

MDM&C Update

May 14, 2020

Need-Based Eligibility Requirements of the Payroll Protection Program (PPP)

An entity is generally eligible for a Payroll Protection Loan under the PPP established by Section 1102 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act if it is a small business concern as defined in Section 3 of the Small Business Act codified at 15 U.S.C. § 632, or has 500 or fewer employees whose principal place of residence is in the United States, or is a business that operates in a certain industry and meets applicable SBA employee-based size standards for that industry.¹

In addition, eligibility for the loan requires that the borrower submit a certification, made in good faith,

“(I) that the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient; (II) acknowledging that funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments;”²

On May 13, 2020, the SBA issued FAQ 46 providing comfort for some borrowers that previously made certifications believed to be in good faith. For Payroll Protection Loans below \$2 million (including affiliates), FAQ 46 provides that: “[a]ny borrower that, together with its affiliates, 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.” The SBA’s rationale for this excepted group is that borrowers in this category are less likely to have “adequate sources of liquidity” in the current economic environment.

For borrowers with PPP loans in excess of \$2 million (including affiliates), in FAQ 46 the SBA confirmed that all such loans will be subject to review by the SBA for compliance with program rules, which is likely to include the support for the borrower’s certification concerning the necessity of the loan, and extended until May 18, 2020 the time period during which borrowers can return PPP funding to the SBA (discussed more fully below).

Background on Certification

The original legislation establishing the PPP as enacted by Congress and signed by the President contained a presumption that all small businesses were adversely affected by the COVID-19 pandemic:

(b) SENSE OF CONGRESS—It is the sense of Congress that—

- (1) all borrowers are adversely affected by COVID-19;***
- (2) relief payments by the Administration are***

appropriate for all borrowers;

Indeed, in order to expand eligibility for a Payroll Protection Loan to restaurant companies that are particularly hard-hit by closure orders, the PPP legislation provides that, for the hospitality industry, the 500-employee limit is to be applied on a per-location (not company-wide) basis. In addition, the CARES Act waived "the requirement that a small business concern is unable to obtain credit elsewhere, as defined in section 3(h)."³ This compelled the conclusion that a borrower could avail itself of the economic stimulus under the PPP even if the borrower is able to obtain credit elsewhere.

In the weeks following enactment of the legislation creating the PPP, lenders, potential borrowers and commentators focused on the technical aspects of eligibility, need being fairly presumed in light of the various gubernatorial stay-at-home orders, as well as guidance issued by the Trump Administration.

As a result of the relaxation of typical SBA loan requirements, several large companies, notably restaurant chains including Shake Shack and Ruth's Chris, received large Payroll Protection loans. Unfortunately, this generated significant publicity, which in turn generated political backlash.

The news media widely-reported the large Payroll Protection Loans to the somewhat large corporations, and the politicians changed their tune. On April 24, 2020, the SBA issued guidance in the form of Frequently Asked Questions, one of which is on point:

31. Question: Do businesses owned by large companies with adequate sources of liquidity to support the business's ongoing operations qualify for a PPP loan?

Answer: In addition to reviewing applicable affiliation rules to determine eligibility, all borrowers must assess their economic need for a PPP loan under the standard established by the CARES Act and the PPP regulations at the time of the loan application. Although the CARES Act suspends the ordinary requirement that borrowers must be unable to obtain credit elsewhere (as defined in section 3(h) of the Small Business Act), borrowers still 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.

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 [18], 2020 will be deemed by SBA to have made the required certification in good faith. (emphasis added).

(On May 5, 2020, the SBA extended the May 7 deadline to May 14, 2020, and on May 13, the SBA extended the deadline to May 18)

On April 28, 2020, Treasury Secretary Steven Mnuchin announced that for any loan over \$2 million, the Small Business Administration will be doing a full review of that loan before there is loan forgiveness.

