

Paycheck Protection Program Loans: Certification, Forgiveness and Return of Funds

May 18, 2020

Client Advisory

The Paycheck Protection Program ("PPP") was a central feature of the federal government's economic response to the COVID-19 pandemic. Over two tranches, the program sought to inject nearly \$660 billion into the economy by making low interest loans to eligible businesses that can be converted to grants if certain conditions are met. Demand for the program has been extremely high – the initial tranche of \$349 billion was oversubscribed for in a matter of weeks.

To streamline access to funds, Congress set out broad eligibility criteria in the CARES Act provisions establishing the PPP. Those broad eligibility criteria led to a backlash when relatively large and well-capitalized companies fit within those criteria and received a substantial portion of the initial tranche of funding. In response, the Department of the Treasury and the Small Business Administration ("SBA"), which administer the program, adopted a restrictive interpretation of the eligibility language in the regulations and guidance implementing the PPP and the PPP application form. The Treasury announced several safe harbor procedures to allow companies that appeared to qualify for the PPP under the broad eligibility rules in the CARES Act but subsequently were excluded by narrower regulations and guidance to avoid penalties by returning PPP funds.

As a result, recipients of a PPP loan must now decide (with the benefit of hindsight and sometimes conflicting guidance from the SBA) whether to return the funds or to continue using the loan proceeds as intended and then seek forgiveness of the loan.

A. Revisiting Eligibility and Certification as to the Need

As we covered in previous advisories,[1] the PPP generally allows businesses employing up to 500 employees,[2] to tap into the program to make payroll, provide benefits and pay associated expenses (like continuation of group health care benefits during sick leave), and pay mortgage, rent, and utility expenses. At least 75% of the PPP loan proceeds must be used to cover payroll, and the amount of forgiveness is reduced if the number of employees of a business, or the wages of employees who make less than \$100,000/year on an annualized basis, are reduced.

The PPP loan application requires applicants to certify that, *"Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant."* Many large, and certain publicly traded, companies applied for and received PPP loans from the initial tranche of PPP funding because they met the eligibility requirements based on the number of their employees, and because the good faith standard in the certification appeared to be quite low (and subjective).

That contributed to the program quickly becoming oversubscribed, resulting in political backlash and accusations of favoritism by banks in pushing through loans for their favored (larger) customers over smaller ones. The initial subject of political ire was large publicly traded restaurant chains, which also had access to the public markets. The backlash quickly spread past the restaurant industry to large publicly traded companies generally.

1. Publicly Traded Companies

In the April 23 update to the periodically revised PPP guidance ("Guidance") published by the SBA,[3] it addressed whether "businesses owned by large companies with adequate sources of liquidity to support the business's ongoing operations qualify for a PPP loan?" The Guidance provided that:

- Applicants "must certify in good faith that their PPP loan request is necessary," which includes the certification on the PPP Application that "Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant."
- Borrowers must make their need-based 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."
- "[I]t 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."
- "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." [4]

Treasury Secretary Steven Mnuchin also stated "there are severe consequences for people who don't attest properly to this certification. And again, we want to make sure this money is available to small businesses that need it, people who have invested their entire life savings."

In the May 13 update to the Guidance, the SBA clarified how it will review a borrower's required good faith certification concerning the necessity of its loan request. Though the SBA did not list specific criteria for determining if the applicant's certification was made in good faith, the SBA did provide that (1) applicants receiving a "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", and (2) if the SBA determines that the applicant lacked an "adequate basis" for the required certification, but the applicant repays the loan upon notification of the SBA's determination, the 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."

Based on the Guidance and statements from Treasury Secretary Steven Mnuchin, recipients should consider several factors when determining whether they can make the certification concerning necessity of the loan:

- *Whether the PPP loan is for under \$2 million.* The May 13 update to the Guidance indicates that applicants for loans under \$2 million will be presumed to have made the certification concerning necessity of the loan in good faith. Unless circumstances exist clearly indicating the applicant did not require the money for its business operations, recipients of loans under \$2 million can confidently use the loan proceeds without little chance of recourse based on the certification concerning necessity of the loan.[5]
- *Whether the recipient a publicly traded company.* Publicly traded companies should be particularly cautious concerning certifications of necessity of the loan. They are, however, not barred from making the certification. The size of the company and ability of the company to obtain funds through the capital markets are important factors. Companies traded on national exchanges are likely to face the greatest scrutiny due to the generally liquid nature of securities traded on national exchanges and the resulting availability of capital.

