SBA Suggests Higher Scrutiny for Paycheck Protection Program Eligibility

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AUTHORS

David Mortlock | Neil W. Townsend | Bruce C. Herzog | Jeffrey R. Poss
Matthew J. Rizzo | John Joy | Ahmad El-Gamal

In the wake of public criticism of certain Paycheck Protection Program ("PPP") loans made to large corporate entities, the Small Business Administration ("SBA") has issued further guidance on the eligibility criteria for the PPP in an interim final rule released on April 24, 2020 and an update to the SBA's PPP FAQs. As congressional and regulatory oversight committees are established to review access to PPP loans and other government stimulus, and political rhetoric grows in intensity, this new guidance may provide an indication of where scrutiny of borrowers will be most focused. Meanwhile, new funding for the PPP program has been authorized by Congress and approved by the president.

1. **Exclusion of Private Equity Firms and Hedge Funds; Impact on Portfolio Companies**

The interim final rule states that hedge funds and private equity firms are ineligible to receive a PPP loan because they are engaged primarily in investment or speculation.

However, the interim final rule states that portfolio companies of a private equity firm are not de facto excluded, and may still be eligible to receive a PPP loan if they otherwise meet the eligibility criteria. In particular, the relevant affiliation rules in 13 CFR 121.301(f), which apply to all PPP loans, still apply to portfolio companies. For example, any applicant owned more than 50 percent or otherwise controlled by a private equity firm must include the employees, receipts, tangible net worth, or other eligibility criteria of the private equity firm and its funds and other affiliates under common control when determining whether the applicant meets the applicable criteria, unless a relevant waiver applies.

2. Enhanced Scrutiny of the "Necessity" of PPP Loans

The SBA also has suggested increased scrutiny of the applicant's need for a PPP loan, including in circumstances where the applicant is a portfolio company of a private equity fund. Any applicant must certify, in good faith, that "current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant." FAQ 31, released on April 24, 2020, states that when making the required good faith certification on the necessity of the loan, borrowers should take into account their current business activity and ability to access other sources of liquidity sufficient to support their ongoing operations in a manner not significantly detrimental to the business. The SBA provides an example of a public company with a substantial market value and access to capital markets, stating that it will likely be unable to make the required certification in good faith. FAQ 31 makes clear that the SBA will exercise scrutiny over the necessity of loans and may request that applicants demonstrate the basis for their certifications.

The SBA does not rationalize the "ability to access other sources of liquidity" clause with the fact that the CARES Act explicitly repealed an SBA rule that had required liquid owners to provide funds before a company could receive a Section 7(a) Business Loan. The interim final rule and FAQ 31 further provide that applicants may need to demonstrate the basis for their certifications if so requested by the SBA. This additional guidance continues to leave a number of questions unanswered as to how the standards will be applied to the many fact-specific and diverse circumstances of applicants impacted by the current health and economic crisis seeking PPP loans.

3. Safe Harbor if Loans Are Returned

The SBA has provided a safe harbor for companies that may have made this certification prior to the newly released guidance. Both the interim final rule and the FAQs state that a borrower who applied for a PPP loan prior to the issuance of the above-mentioned guidance and repays the loan in full by May 7, 2020 will be deemed to have made the original certification in good faith.

4. Considerations for Portfolio Companies and Sponsors

This new guidance presents several issues for consideration by boards and executives of portfolio companies who will be considering the certifications required for a PPP loan, whether to receive PPP funds, or to repay PPP loans prior to the May 7 safe harbor date referenced above.

a. Watch carefully for further guidance from the SBA or Treasury for considerations that will clarify these issues as they relate to portfolio companies of private equity firms. The SBA in particular has issued iterative guidance where, as here, questions have been left unanswered in prior guidance.

b. Consider carefully other investments or loans recently made, planned to be made, or available to the portfolio company and how that impacts the considerations described in the recent guidance. Consider carefully the

impact that availability of the PPP loans will have on business operations. Are the PPP loans necessary to support ongoing operations?

c. Consider whether circumstances have changed since the date of the application for the PPP loans. Guidance has evolved. If facts have evolved as well, keep in mind that review of the application and certifications could be made with the benefit of or influenced by hindsight. Consider these developments and related optics when determining whether to utilize the May 7 safe harbor.

Finally, access to PPP loans by private equity firms and their portfolio companies has been debated since the first stimulus bills were contemplated. Scrutiny of utilization of the PPP by portfolio companies could be intense, even in circumstances where, as with recent cases, applicants believed in good faith that they satisfied the eligibility criteria. Especially in light of recent guidance and related political theater, applicants should carefully evaluate the potential risks associated with anticipated oversight and publicity when considering using the PPP or other government stimulus programs.

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If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

David Mortlock
202 303 1136
dmortlock@willkie.com

Neil W. Townsend
212 728 8272
ntownsend@willkie.com

Bruce C. Herzog
713 510 1717
bherzog@willkie.com

Jeffrey R. Poss
212 728 8536
jposs@willkie.com

Matthew J. Rizzo
212 728 8454
mrizzo@willkie.com

John Joy
212 728 8713
jjoy@willkie.com

Ahmad El-Gamal
202 303 1142
ael-gamal@willkie.com