As a result of this change in public and political attitude, borrowers of Payroll Protection Loans should take overt steps to support the certification submitted, that the uncertainty of current economic conditions makes necessary the loan request to support ongoing operations, and that the loan proceeds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments.

Standard for Certification

Unfortunately, there is no legal standard beyond the language of the required certification, and at present no guidance from the SBA beyond FAQ 31.

An important question that cannot be answered at present is whether, despite the express waiver under the CARES Act of the "requirement that a small business concern is unable to obtain credit elsewhere," the SBA will consider availability under a borrower's existing commercial credit facility to constitute access to "other sources of liquidity" making the PPL loan request unnecessary, and a borrower unable to make the required certification. Also unclear is whether, despite the waiver of any requirement for an owner guaranty, the ability of an owner to make capital contributions would be considered by the SBA as source of liquidity for a borrower.

Putting aside the issue of availability under an existing credit facility, factors that bear on whether a Payroll Protection Loan is necessary to support on-going operations include revenue projections (declines) through the period of instability, cash on hand to meet needs and expense projections for the same period.

We recommend that borrowers take steps to document their anticipated need for the Payroll Protection Loan. As an initial step, borrowers should prepare a balance sheet as of the date of the loan request. A balance sheet showing sufficient cash or working capital to maintain operations through eight weeks (*i.e.*, the loan forgiveness period for purposes of the PPP) or more may call into question whether the certification can be supported.

In addition to a balance sheet, we recommend borrowers create revenue projections to determine cash flow needs. Borrowers will likely have prepared some projected analysis to determine effects of PPP or Payroll Tax Credit. The revenue and additional costs could be integrated into this analysis to show a shortage in cash to meet projected business expenses (even taking into account existing working capital). Ideally, the analysis would be done, or confirmed, by an accounting firm with standards consistent with those used for reporting to banks. Although such projections would be subject to information from the borrower, the accounting firm would have to attest to the reasonableness of the estimates.

In the event there of an exam or other inquiry by the SBA, these projections could support the borrower's good-faith determination of its need for the funds.

Importantly, although no detail clarification regarding FAQ 31 was provided, in FAQ 46 the SBA explains that:

[i]f SBA determines in the course of its review 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.** (emphasis added).

Based on the above, borrowers of loans should document the basis for their determinations of need to the Payroll Protection Loan and may take comfort in that, if second-guessed by the SBA, the consequences are repayment of the loan without further penalty.

Again, the safe harbor period to return funding to the SBA is May 18, 2020 should a borrower believe that it cannot in good faith make the required certification that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant” And, in making this certification, borrowers must 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.”

¹ The size standards are subject to the SBA affiliation rules at CFR §121.301.

² And (III) that the eligible recipient does not have an application pending for a loan under this subsection for the same purpose and duplicative of the amounts applied for or received under a covered loan; and (IV) during the period beginning on February 15, 2020 and ending on December 31, 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.”

³ 15 U.S.C.A. § 632(h) provides that:

The term “credit elsewhere” means--

- (1) for the purposes of this chapter (except as used in section 636(b) of this title), the availability of credit on reasonable terms and conditions to the individual loan applicant from non-Federal, non-State, or non-local government sources, considering factors associated with conventional lending practices, including--
- (A) the business industry in which the loan applicant operates;
 - (B) whether the loan applicant is an enterprise that has been in operation for a period of not more than 2 years;
 - (C) the adequacy of the collateral available to secure the requested loan;
 - (D) the loan term necessary to reasonably assure the ability of the loan applicant to repay the debt from the actual or projected cash flow of the business; and
 - (E) any other factor relating to the particular credit application, as documented in detail by the lender, that cannot be overcome except through obtaining a Federal loan guarantee under prudent lending standards; and
- (2) for the purposes of section 636(b) of this title, the availability of credit on reasonable terms and conditions from non-Federal sources taking into consideration the prevailing rates and terms in the community in or near where the applicant business concern transacts business, or the applicant homeowner resides, for similar purposes and periods of time.

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