

*Below is some additional guidance that was provided through the DFMC website as it relates to the PPP loans. Please refer specifically to the highlighted areas. In reviewing these guidelines, we **HIGHLY** recommend that you meet with your Finance Council and Business Managers and create a document explicitly documenting good faith effort showing why the PPP loan was necessary to support your parish's ongoing operations.*

Since the enactment of the CARES Act, the Small Business Administration and U.S. Department of the Treasury have continually updated the rules governing the Paycheck Protection Program (PPP) through formal rulemaking and less formal guidance. In some cases, these rules and guidance have contradicted the plain language of the Act itself.

The PPP, of course, is designed to provide businesses and nonprofits with 500 or fewer employees (subject to certain notable exceptions) access to 2 months of payroll for their employees in light of the economic uncertainty brought on by the COVID-19 Pandemic.

Treasury's New Guidance Pressures Businesses to Return PPP Funds

Under the CARES Act, borrowers are required 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." Following several high-profile media stories about how large publicly traded companies had obtained PPP loans, on April 23 – well after the first round of PPP loans had been funded – the SBA and Treasury issued additional guidance in the form of FAQ No. 31.

FAQ No. 31 appears to add a new standard for receiving a loan, namely that borrowers must "assess their economic need for a PPP loan." FAQ No. 31 also requires – for the first time – that borrowers must "tak[e] 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." FAQ No. 31 specifically calls out public companies with "substantial market value and access to capital markets" and notes that "such a company should be prepared to demonstrate to the SBA, upon request, the basis for its certification."

On April 24, Treasury issued additional Interim Final Rules that formalized and expanded on FAQ No. 31, specifically providing, among other things, a "limited safe harbor with respect to certification concerning need for PPP loan request." This new rule builds on the apparent requirements first enunciated in FAQ No. 31, and states again that "[a]ny borrower that applied for a PPP loan prior to issuance of this regulation and repays the loan in full by May 7, 2020 will be deemed by SBA to have

made the required certification in good faith." The rule further explains that "this safe harbor is 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." This safe harbor provision implicitly seeks to remind all PPP loan borrowers that the government might ultimately review any decision to receive loan proceeds by considering whether the recipient really needed the loan. Furthermore, this new Rule re-emphasizes the need for private equity portfolio companies to "carefully review the required certification on the [PPP application]," suggesting that these borrowers, in addition to publicly traded companies, might be subject to particular scrutiny.

On April 28, 2020, Treasury Secretary Steven Mnuchin announced that the government will be performing a "full audit" of every loan over \$2 million, prior to forgiveness. As of April 16, 2020, the date the SBA last reported on aggregate loan approvals, at least 25,000 businesses will be subject to this review.

FAQ No. 31, the Safe Harbor Rule, and Secretary Mnuchin's announced audit plans collectively reflect a significant departure from the plain language of the CARES Act. The CARES Act seemingly encourages PPP loan applications and maximum loan amounts by imposing very few borrower requirements. For example, the CARES Act dispenses with the typical SBA requirement that borrowers of 7(a) SBA loans must show they are unable to obtain "credit elsewhere." And the CARES Act directs the SBA to defer payments of principal and interest on PPP loans for at least 6 months because eligible recipients are "presumed to have been adversely impacted by COVID-19." Moreover, the SBA's Interim Final Rule encourages borrowers to apply for the maximum loan amount, indicating a lack of concern that borrowers would receive more PPP funds than they actually need. And the CARES Act includes provisions specifically designed to expand eligibility beyond the SBA's usual "small business concerns" to include businesses with up to 500 employees, as well as to businesses in the hospitality industry (NAICS 72 businesses) with no more than 500 employees per location, franchises assigned a franchise identifier code by the SBA, and businesses that receive financial assistance from Small Business Investment Companies.⁴

Finally, we note that FAQ No. 31, the newly issued Rules, and Secretary Mnuchin's plans to audit loans greater than \$2 million are not limited in their application to only publicly traded companies or those with private equity or venture capital investors. Indeed, it is important that any business that seeks a PPP loan meticulously document the ways that it can make a good faith showing "that the uncertainty of current economic conditions makes necessary the loan request to support the [borrower's] ongoing operations."

Public Investigations and Private Actions Are Likely to Follow

On April 23, Sen. Elizabeth Warren (D-MA) and Rep. Nydia Velázquez (D-NY), Chairwoman of the House Committee on Small Business, wrote a letter to the Inspectors General of the SBA and Treasury, requesting that these IGs investigate the implementation of the PPP and the agencies' failure to "take adequate steps to prevent a number of foreseeable errors." The letter cites reports that big banks were "playing favorites" with loan applicants during the first round of PPP funding, prioritizing existing customers seeking large loans, and that large restaurant chains, hotel chains, and publicly traded companies were approved for large loans – to the detriment of the smaller "mom and pop" businesses that Congress intended to benefit from the PPP loan program.

