

PAYCHECK PROTECTION PROGRAM: ANALYZING BORROWER CERTIFICATION RISKS

May 12, 2020

The shifting narratives around the government's interpretations regarding eligibility for participation in the Paycheck Protection Program (PPP) has caused many borrowers to reconsider their own applications and to consider exiting the program by returning PPP funds by the government's current safe harbor return deadline of May 14th.

As part of the PPP loan application process, each borrower must certify that "[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant." This certification is one of seven certifications that borrowers must certify in good faith as part of the PPP loan application. Neither the PPP loan application nor the text of the certification has been changed since implementation of the PPP on April 3, 2020.

With the backdrop of increasing criticism with regard to a small number of PPP borrowers, in a series of informal guidance releases, the Treasury and SBA have provided further guidance on what the Treasury and SBA appear to believe is required by this certification.

On April 23, 2020, the Treasury published FAQ 31 providing "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." FAQ 31 went on to provide that any borrower that applied for a PPP loan prior to this guidance who repaid the loan in full by May 7, 2020, would be deemed by the SBA to have made the certification in good faith.

On April 24, 2020, the Treasury and SBA published an Interim Final Rule that put the FAQ 31 safe harbor in regulation. In adopting the regulation, the agencies noted that the safe harbor was "necessary and appropriate to ensure that borrowers promptly repay PPP loan funds that the borrower obtained based on a misunderstanding or misapplication of the required certification standard." It did not adopt all of the language from FAQ 31.

On April 28, 2020, the Treasury issued FAQ 37, which expanded FAQ 31 to also include private companies with adequate sources of liquidity to support the businesses' ongoing operations.

On April 29, 2020, the Treasury issued FAQ 39, which indicated that "to further ensure PPP loans are limited to eligible borrowers in need," that the SBA will review all loans in excess of \$2 million. The Treasury further noted that additional guidance implementing this procedure would be forthcoming.

On May 5, 2020, the Treasury issued FAQ 43 extending the repayment date for the FAQ 31 safe harbor to May 14, 2020, and on May 8, 2020, the Treasury adopted another Interim Final Rule to implement this change. The Treasury also indicated that the "SBA intends to provide additional guidance on how it will review the certification prior to May 14, 2020."

As of the drafting of this summary, the Treasury and SBA have not provided any further guidance on the certification review process, and have provided no specific guidance or regulations on the PPP forgiveness application process. To the extent further guidance is subsequently provided, it certainly could affect borrower decisions with regard to PPP loans.

While each borrower needs to make an independent decision regarding their respective PPP loan applications and whether they made such certifications in good faith, we think the following overview presents an appropriate framework for analyzing the legal and reputational risks involved in making a decision with regard to PPP loan certifications and the potential for utilizing the safe harbor return of funds.

We believe the risks can be placed in three buckets: (1) reputational risk, (2) forgiveness risk (financial), and (3) litigation risk.

1. Reputational Risk - The shifting narrative of which small businesses "deserve" PPP loans underlies the reputational risks associated with participation in PPP. Regardless of compliance with the legal framework, ultimately all borrowers run a risk that individual members of society, the press, the government, customers and/or investors will ultimately deem that the borrower "should not" have obtained the loan. This risk can be elevated (for various reasons) for different borrowers, but probably cannot be eliminated for any borrower.

In analyzing this risk, we believe it is likely that the SBA will ultimately disclose the names of all borrowers under the PPP, including disclosure of loan amounts, and that such disclosure may be made regardless of whether the PPP proceeds are returned under the safe harbor or not.

2. Forgiveness Risk - As noted above, the Treasury and SBA have yet to provide any regulations with regard to the forgiveness of the PPP loans. Under the CARES Act, such loan forgiveness is anticipated to be formulaic based on the uses of proceeds with the potential for a reduction in forgiveness based on full-time equivalent employee counts and payroll expenditure levels.

In light of the enhanced scrutiny, it is certainly possible that the Treasury will impose additional “need-based” criteria for forgiveness, including, potentially, clear bright-line standards of ineligibility for forgiveness based upon things like public company market capitalization levels, levels of liquidity, and/or prior year profitability or revenue comparisons. This may take the form of additional certifications that will be made on a loan forgiveness application.

3. Litigation Risk - Barring particular facts of fraud or other illegal activity, we believe the government will generally have a difficult time making a case against any particular borrower on the basis of an allegedly false certification. This belief is based on a number of general factors, including timing of the certification, the “good faith belief” standard for the certification, the extent of “current economic uncertainty,” and how businesses reasonably measure the liquidity “necessary to support ongoing operations.” We also note that the CARES Act specifically eliminated the obligation of borrowers (as is otherwise required for SBA loans) to certify that they were unable to obtain liquidity elsewhere.

Our experience with past government support programs (such as TARP) and the government’s initial criminal charges in connection with PPP also support that government action is focused on situations where the underlying action is clearly fraudulent and not merely a difference in opinion on the severity of economic need.

Note: In light of the extension of the safe harbor return to May 14th, and the promise of additional guidance on what that review process will look like, we encourage all borrowers to consider delaying a final decision (particularly one to keep the loan) until such guidance is available and can be factored into the borrower’s analysis. While such guidance may not change much of the underlying analysis, any additional guidance can potentially add clarity.

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