April 10th. Media reports described other large publicly traded companies as also having availed themselves of the program. Recall that the PPP deemed certain multi-location businesses in the food service and accommodation industry are able to qualify as “small businesses” under the program even though they exceeds 500 employees after applying the affiliation rules.
- On April 23rd, 2020 the SBA published FAQ 31 entitled “Do businesses owned by large companies with adequate sources of liquidity to support the business’ ongoing operations qualify for a PPP loan?” The SBA’s Answer, while referencing publicly traded companies but not expressly tying the standard to them, appeared to reintroduce the SBA’s original Credit Elsewhere rule (regardless of the language of the Act), by stating that “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. [Emphasis added]*** (the “Modified Necessity Standard”).
- On April 27th it was reported that the Los Angeles Lakers had applied for and received a PPP loan.
- On April 28th, the SBA published FAQ 37 clarifying that the limitations described in FAQ 31 to all “private companies” (e.g., all applicants with any private company owners).

- Both FAQ 31 and 37 create a new safe harbor whereby applicants that have received funds may return the money on or before May 7th and not be held in violation of the PPP good faith certification requirement. Interim Final Regulations issued on April 24th reiterate the Safe Harbor but do not mention elimination of the credit elsewhere standard. FAQ 39, released on April 29th, also makes clear that the SBA will review all loans over \$2M at the time the applicant applies for forgiveness.

This is confusing. What does this mean?

While the SBA FAQ's do not have the force of law, they have been widely followed by practitioners and certainly carry some weight as indicia of SBA personnel thinking. To be clear, we think that although the Act focused on eliminating the No Credit Elsewhere requirement, the SBA FAQ's read a broader set of concerns into the Necessity Standard. Specifically, the FAQs reference "other sources of liquidity" and "access to capital markets," which we presume would include access to debt and equity financing. Regardless of the source of the guidance and the differing language, we believe a conservative reading of the FAQ's must be taken at face value as the new, broader standard of necessity. We sympathize with readers pointing out that the FAQ's appear to conflict – or at least create confusion with – the text of the Act itself on the No Credit Elsewhere requirement, but the practical reality is that the regulating agencies and the court of public opinion are reading a strict set of requirements into the law.

For now, the practical advice is that if you have not reviewed, with counsel, your eligibility for PPP under the Modified Necessity Standard (as modified by the SBA FAQ guidance issued as recently as April 29th we recommend that you revisit your analysis before the May 7th safe harbor expires. Your new review of the Modified Necessity Standard should now include analysis of your access to "other sources of liquidity" and "access to capital markets." In addition, because of the slow creep of guidance, quickly changing landscape, public availability of PPP loan information, and the attention of the media, we also recommend that all employers consider the optics and public relations aspects of taking the PPP loan money. In that analysis, employers should also consider the possibility that the standards will change again when apparently egregious situations arise. These recommendations are applicable to all PPP applicants – public and private. Further, as discussed below, we would also recommend that you perform the analysis again at the time you ask for the loan to be forgiven.

I am still confused, is this about access to capital markets, access to credit, or both?

Probably both, but the focus should be on the **Modified Necessity Standard**, which contains three primary elements: Companies must take into account their current business activity *and their ability to access other sources of liquidity (Element 1) sufficient to support their ongoing operations (Element 2) in a manner that is not significantly detrimental to the business (Element 3).*

What do they mean by "current business activity"?

Although there is little definition here, we believe that this is meant to raise the question of whether your current business activity is able to support your ongoing operations. If so, the next question is whether that is in a manner that is not significantly detrimental to your business.

What do they mean by "ability to access other sources of liquidity"?

This is the least clear aspect of the new standard. That being said, the example for a public company is its access to capital markets. For a private company, the analogue might access to private capital, such as from owners and other investors.

Does that mean that if a company has a rich owner it does not qualify for the PPP?

Unfortunately, this is unclear. For example, does a billionaire holding one share of stock in your company mean an applicant is ineligible? Must that theoretical billionaire actually make the offer before it should be taken into account? These are unknowns, but we would urge businesses to consider the potential impact of the court of public opinion, as well.

What if owner(s) have access to credit or liquidity but no obligation to remit it to the applicant?

The FAQ's do not appear to require that an owner have any existing legal obligation to fund, through debt or equity, the applicant. We presume that an applicant must conduct a reasonable review of its ability to secure liquidity from owners.

Does having access to credit or other sources of liquidity automatically disqualify me?

