

PPP Loan Scrutiny Requires Immediate Borrower Attention

By Rachel Maimin, Gregory Baker, Jamie Furia, Kathleen McGee and Rebecca Ryan (May 6, 2020)

Just one day after lending under the Paycheck Protection Program reopened, Treasury Secretary Steve Mnuchin warned that the Small Business Administration would audit all loans over \$2 million. The announcement follows high-profile refunds of PPP loans by large businesses that regulators, commentators and the public would not have expected to qualify for — never mind apply for — relief under this program intended to expeditiously assist small businesses impacted by COVID-19.



Rachel Maimin

The ever-evolving guidance is reacting in real-time to the realities of the program's implementation. However, that leaves borrowers with more uncertainty in already uncertain times and only increases the potential for future liability — beyond the repayment of loans later determined not to qualify for forgiveness under the program.



Gregory Baker

Mnuchin's comments came days after the SBA posted a new frequently asked question on its website addressing whether "businesses owned by large companies with adequate sources of liquidity to support the business's ongoing operations qualify for a PPP loan."



Jamie Furia

In its answer, the SBA advised that "[i]n 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."



Kathleen McGee

The SBA reiterated that a potential borrower "must certify in good faith that their PPP loan request is necessary." Thus, before submitting a PPP application, the SBA counseled borrowers to "review carefully the required certification that '[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.'"



Rebecca Ryan

The bombshell came in the SBA's guidance on how, specifically, to assess "need," with the SBA introducing an entirely new standard for applicants, both retroactively and moving forward. According to the SBA, a borrower's assessment should include consideration of "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."

The U.S. Department of the Treasury further made clear that this new requirement that applicants establish significant detriment to their current business operations and that they consider other sources of funding prior to certifying their PPP application has created a dilemma for applicants, and particularly applicants whose loans were already approved and / or disbursed. The retroactive nature of the new qualification metrics means all applicants, regardless of phase of application, must consider their application under the new standards.

Importantly, the SBA has promulgated a limited safe harbor for any borrower that applied for a PPP loan prior to April 23 and repays the loan in full by May 14: they "will be deemed by SBA to have made the required certification in good faith."^[1] Notably, this limited safe harbor provision only applies to that one certification issue; it does not extend to any other representations on the PPP application.

Because of this limited safe harbor, any borrowers that have received PPP funds, have pending applications, or are considering applying should carefully reassess whether any potential long-term risks outweigh the near-term benefits of receiving such funds. Any such analysis should not occur in a vacuum, but rather should be read in conjunction with the PPP's other rules, including those concerning a business's affiliates and its impact on eligibility.

Even if a business's relationship with, for example, a private equity firm, does not per se disqualify it for relief under the affiliation rules, a business should consider whether such actual or perceived access to liquidity would call into question its good faith certification of need.

For those borrowers who do not refund or repay the loans in full, the SBA in its audit may not just look to whether a loan should be forgiven (i.e., whether the funds were spent appropriately under the act),^[2] but also to whether the borrower was an appropriate candidate in the first instance. Whether that borrower's liability will be limited to not having the loan forgiven, or extend to civil or criminal liability, will remain to be seen.

As disclosed on the forms, applicants may be penalized for "knowingly making a false statement to obtain a guaranteed loan from SBA," and knowingly using the funds for unauthorized purposes.^[3] The statutes of limitations for the federal crimes under which charges may be brought range from five to ten years.^[4]

In addition to criminal liability, however, businesses should keep in mind the potential civil liability and reputational harm of applying for, retaining, or returning, these funds. Businesses should act now — in the brief respite provided by the limited safe harbor — to protect against any future claims against directors for breach of fiduciary duty based on alleged (1) affirmative wrongdoing, i.e., by applying for PPP loans in bad faith; or (2) failure to appropriately oversee and be informed of the company's COVID-19 response.

Affected businesses should consider holding board meetings to reassess their eligibility and debate the relative risks and benefits of receiving such funds. If companies ultimately decide to apply for or retain PPP funds, they should appropriately record the bases for their opinions. Businesses should also be forthcoming with disclosures to shareholders about their financial health and response action plans, ensuring that they are consistent with any representations or certifications made to the government.

The SBA's recent guidance should also cause lenders to reconsider their approach to processing these loans. While making clear that the onus is on the borrower to make truthful certifications, Mnuchin has questioned whether lenders should have considered whether to provide PPP loans to large businesses and run that reputational risk. Moreover, lawsuits are already mounting against lenders who are alleged to have prioritized PPP applications from big businesses over the small businesses that the loans were intended to assist.

While there is undoubtedly a need to make decisions swiftly — particularly with respect to quickly dissipating PPP funds — the limited safe harbor and SBA guidance require applicants to pause and contemplate further action prior to the looming May 14 deadline.

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[1] Paycheck Protection Program Loans Frequently Asked Questions (FAQs), U.S. Small Bus. Admin. (Apr. 28, 2020), https://www.sba.gov/sites/default/files/2020-04/Paycheck-Protection-Program-Frequently-Asked-Questions_04%2028%2020.pdf.

[2] In an interview with the Wall Street Journal, Mnuchin stated that one of the audit's focuses will be substantiating that the loan was spent on payroll and other items that qualify for forgiveness. See Bob Davis & Kate Davidson, U.S. Audits of Small-Business Loans Face Daunting Challenges, Wall St. J. (Apr. 28, 2020 9:07 PM), https://www.wsj.com/articles/sba-to-face-big-challenges-ensuring-coronavirus-loans-arent-misspent-11588094140?mod=hp_lead_pos7.

[3] Paycheck Protection Program Borrower Application Form, <https://www.sba.gov/sites/default/files/2020-04/PPP-Borrower-Application-Form-Fillable.pdf>.

[4] See 18 U.S.C. § 3282 (five-year statute of limitations generally applies); 18 U.S.C. § 3293 (10-year statute of limitations for financial institution offenses, including mail fraud affecting a financial institution (18 U.S.C. § 1341), wire fraud affecting a financial institution (18 U.S.C. § 1343), false statements to banks with respect to loans (18 U.S.C. § 1014), and bank fraud (18 U.S.C. § 1344)).