The Price of PPP – Guidance for Management & Boards on Mitigating PPP Risk

Friday, May 1, 2020

As we have previously discussed in several prior Client Alerts, the Paycheck Protection Program (“PPP”), launched last month as part of the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”), is intended to mitigate, on an expedited basis, the economic crisis that many businesses are facing as a result of the COVID-19 pandemic. When the CARES Act was quickly negotiated, drafted and approved and the PPP was launched just days thereafter, it was obvious that many of the details of PPP would be clarified post-launch. What has been somewhat unexpected is how sporadic, inconsistent and vague much of the guidance from the U.S. Small Business Administration (“SBA”) and U.S. Treasury has been since then.

One thing that is now clear is that while the application process is primarily based on certifications made by the applicant, there will be significant oversight and scrutiny of many borrowers from the government, lenders, the public, and other
third-parties. This is in addition to the government publishing the names and PPP loan amounts of borrowers and any current and future self-reporting requirements imposed on borrowers.

The news from the SBA and U.S. Treasury over the past several days has confirmed a high level of scrutiny and oversight is coming. The most significant items include the following (emphasis added):

Frequently Asked Question #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 7, 2020 will be deemed by SBA to have made the required certification in good faith.

Frequently Asked Question #37

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

Answer: See response to FAQ #31.

Joint Announcement on April 28, 2020

U.S. Treasury Secretary Steven T. Mnuchin and U.S. Small Business Administrator Jovita Carranza issued the following statement today on the Paycheck Protection Program (PPP):

“The Paycheck Protection Program is providing critical support to millions of small
businesses and tens of millions of hardworking Americans.

“We have noted the large number of companies that have appropriately reevaluated their need for PPP loans and promptly repaid loan funds in response to SBA guidance reminding all borrowers of an important certification required to obtain a PPP loan. To further ensure PPP loans are limited to eligible borrowers, **the SBA has decided, in consultation with the Department of the Treasury, that it will review all loans in excess of $2 million, in addition to other loans as appropriate, following the lender’s submission of the borrower’s loan forgiveness application.** Regulatory guidance implementing this procedure will be forthcoming.

“We remain fully committed to ensuring that America’s workers and small businesses get the resources they need to get through this challenging time.”

In addition, there are already reports that the Justice Department is finding signs of fraud associated with PPP.

As mentioned in FAQ 31 above, because the SBA’s and U.S. Treasury’s guidance has changed frequently over the past several weeks, the government has provided a “safe harbor” period for any borrowers or applicants who desire to return any PPP funds already received. Any business wishing to take advantage of the “safe harbor” has until May 7, 2020 to repay their PPP loan proceeds to their lender. Given these new guidelines, and the significant amount of press they have generated, many companies are reassessing or reconfirming whether or not they qualify for PPP. **If businesses would like to take advantage of the “safe harbor,” they have until May 7 to make a decision.**

Given how broad, and in many ways vague, the above guidance is, there is no “one size fits all” answer for businesses. **At this time, our recommendation for any business that is concerned about the new qualification guidelines is to prepare, in conjunction with the company’s senior management, board of directors and legal counsel, an internal assessment of its current and near-term operations and finances in light of the economic hardships caused by Covid-19 and the government’s response to the pandemic.** This assessment should be in writing and may be as informal as an internal email or as formal as a written memorandum or board presentation.

Until the government provides additional guidance, each applicant and borrower is left to determine what factors it may wish to include in any assessment and consider when making the required certifications in a PPP application or other documentation. These may include answers to the following questions:

- Has the company had to close temporarily due to governmental regulations requiring closure or COVID-19 infections on-site? How has this closure impacted revenue?
- What is the re-opening plan and timeline if the business was forced to close? Do you expect demand to be down even after it re-opens?
- Has there been a reduction in customer orders? How likely is it that significant customers may reduce orders in the near future?
- Have customers delayed existing or future orders?
• Have customers gone silent when typical behavior is to regularly check in?
• Are customers asking to push out their accounts receivable or otherwise not paying in a timely manner?
• Was there a “bump” in March and April as customers increased inventory, but a significant drop is expected in the coming weeks?
• Has the company conducted layoffs or furloughs or initiated salary reductions?
• How many employees would the company likely terminate or furlough if it was down X%, Y% or Z%? How likely is it expected to be down those percentages?
• Has the company suffered a loss in productivity due to employees working remotely or balancing childcare and work responsibilities?
• Is the company taking other steps to reduce costs, such as delayed capital expenditures, preserving cash or instituting a hiring freeze?
• Has the company sought guidance from internal or external counsel?
• Has the company prepared financial projections for at least the next few months? What is the base case for the financial models?
• Are there any concerns with disruptions or delays in the company’s supply chain? Have material suppliers delayed or declined to accept orders?
• Does the company have reasonable access to liquidity from banks, equity owners or third-parties? If so, what are the pricing and other terms and how would such a drawdown or transaction impact the business? How does the leverage align with the businesses’ past performance (e.g., is the company traditionally debt adverse or highly leveraged)?
• How likely is an event of default to occur under existing credit facilities or other agreements? For example, are the financial ratios too close for comfort?
• Does the company’s ownership group include a publicly traded company, a private equity or venture capital firm, or a similarly large business?
• Are there reasons that the company may want to avoid any level of governmental scrutiny?
• Could the company tolerate negative publicity?
• Are the company’s competitors facing significant declines in revenue or other challenges that you expect your company may face as well?

Regardless of whether a business is concerned about its qualification, it should, at a minimum, take the following into consideration:

1. Enter into a PPP loan with “eyes wide open” - be prepared and understand the risks and burdens associated with participating in any government-funded program;
2. Put in place internal controls and a review system that can defend any questions from the management team, the company’s board or any third-parties related to the company’s PPP application and the use of funds;
3. Consider the benefits of not participating in PPP and taking advantage of the employee retention tax credit and tax deferrals under the CARES Act when (and if) eligible;
4. Keep in mind there is nothing requiring a business to apply for complete forgiveness or keep 100% of a loan proceeds - consider not fully participating in the forgiveness portion of PPP or repaying a portion of the loan early if the extent to which your business is down is disproportional to the loan amount (e.g., if the business is down 30%, it might not require 100% of payroll costs forgiven);
5. Provide regular updates to the company’s management team, board and other relevant stakeholders about the program’s impact on the company; and

6. Review and follow any guidance related to forgiveness and take a conservative approach when interpreting any ambiguities.

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