ALERTS

Treasury Department Again Issues New Guidance on PPP Loan “Necessary to Support Ongoing Operations” Certification

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On April 23, 2020, the Treasury Department issued updated guidance (“FAQ 31”) regarding a confusing aspect of the CARES Act’s popular Payroll Protection Program (“PPP”). A day later, on April 24, 2020, the Treasury Department issued a new Interim Final Rule (the “IFR”) formally implementing and expanding the scope of some of the PPP guidance in FAQ 31. In applying for a PPP loan, among other things, applicants are required to certify that “current economic uncertainty makes this loan request necessary to support the ongoing operations” of the borrower (the “Necessity Certification”). Since the PPP’s launch, this subjective Necessity Certification has given potential applicants a tough choice between two imperfect options: make the certification without complete data regarding the extent of the effect of the COVID-19 crisis on their businesses or forego PPP funds until they see a proven necessity and risk the PPP running out of money before they can apply. However, on May 13, 2020, the Treasury Department and SBA issued a new FAQ, discussed below (“FAQ 46”), which provided clarity and relief for many borrowers that were confused by FAQ 31 and the IFR – namely, FAQ 46 has provided a safe harbor (the “Small Loan Exemption”) for borrowers who, together with their affiliates, have received under $2 million in PPP loans, deeming such borrowers to have made the Necessity Certification in good faith.

FAQ 31 and portions of the IFR address the Necessity Certification and in doing so both resolve some existing confusion and create more uncertainty for borrowers. Most importantly, FAQ 31 states, and the IFR reiterates, that PPP applicants must make the Necessity Certification “taking into account their current business activity and their ability to access other sources of liquidity to support their ongoing operations in a manner that is not significantly detrimental to the business.” Focusing first on the “liquidity access” element, the CARES Act removed for PPP loans the requirement of other SBA loans that applicants be unable to secure financing from other sources. The removal of this requirement led many PPP applicants to infer that they needn’t consider non-PPP sources of liquidity in making the Necessity Certification; however, FAQ 31 and the IFR clarifiy that such access should be considered, though neither make clear what types of liquidity would need to be accessible, nor what lengths borrowers would need to go to obtain such access before determining it does not exist. Further, neither FAQ 31 nor the IFR address whether equity or debt raises need to be attempted or whether extensions of fully drawn credit facilities need to be requested, leaving many applicants with little additional practical guidance.

In addition to the "liquidity access" element, the "current business activity" element focuses on activity as of the date the applicant makes the Necessity Certification. Although the "current business activity" element was a more intuitive element of the Necessity Certification prior to FAQ 31 and the IFR, the new guidance indicates that current business activity needs to be considered in concert with liquidity access and that such combination needn't maintain operations at pre-COVID-19 levels, but only at levels that are "not significantly detrimental to the business." It remains unclear whether "current business activity" can be deemed to refer to future periods for purposes of analyzing an applicant's ability to make the Necessity Certification (i.e., can applicants consider a significant forecasted business slowdown in late May in spite of stability in late April?).

To soften the impact of the tightening of the Necessity Certification discussed above, FAQ 31 and the IFR also provide relief for PPP borrowers which have already received funds based on previously available guidance. The safe harbor included in FAQ 31 and the IFR, which has been extended by subsequent guidance, allows borrowers that applied for PPP funds prior to the issuance of FAQ 31 to repay the PPP loan in full by May 18, 2020 – in such case, the SBA will deem the Necessity Certification to have been made in good faith, which tacitly suggests that the SBA will not bring action against borrowers repaying their PPP loans in accordance with the safe harbor. This safe harbor is a key element to FAQ 31 and the IFR for businesses that have already received PPP funds and are having difficulty determining whether they correctly made the Necessity Certification. The IFR explains that the safe harbor is "necessary and appropriate to ensure that borrowers promptly repay PPP loan funds… obtained based on a misunderstanding or misapplication of the required certification standard." Secretary Mnuchin referred to this safe harbor in an April 21 briefing previewing FAQ 31 and subsequently alerted the noncompliant, stating that "to the extent these companies didn't understand this and they repay loans, that will be OK, and if not there will be potentially other consequences." Clearly, the Treasury Department is pushing for quick repayment based on the updated guidance in FAQ 31 and the IFR.