1. Sen. Warren and Rep. Velázquez requested that the Inspectors General open a "broad" investigation into the program's implementation, including:
2. Assessing SBA and Treasury's rulemaking and guidance process to determine whether it was effective and appropriately protected against waste, fraud, and abuse;
3. Analyzing the lending process and the banks' role in providing funds, including whether banks favored larger, wealthier customers and existing customers; and
4. Determining whether larger businesses and public companies that received PPP loans actually needed the loans, and the cost to taxpayers of those loans, as well as whether businesses with political connections were able to receive PPP loans.

The letter stops short of requesting a government investigation into the conduct of the businesses themselves. But nonetheless, if the Inspectors General take up this request, borrowers (and lenders) could find themselves in the public spotlight and/or under a political microscope – notwithstanding the fact that borrowers may have been eligible under the terms of the Act and all applicable rules.

"Too Unsympathetic to Benefit" – Newly Filed Class Action Lawsuits Demonstrate Additional Risks For Loan Recipients

Recently filed lawsuits have largely focused on the conduct of lenders in allegedly prioritizing PPP loan applications for certain customers over others. However, plaintiffs in at least one class action have gone so far as to name a purported defendant class of loan recipients, in addition to lenders. Putting aside the merits, unfounded as they may be, these lawsuits represent a new, but anticipated litigation risk for PPP loan recipients that are deemed to be unsympathetic, even if they otherwise satisfy the CARES Act's specific PPP loan requirements. For some recipients, it may be the industry in which they operate or, in others, their potential access to other sources of liquidity – but, whatever the reason, these lawsuits will continue to draw focus from private litigants. It is, therefore, important that PPP loan recipients (and future applicants) appreciate the risk of private actions and engage legal counsel early in the process.

Borrower Considerations in Light of the New Rules

The uncertainty created by FAQ No. 31, the Safe Harbor Rule, and Secretary Mnuchin's audit announcement, coupled with the government's other statements, letters, and the growing list of private lawsuits, has already caused many organizations to assess whether they should apply for a PPP loan and, for those that already have received funding, whether they should return the PPP proceeds during the "safe harbor" period. This consideration involves a complex calculus, but there are certain steps an organization can take to aid its decision making and, in the event that the organization decides to apply for the loan or keep loan proceeds, to help its decision withstand possible future external scrutiny:

- 1. Document the economic uncertainty that necessitates the loan request.**

This analysis should meaningfully describe the circumstances that support the organization's need for a loan to support payroll expenses. The business may wish to reference or attach revenue and budget projections and modeling, describe contracts that are likely to be cancelled and opportunities that are likely to disappear, and explain industry-specific difficulties. The organization also should analyze how these conditions have created a payroll shortfall, and what consequences this has had or could have for employees (e.g., that without a PPP loan the organization otherwise would be compelled to engage in layoffs or make substantial reductions in compensation).

2. Explain why alternative sources of liquidity are not available or are insufficient.

To comply with FAQ No. 31's instruction that a borrower must consider whether it has access to other sources of liquidity that could support ongoing operations without significant detriment to the business, an organization should document an assessment of alternative funding options and whether they are viable sources to support payroll. The organization should be mindful of how it receives funding in the ordinary course of business. For example:

3. Weigh the risks.

The analyses described above will help a business document and ultimately explain its decision to accept PPP funds. But if this decision comes under scrutiny for whatever reason, there are, of course, potential reputational and legal risks to that business. Even an organization that has a well-justified PPP loan may be attacked in the media because it is part of a controversial or disfavored industry, or because it is deemed to be too big to need a PPP loan (notwithstanding the CARES Act's provisions). There also is the apparent guarantee of an SBA audit for certain loans, and/or the prospect of an Inspector General or Congressional Investigation.

While an organization may emerge from a non-public government investigation without an adverse legal finding, the existence of an audit or investigation – and the prospect of potential liability – could affect a business's operations, its allocation of resources, and, possibly, its reputation, especially if it is publicly traded. Class action suits, even if wholly unfounded, are always an unwanted distraction.

All of these risks are necessarily weighed against the prospect of mass employee layoffs or drastic reductions in compensation during the COVID-19 pandemic.

Footnotes:

¹ CARES Act, § 1102(a)(2)(36)(I).

² Id. at § 1102(a)(2)(36)(M).

³ SBA, Business Loan Program Temporary Changes; Paycheck Protection Program, 85 Fed. Reg. 20,811, 20,813 (Apr. 15, 2020) (to be codified at 13 CFR pt. 120).

⁴ CARES Act, § 1102(a)(2)(36)(D).