The 'Laker Effect' Continues: Ongoing Uncertainty With PPP Borrowers’ Uncertainty Certification

COVID-19 Resource

Probably the best known provision of the CARES Act is the creation of the forgivable payroll protection program (PPP) loan, but the devil truly has been in the details and those trying to keep up with the changing landscape could be forgiven if they throw their hands up in frustration. While it initially appeared that Congress had greatly expanded the pool of eligible borrowers, PPP funds were quickly depleted and a backlash flared up when it came to light that some publicly-traded companies had been early beneficiaries. Comments by the Treasury Secretary and others, followed by a somewhat cryptic FAQ, dictated that borrowers exercise caution when representing the effect of current economic uncertainty on their business. Yesterday, April 28, brought us the “Laker effect,” which has resulted in further guidance muddying the already murky PPP waters on what constitutes “uncertainty” for PPP purposes.

The fundamental premise of PPP is a policy decision to make payroll loans widely available. Thus, Congress:

• Expanded eligible borrowers to include any business with not more than 500 employees (with exceptions for certain industries under...
certain size standards).

• Turned off the affiliation rules for restaurants and hotels that generally combine commonly controlled businesses, separately applying the employee limit to each location.

• Requiring all borrowers to certify that “[c]urrent economic uncertainty makes this [PPP] loan request necessary to support the ongoing operations of the Applicant.”

• Suspended the ordinary requirement that borrowers must be unable to obtain credit elsewhere as a condition of receiving a PPP loan.

By removing the “no credit available elsewhere” requirement from small business lending, the business community understood that Congress was eager to support all businesses that needed support to maintain their ongoing operations in the face of COVID-driven economic uncertainty, not just those businesses that would otherwise fail. This legislative policy decision was discussed in terms of supporting small businesses who might otherwise furlough or lay off their employees. Current economic uncertainty seemed to be the requisite driver of need for government support, not insufficient access to capital. Just about anyone who could or would otherwise reduce their payroll in the absence of a PPP loan felt they could make the required certification in good faith. After the first $349 billion of funds were quickly absorbed, Congress added another $310 billion to the program – which itself is expected to be deployed within a few days of the time SBA systems were ready to accept additional loans.

The first backlash arose when eligible publicly-traded companies (Ruth’s Chris, Potbelly and Shake Shack) actually received PPP loans. On April 22, Treasury Secretary Steven Mnuchin, among other public figures, made comments suggesting that these companies were not eligible. We immediately published a Legal Update trying to address the meaning of his statements, and another Legal Update the following day after the SBA revised its PPP loan FAQs to add FAQ 31. Those Legal Updates reminded all borrowers of the need to be thoughtful, and document, the basis for their certifications, and provided our best guess of the types of criteria that ought to be considered.
New Comments Lead to New Guidance (Sort of Maybe)

On April 28, Secretary Mnuchin discussed similar outrage that the Los Angeles Lakers received a PPP loan, which the Lakers have since returned. Secretary Mnuchin did not discuss the obvious economic harm to the Lakers when the NBA cancelled the remainder of the basketball season. Nor did he address what these larger employers would do to their payrolls if the government was not funding payroll for the next eight weeks via PPP loans. Rather, Mnuchin appeared to announce a new policy, stating, “For any loan over $2 million, the SBA will be doing a full review of that loan before there is loan forgiveness.” In addition, Secretary Mnuchin stated that borrowers who made the certification without the requisite good faith could face criminal liability.

Later on April 28, the SBA updated the PPP loan FAQs to add FAQ #37, which reads in its entirety:

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.

[Emphasis supplied.]

Significantly, before focusing on the answer, we note that the question itself (like FAQ #31 before it) is literally directed only at borrowers owned by another company, in this case a private company. Further, the phrase “with adequate sources of liquidity” does not modify “businesses” (i.e., the borrower), it modifies their private company owners. The FAQ is simply not directed at well-resourced PPP borrowers, or borrowers owned by individual(s), regardless of their wealth. Similarly, the FAQ is not directed at nonprofits or other organizations that are otherwise eligible PPP borrowers.