The Necessity Certification impacts eligibility, not forgivability (about which Moore & Van Allen published further commentary). While PPP funds that are deemed unforgivable would require borrowers to repay such funds with 1.00% interest, borrowers who are deemed to have not made the Necessity Certification in good faith will be deemed ineligible to have received the PPP loan in the first place, which carries much more severe consequences. If a borrower takes a PPP loan, does not repay it in full by May 18, 2020 and it is determined that the Necessity Certification was not made in good faith, the borrower could be subject, among other things, to liability under the False Claims Act, which could result in treble (3x) damages applied to the amount of the PPP loan itself or even criminal penalties. However, in addition to the Small Loan Exemption, FAQ 46 also provided clarity on the enforcement actions that the SBA plans to take with respect to borrowers who, together with their affiliates, receive $2 million or more in PPP loans. Specifically, if the SBA determines that such a borrower did not have adequate basis for making the Necessity Certification, it will request that such borrower repay the outstanding balance of the loan; if the borrower complies, the SBA will not pursue administrative enforcement action against such borrower. This review policy is not binding on the Department of Justice and other enforcement regimes, nor does it extend to any defect with a PPP application other than with respect to the Necessity Certification (e.g., the application of affiliation rules). However, given updated guidance, issued in an FAQ on April 29th ("FAQ 39") and later codified in an interim final rule, indicating that the SBA "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," FAQ 46 should

give borrowers of $2 million or more greater comfort that, in spite of the compulsory SBA audits in connection with their forgiveness applications, treble damages or criminal charges related to a defective Necessity Certification are remote.

In examining the types of companies that have received media attention for their PPP participation and the example scenario involving a public company contained in FAQ 31, we initially suspected that FAQ 31 was aimed principally at public companies with access to public debt and equity markets. However, by specifically referencing private equity portfolio companies (and providing an unambiguous declaration that private equity and hedge funds themselves are ineligible for PPP participation), the IFR makes clear that it is not only public company PPP borrowers that should reexamine their Necessity Certification, but private companies and investors, as well. Specifically, PPP borrowers that have availability in (or the ability to upsize) their existing credit facilities, equity investors with deep pockets or operations that have not yet seen a significant impact due to COVID-19 should be weary of FAQ 31's and the IFR's potential reach. Although we do not anticipate the SBA requiring the circulation of private placement memoranda and conducting of road shows for capital raises before a Necessity Certification can be made in good faith, the Treasury Department is clearly sending a message to PPP applicants (and current PPP borrowers) that they should think twice before applying for or keeping PPP funds. Once the dust has settled on the COVID-19 crisis, the federal government will have ample support under FAQ 31 and the IFR for alleging borrowers in close cases did not make the Necessity Certification in good faith.

For PPP applicants and borrowers that find themselves in a quandary as to whether they can make (or did make) the Necessity Certification in good faith, consider Shake Shack (NYSE: SHAK). FAQ 31 can be labeled the "Shake Shack Rule" as it almost directly tracks the high profile actions of Shake Shack Inc.: Shake Shack received negative press coverage regarding taking a $10 million PPP loan as a large public company, which caused it to revisit whether it had other non-PPP sources of liquidity available to it. Once Shake Shack was able to raise non-PPP capital to ensure its long-term stability, it returned the loan in its entirety and is now back in both the media's and the government's good graces.

The favorable responses that Shake Shack's actions have garnered (including praise in a tweet from Secretary Mnuchin) are an example of how PPP borrowers can use the repayment of PPP loans under the FAQ 31 and IFR "safe harbor" as not only a way to avoid False Claims Act liability, but as a marketable show of solidarity with small business that may need PPP funds more. Shortly after FAQ 31's publication, larger public PPP borrowers such as Ruth's Hospitality Group, Inc. (the owner of the Ruth's Chris Steak House chain, NASDAQ: RUTH) and investment firm Manning and Napier Inc. (NYSE: MN) publicly announced their intent to repay their PPP loans under the aforementioned safe harbor, albeit amid prior public outcry.

Moore & Van Allen's attorneys remain actively engaged in counseling businesses and individuals through the COVID-19 crisis, including through tracking updated guidance like FAQ 46 and providing timely analysis and strategic advice. The Moore & Van Allen COVID-19 Resource Center, containing all Moore & Van Allen guidance and commentary related to the COVID-19 crisis, can be accessed by visiting covid19resourcecenter. ______________ Contact:

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