- *Whether the recipient has documented its need for the loan and whether management considered the certification?* The certification is ultimately a judgment that must be made in good faith. Recipients can, however, help protect themselves should their certification be called into question by demonstrating that its management considered alternatives to the loan and ultimately concluded the loan was necessary to maintain business operations.
- *The public relations effects of keeping the loan.* Public perception after the initial tranche of PPP loans was that in many instances the funds ended up in the hands of companies too large to justify their participation in program design to assist small companies to pay employees and cover certain essential expenses. This reaction, coupled with the guidance from the SBA, prompted several loan recipients to return their loans. Recipients should consider the potentially negative public sentiment they may face for electing to keep loans.

2. Companies With Foreign Affiliates or Employees

Another area some companies may need to revisit is whether they satisfy the employee limit under the SBA's evolving guidance.

Subject to certain exemptions for companies in specific industries, the PPP requires applicants to have 500 or fewer employees. The interim final rule implementing the PPP, and the updates to the Guidance published on April 6, both indicate that the number of employees only includes those employees whose principal place of residence is in the United States.[6] This works in tandem with the SBA's affiliation rules, which aggregate the employees of affiliated companies but would, under prior guidance, exclude most employees of foreign affiliates when calculating the size of the PPP loan applicant.

This assumption, which was the basis for certain application, has been thrown into question recent guidance from the SBA (issued at the same time the SBA moved to exclude large publicly traded companies from the program). The May 5 Guidance provides, in Question 44, that:

*For purposes of the PPP's 500 or fewer employee size standard, an applicant must count **all of its employees and the employees of its U.S and foreign affiliates**, absent a waiver of or an exception to the affiliation rules. 13 C.F.R. 121.301(f)(6). Business concerns seeking to qualify as a "small business concern" under section 3 of the Small Business Act (15 U.S.C. 632) on the basis of the employee-based size standard must do the same.*

The statement appears to contradict the interim final rule and previous guidance from the SBA by requiring all employees be counted towards the 500-employee limit. As a result, companies that have less than 500 employees in the United States, but more than 500 employees worldwide are left without clear guidance as to whether they are eligible. This requires a fact-specific analysis by the applicants (and their counsel) before a decision is made about whether the funds should be returned.

B. Loan Forgiveness

If a business determines that its certification was made in good faith, and that it was otherwise eligible for the loan, it must next give thought to how best to maximize forgiveness of the loan.[7] As noted in the SBA's guidance, the eight-week period for measuring payroll costs used in the forgiveness calculation begins "on the date the lender makes the first disbursement of the PPP loan to the borrower" which, in turn, must be made within ten calendar days of the date of the loan approval. See Question 20.

At the conclusion of that measuring period the employer would need to apply for forgiveness through its lender. For payroll-related costs (which must comprise 75% of the costs incurred) the employer will need to provide documentation verifying that it retained employees, provide information about the employees' pay rates, and provide payroll tax filings. For the 25% of allowable non-payroll costs (such as rent and utilities), the employer will need to provide documentation that the payments were actually made. The owner of the business will be required to certify that all of the documentation is true and accurate.[8]

That guidance has been formalized in the Loan Forgiveness Application Instructions for Borrowers released by the SBA on May 15, 2020.[9] The application has four components: (1) the PPP Loan Forgiveness Calculation Form; (2) PPP Schedule A; (3) the PPP Schedule A Worksheet; and (4) the (optional) PPP Borrower Demographic Information Form. The Calculation Form (which includes several certifications by the borrower) and Schedule A must be submitted to the lender. The forgiveness application includes a certification that the amount for which forgiveness is requested:

- was used to pay costs that are eligible for forgiveness (payroll costs to retain employees; business mortgage interest payments; business rent or lease payments; or business utility payments); includes all applicable reductions due to decreases in the number of full-time equivalent employees and salary/hourly wage reductions;
- does not include nonpayroll costs in excess of 25% of the amount requested; and
- does not exceed eight weeks' worth of 2019 compensation for any owner-employee or self-employed individual/general partner, capped at \$15,385 per individual.

The borrower must certify that it accurately verified the payments of eligible payroll. This must be supported by documentation verifying the eligible cash compensation and non-cash benefit payments from the covered period, including (1) bank account statements or third-party payroll service provider reports, (2) tax forms for the same period (such as IRS Form 941 and state quarterly business and individual employee wage reporting and unemployment insurance tax filings), and (3) payment receipts, cancelled checks, or account statements, document the amount of any employer contributions to employee health insurance and retirement plans (if those amounts are sought to be forgiven).

For non-payroll costs, the borrower must document the existence of the obligations prior to February 15, 2020, in addition to eligible payments of those obligations during the covered period. The following categories of documents are required to be submitted to the lender:

- Business mortgage interest payments: Copy of lender amortization schedule and receipts or cancelled checks verifying eligible payments from the Covered Period; or lender account statements from February 2020 and the months of the Covered Period through one month after the end of the Covered Period verifying interest amounts and eligible payments.
- Business rent or lease payments: Copy of current lease agreement and receipts or cancelled checks verifying eligible payments from the Covered Period; or lessor account statements from February 2020 and from the Covered Period through one month after the end of the Covered Period verifying eligible payments.
- Business utility payments: Copy of invoices from February 2020 and those paid during the Covered Period and receipts, cancelled checks, or account statements verifying those eligible payments.