Accordingly, FAQ #37 arguably has a narrow audience of borrowers, such as the Los Angeles Lakers and portfolio companies owned by venture capital, hedge funds and private equity.

We will leave for another day the question of why FAQ #37 is directed at borrowers owned by a private company with access to capital, but
excludes borrowers with their own ample resources or liquidity access. Should different certification standards apply if the Lakers were owned directly by the Buss family and other wealthy individuals instead of owned via a holding company that itself is owned by the same group of individuals? Indeed, a reasonable argument could be made that the certification standard should be more stringent where the borrower itself has adequate sources of liquidity, at least where there is not a complete identity of economic interest between the borrower and its private company’s owners.

Obviously borrowers owned by private companies with significant access to capital need to take this guidance to heart when assessing their ability to make a good faith certification of their need. But for reasons discussed below, we think it prudent for all borrowers, including those not owned by well-resourced private or public companies, to document their need for a PPP loan to support their ongoing operations. This is the same advice we gave to borrowers not directly covered by FAQ #31.

We repeat FAQ #31 here because (i) our advice in connection with FAQ #37 follows the advice we gave in response to FAQ #31, (ii) the answers to both FAQ questions are effectively the same, and (iii) we recognize that not all of our readers remember the language we dissected last week:

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.

[Emphasis supplied.]

FAQ #31 was literally directed only at borrowers “owned by large companies with adequate sources of liquidity to support the business’s ongoing operations.” FAQ #37 officially extended the answer in FAQ 31 to any borrower owned by a private company with adequate sources of liquidity. To be clear, the primary focus of the extension is likely portfolio companies controlled by hedge funds, venture capital and private equity. But the language is not so limited; this rule applies to any business owned by private companies with access to capital. Further, the answer does direct that:

*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.” [Emphasis supplied.]

Again, FAQ #37’s extension of FAQ #31 should not be surprising to anyone who read our April 23 Legal Update. Taken together, these FAQs imply that, if a PPP borrower didn’t focus on their need for a PPP loan to support their business when making the certification before, they should definitely do so now.

**Certification About Need, Not (Just?) Economic Uncertainty**

FAQ #31 and FAQ #37 both concern the certification that PPP loan applicants must make in good faith that “current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” Our prior article attempted to interpret the meaning of
this certification based on its text. Our subsequent article expanded on this interpretation in light of the guidance provided in FAQ #31.

Our prior interpretation of the impact of FAQ #31 on the uncertainty certification remains substantially unchanged after Secretary Mnuchin’s April 28 comments and the issuance of FAQ #37: All PPP loan applicants should take the certification seriously and should memorialize the deliberations undertaken to make the certification in good faith. Indeed, Secretary Mnuchin’s comments about audits of forgiveness of PPP loans over $2 million indicate that PPP loan borrowers should have the documentation ready and available when seeking forgiveness.

We recognize that nothing in the CARES Act explicitly requires this level of due diligence. Certainly it is reasonable for PPP borrowers who already made the certification to be frustrated by this late-required business need to document that they took other sources of liquidity into account when certifying their need, especially if they relied upon the original CARES Act language to their detriment by retaining employees and maintaining payroll. Such frustration is no doubt particularly acute now, when many borrowers are focused on existential questions about the ongoing viability of their business both today and when the “new normal” finally materializes. Nonetheless, we should all remain mindful of the golden rule: the person who has the gold makes the rules. Borrowers who received PPP loans in excess of $2 million should expect to be required to demonstrate the basis for their economic uncertainty certification in connection with seeking forgiveness. Those that lack that substantiation can expect even greater scrutiny of their decisions.

**What Is Meant by “the Ability to Access Other Sources of Liquidity”**

The CARES Act unambiguously provides that the usual SBA requirement that borrowers be unable to obtain credit elsewhere does not apply to PPP loans. Equally unambiguously, Secretary Mnuchin’s comments and FAQs #31 and #37 demonstrate that the SBA expects borrowers (at least those owned by well-resourced companies) to “take into account their current business activity and their ability to access other sources of liquidity when certifying their economic need.”