No. The law, including the guidance, calls for applicants to "take into account" access to other sources of capital. We believe you should still conduct an analysis to determine the capital you have access to is sufficient to alleviate the need for PPP.

When will other credit or equity terms be so draconian as to not qualify as "other sources of liquidity"?

The FAQ's do not address this fact. Most financing sources are not likely to be as favorable as a PPP loan. However, we suspect some owners or third parties will attempt to offer highly unfavorable terms. We believe the business judgement rule will continue to protect boards and qualify them for PPP even if they turn down such draconian offers. We note that owners that also hold board seats, such as venture capitalists or private equity funds, that might also qualify as the other source of liquidity should carefully weigh their fiduciary obligations when extending an offer for liquidity to the company. Offers which serve to eliminate PPP eligibility could create fiduciary liability for the well intentioned benefactor.

What does it mean to "support ongoing operations"?

We read this second element of the Modified Necessity Standard to refer to being able to continue your business operations during the crisis. Taking into account the general purpose of the PPP, the primary indicator of this is likely to be the ability to continue to maintain your workforce and payroll at pre-COVID-19 levels.

What does "significantly detrimental to the business" mean?

This is also unclear, of course. That being said, we would suggest considering the impact of accessing liquidity. For example, if a company has lines of credit available for a building project that is in process, and accessing those lines of credit for ongoing operations would negatively impact the building project, we would read the accessing of those lines of credit as detrimental to the business and possibly significant. Unfortunately, this will be a detailed facts and circumstances analysis in each case.

Does the SBA FAQ apply to nonprofit organizations?

Not on its face, but we would recommend that such organizations undertake the same analysis, considering the possibility that the agencies or the court of public opinion further expand this type of scrutiny to such organizations.

I already reviewed my necessity carefully with counsel. Do I need to do that again? Does it matter if my business didn't turn out to be as harmed as I thought it might be when I originally applied?

We think likely yes. The FAQ and April 24th Interim Final Regulation create a new timeline for review – May 7th – as well as this new standard. Consideration should be given as to whether to return the funds. Given the timing we think a review of now current (not at the time of application) business conditions is also prudent.

I am very frustrated, how can the SBA keep moving the goalposts?

Unfortunately, under current law agency interpretations of the law tend to receive what is known as “Chevron Deference” from courts. Chevron requires courts to defer to an agency’s interpretation of the law if the law is ambiguous and the interpretation is reasonable. Although the Supreme Court recently narrowed the scope of Chevron Deference a little bit, the doctrine still makes it very difficult to challenge a federal agency’s interpretation of the law.

What if I determine that my business still qualifies today but after May 7th my business didn't turn out to be as harmed as I thought it might?

Although you are outside the May 7th safe harbor, we recommend that you perform the same eligibility analysis prior to asking for forgiveness on the PPP loan. The SBA has only said that it will review loans at the time a borrower asks for forgiveness. If it is subsequently determined that a borrower was not harmed as bad as predicted, either because the economic damage was less severe than predicted or an unanticipated source of capital appears, we would recommend prepaying the PPP loan. Although there may be some risk because a company falls outside the safe harbor, the legal and public relations risk of a prepayment is significantly reduced because the taxpayer funds would be repaid in full with interest.

What should I do?

Given the heightened attention being paid to the PPP program as well as the unusually vague and seemingly changing guidelines we recommend that applicants think both legally and with an eye towards publicity.

Legally, applicants should re-review their eligibility for the PPP, keeping in mind the Modified Necessity Standard. Most importantly, document the decisions and the process that went into making those decisions – consider reviewing our suggestions in our prior client alert on Q&A 31.

Seek counsel from experts in branding and public relations. Some applicants may very well meet the standard articulated by Congress and in the FAQs but still find themselves the subject of public and media ire. Be prepared and consider making a decision on this basis even if the legal conclusion seems clear.

What does Michael Best make of this?

We understand that Congress was pressed to pass legislation quickly to save lives. We applaud Congress and the SBA for moving quickly. We also recognize that there will be some businesses receiving funds that many think inappropriate. We encourage applicants to use common sense, document the processes they undertake to make decisions and to focus on the very namesake of the program – save as many paychecks as they can during the eight-week covered period. We do fear that too much ambiguity will dissuade even qualified applicants from taking the funds – and thus creating more

avoidable job loss. In the interim, we hope further guidance is released clarifying how to proceed and that all eligible businesses receive the help the CARES Act intended for them.

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