The instructions also specify documents the borrower must maintain, for a period of six years after the loan is forgiven or repaid in full, but is not required to submit with its forgiveness application. These include the Schedule A Worksheet, all documentation submitted with its PPP application, any documentation supporting its good faith necessity certification and its eligibility for the loan, as well as documentation necessary to support the loan forgiveness application and documentation demonstrating its material compliance with PPP requirements.

The business owner's certification also acknowledges that (1) if funds were knowingly used for unauthorized purposes, or (2) information provided with the application is not true and correct in all material respects, the federal government may pursue recovery of the amounts, as well civil or criminal fraud charges.

Conclusion

Businesses should consider whether, in light of evolving SBA guidance, they are eligible for PPP loans. If they determine they are not, they have until May 18, 2020, to return the funds to take advantage of the safe harbor. If the question is a close one, they should consider whether they should take their chances with the audit loans larger than \$2 million may face. Eligible borrowers should also start planning for forgiveness by following the procedures in the PPP interim final rule and the Loan Forgiveness Application released by the SBA.

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[1] See “Congress Replenishes Two Important Small Business Assistance Programs, While State and City Level Programs Remain Oversubscribed,” *available at* <https://www.clm.com/publication.cfm?ID=5713>.

[2] Or no more than 500 employees at one physical location if they are assigned a North American Industry Classification System code beginning with 72 (Accommodations and Food Services). Businesses that qualify as a “small business” under the SBA’s pre-existing size standards in 13 C.F.R. 121.201 are also eligible. Those size standards vary based on industry (NAICS code) and, in some industries, accommodate businesses with more than 500 employees.

[3] *Available at* https://www.sba.gov/sites/default/files/2020-05/Paycheck-Protection-Program-Frequently-Asked-Questions_05%2013%2020_2.pdf (current as of May 13, 2020).

[4] This safe harbor was later moved to May 18, and in some ways mooted by concurrent guidance that stated that if the loan is repaid upon receipt of notification of ineligibility from the SBA, the “SBA will not pursue administrative enforcement or referrals to other agencies” if the loan is repaid “promptly.” See Questions 46 & 47.

[5] Clearly fraudulent loans will not qualify for this safe harbor, as shown by recent arrests in Rhode Island, which were below that threshold. See <https://www.justice.gov/opa/pr/two-charged-rhode-island-stimulus-fraud>.

[6] The Guidance is available at https://www.sba.gov/sites/default/files/2020-05/Paycheck-Protection-Program-Frequently-Asked-Questions_05%2013%2020_2.pdf (current as of May 13, 2020); the interim final rule is available at <https://www.sba.gov/document/policy-guidance-ppp-interim-final-rule>.

[7] See, generally, Interim Final Rule (<https://home.treasury.gov/system/files/136/PPP-IFRN%20FINAL.pdf>) at pg. 20813-16. It should be noted that the SBA will not reduce the forgiveness amount if a laid-off employee was given a good faith, written offer of rehire, and that offer was rejected (with the rejection being documented). See Question 40. This is a recognition that the enhanced unemployment benefits will, in some instances, exceed the amount an employee was being paid. The SBA warns however, that employees “should be aware that employees who reject offers of re-employment may forfeit eligibility for continued unemployment compensation.”

[8] See Interim Final Rule Sec. (III)(2)(t)(“What certifications need to be made?”).

[9] *Available at* <https://content.sba.gov/sites/default/files/2020-05/32450407%20SBA%20Form%203508%20PPP%20Forgiveness%20Application.pdf>.

Carter Ledyard has created a COVID-19 Response Group to monitor the evolving legal landscape, address client questions and ensure client compliance with the laws and regulations issued in response to the COVID-19 pandemic. The Carter Ledyard COVID-19 Response Group consists of **Jeffery S. Boxer** (212-238-8626, boxer@clm.com), **Judith A. Lockhart** (212-238-8603, lockhart@clm.com), **Bryan J. Hall** (212-238-8894, hall@clm.com), **Alexander G. Malyshev** (212-238-8618, malyshev@clm.com), **Melissa J. Erwin** (212-238-8622, erwin@clm.com), and **Leonardo Trivigno** (212-238-8724, trivigno@clm.com). Clients should contact the attorneys listed above or their regular CLM attorney for any questions concerning legal obligations arising from the COVID-19 pandemic.

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