We do not believe the newly added gloss on the definition of “need” means that a business with access to other sources of liquidity
(presumably, including borrowing capacity or the ability to sell dilutive equity) cannot make the required certification in good faith. Otherwise, it would limit the PPP to that subset of borrowers who failed to adequately plan for even a short term business recession or other contingencies, or to those whose business was already at risk of failing because of inadequate capital, i.e., the target audience for the SBA’s Pre-CARES Act 7(a) lending. We think it doubtful that Congress would have allocated some $660 billion to a program that had such limited applicability.

Instead, we believe FAQ #37 means that borrowers should balance their access to other capital against their current needs in light of the economic uncertainty accompanying a global pandemic. That balancing act should also consider their capital needs to support ongoing operations in conjunction with the decisions they would otherwise make about staffing levels and payroll maintenance. And it means that such borrowers should be prepared to justify their reasons for preserving whatever access to capital they may have to avoid taking actions that could prove “significantly detrimental to the business.”

Unfortunately, all of the above described focus on demonstrating financial need for a PPP means that some businesses (at least those owned by well-resourced companies) will decide to both:

- Forego a PPP; and

- Preserve their access to capital by reducing their payroll. Such a business decision may seem brutally capitalistic, but probably made easier because:

  - Enhanced unemployment benefits provided by the CARES Act ameliorates the impact on (especially) lower-paid employees;

  - It avoids the liability associated with asking employees to continue working in the face of a pandemic; and

  - Given the number of unemployed that will be looking for jobs when the pandemic subsides, it may allow an employer to staff back up at lower cost.
Indeed, such a business decision could seem quite reasonable when the alternatives are either:

- To deplete the business’s (or owner’s) own resources (or take on additional debt or suffer dilution) in order to maintain payroll larger than the current needs of the business; or

- To borrow (or retain) PPP loan proceeds the primary beneficiaries of which are (arguably) employees who would otherwise face furloughs or termination, especially when doing so is coupled with a risk of post-hoc scrutiny of the business decision by a skeptical government agency that has the ability to threaten criminal prosecution.

We understand that this may be a logical reaction to the public backlash and the confusion created by the comments and guidance that followed. However, we believe that most businesses can still reach a different conclusion — one that protects payrolls and preserves the ability to more quickly restart their businesses when the infection rate wanes. As noted above, we believe that most businesses can still use PPP loans for their intended purpose, albeit after taking the necessary time to carefully consider the uncertainty certification and memorialize that factors that allow the business to make the certification in good faith.

Potential Silver Lining: Increase in Deferral of the Employer Portion of Social Security Tax

Prior statements and guidance about the uncertainty certification have already made some businesses that need a PPP loan nervous about obtaining this relief. Secretary Mnuchin’s new statements, including an automatic audit for forgiveness of PPP loans over $2 million and his reference to criminal charges, will only add to this anxiety.

On the other hand, a delay in forgiveness because of the audit could actually benefit borrowers by increasing the amount of the interest-free loan they effectively receive with respect to the employer portion of social security taxes. Specifically, as described in a prior Legal Update, the payment of the employer portion of social security taxes otherwise due between March 27 and December 31 can be deferred under the CARES Act. Half of the deferred taxes are due by December 31, 2021, with the other half due by December 31, 2022. The ability to continue deferring payment of these payroll taxes ceases once the lender issues its decision...
that some or all of the PPP loan would be forgiven. Amounts deferred until
then continue to be deferred until December 31, 2021 and December 31,
2022. The delay in forgiveness caused by the SBA review of forgiveness
applications generally should increase the amount of these deferred
taxes. Of course, it also increases the one percent interest a PPP borrower
must pay on the PPP loan.

1 Note that the certification language in the PPP application differs slightly
from that set forth in the CARES Act, which states: “the uncertainty of current
economic conditions makes necessary the loan request to support the
ongoing operations of the eligible recipient.”