The Paycheck Protection Program's Headache For Borrowers

By Bert Lacativo and Susana Franco

This article reflects PPP guidelines as of May 27, 2020.

Recently, the United States Government, through the Small Business Administration (SBA), committed billions of dollars to a loan program called The Paycheck Protection Program (PPP). The PPP was designed to provide a specific incentive to small businesses to keep their workers on the payroll. As part of the program, the SBA will forgive loans if all employees are kept on the payroll for eight weeks and the money is used for payroll, healthcare benefits, rent, mortgage interest, or utilities.

All good right? Borrower beware. This may not be one of the old-fashioned government give-away programs that were not monitored to provide some level of assurance that the money went where it was intended and was used for the stipulated purpose(s). Borrowers need to make sure they are eligible based on the nature of their business, affiliation with other businesses, number of employees, proper certification of needs and proper use of loan proceeds.

On April 28, 2020, U.S. Treasury Secretary Steven T. Mnuchin and SBA Administrator Jovita Carranza issued the following statement on the PPP:

> *"The Paycheck Protection Program is providing critical support to millions of small businesses and tens of millions of hardworking Americans.*
>
> *We have noted the large number of companies that have appropriately reevaluated their need for PPP loans and promptly repaid loan funds in response to SBA guidance reminding all borrowers of an important certification required to obtain a PPP loan. To further ensure PPP loans are limited to eligible borrowers, the SBA has decided, in consultation with the Department of the Treasury, that it 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. Regulatory guidance implementing this procedure will be forthcoming.*
>
> *We remain fully committed to ensuring that America's workers and small businesses get the resources they need to get through this challenging time."*

Those receiving PPP loans in excess of $2 million will be audited if they ask for loan forgiveness and perhaps the government will even pursue criminal action against those companies who improperly certified the need for the loan. Laws such as the False Claims Act ("FCA"), which allows the government to pursue legal action against the misuse of federal funds, will likely be the basis upon which the Department of Justice (DOJ) pursues criminal action. Small businesses, but also private equity and venture capital firms whose portfolio companies may be the recipients of these funds, may face criminal charges under the FCA.

Mnuchin also states that those receiving less than $2 million may be audited upon requesting loan forgiveness. If a company does not want to worry about a potential government audit and potential criminal action it simply does not request loan forgiveness. However, why would a company want to do that if they can simply prepare for the audit by making sure that it has complied with all the rules surrounding loan eligibility. Easy right? Not so simple given the eligibility and required certifications have been a moving target.

From the SBA's Frequently Asked Questions section on its website comes this answer to an April 23, 2020 question:

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"....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."

So, if an individual or company has not returned the loan proceeds by May 14, 2020 it better get ready for an audit. What can an individual or company do to proactively prepare for a potential audit and make sure they are using the funds appropriately? Let's look at the PPP guidelines/requirements and recommended information/documentation that an individual or company should have available to support compliance with the guidelines/requirements:

Elgibility:

- Any small business concern that meets SBA's size standards (either the industry based sized standard or the alternative size standard)
- Any business, 501(c)(3) non-profit organization, 501(c)(19) veterans organization, or Tribal business concern (sec. 31(b)(2)(C) of the Small Business Act) with the greater of:
  - 500 employees, or
  - That meets the SBA industry size standard if more than 500
- Any business with a NAICS Code that begins with 72 (Accommodations and Food Services) that has more than one physical location and employs less than 500 per location
- Sole proprietors, independent contractors, and self-employed persons
- Affiliates – the no more than 500 employees is inclusive of employees of affiliated businesses which is determined based on equity ownership; stock options, convertible securities and agreements to merge; Managements association with other entities; and identity of interest (close relatives).

Recommended Information/Documentation:

- Information supporting the company's eligibility based upon the SBA's size standards.
- Information detailing the type of business including, but not limited to, articles of incorporation, application/approval for non-profit status or other information supporting the organization as a veterans or Tribal business concern. Payroll or other records detailing the number of employees with a reconciliation to the SBA industry size standard as applicable.
- Business records such as articles of incorporation describing the business as in the Accommodations and/or Food Services business. Business records detailing the number of locations along with payroll or other records detailing the number of employees per location.
- Documentation such as LLC filings and tax returns supporting the position that the business is a sole proprietorship or that the individual applying for the loan is an independent contractor and/or is self-employed.
- Documentation which clearly outlines ownership structure, such as articles of incorporation, list of board of directors, and stock option owners, and organizational structure.

Businesses that are not eligible include hedge funds, private equity (however, portfolio companies may be), life insurance companies, investment companies, financial lenders, political or lobbying type businesses, foreign entities, businesses related to live performances that are sexual in nature. Businesses that are not eligible should return the money immediately or face criminal charges under FCA.

Loan Forgiveness:

- The loan will be fully forgiven if the funds are used for:
  - payroll costs
  - interest on mortgages
  - rent
  - utilities
- Note that, due to likely high subscription, at least 75% of the forgiven amount must have been used for payroll costs.
- A reduction in workforce or reduction in salaries on an individual basis by more than 25% anytime between February 15, 2020 and April 26, 2020 without reinstatement of those employees or wages prior to June 30, 2020 will affect the amount of forgiveness of the loan.
- Forgiveness is based on the employer maintaining or quickly rehiring employees and maintaining salary levels. Forgiveness will be reduced if full-time headcount declines, or if salaries and wages decrease.

Recommended Information/Documentation:

- Documentations such as:
  - payroll records containing date of employees' hire and/or re-hire along with salary information before and after the loan proceeds were received; Form 841 payroll tax filings; state income, payroll and unemployment filings.
  - mortgage statements with proof of payment
  - leases along with proof of rental payments
  - utility bills with proof of payment.
- Proof of payment should include cancelled checks, bank statements or other receipts showing that the payments were made.
- The following is a non-exhaustive list of items for consideration when developing an analysis to support the necessity for a PPP loan:
  - From the SBA's answer to FAQ question #31 on April 23, 2020: *"The loan applicant's ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not detrimental to the business."*
  - The loan applicant's forward-looking projections of revenue and cash flow considering the uncertainty surrounding how long the pandemic and related shutdowns will last.
  - Strength of the loan applicant's balance sheet including unrestricted cash and levels of current accounts payable.
  - Loan applicants' current debt service and loan covenants and whether there will be sufficient liquidity to pay the loans and not breach loan covenants.
  - Copies of queries to financial institutions indicating their unwillingness or hesitancy to make loans to the applicant.
  - The loan applicant's industry and geography trends. In particular, is the applicant in an area with extended stay at home orders and/or is there an anticipated drop in orders for its goods and services. Also, consider whether the applicant's business has been forced to shut down.
  - Consider the scope of additional/unforeseen costs to be incurred by the loan applicant for PPE, etc.

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If the prospect of an audit is not scary enough, those receiving loans should not forget the following certification that was made on the loan application:

> *"I further certify that the information provided in this application and the information provided in all supporting documents and forms is true and accurate in all material respects. I understand that knowingly making a false statement to obtain a guaranteed loan from SBA is punishable under the law, including under18 USC 1001 and 3571 by imprisonment of not more than five years and/or a fine of up to $250,000; under 15 USC 645 by imprisonment of not more than two years and/or a fine of not more than $5,000; and, if submitted to a federally insured institution, under 18 USC 1014 by imprisonment of not more than thirty years and/or a fine of not more than $1,000,000."*

But even with self-certification, recipients of PPP loans should be aware that the FCA contains a *qui tam* or "whistleblower" provision. The provision allows for private citizens, who may also be your current or former employees, to bring suit on behalf of the federal government and receive a monetary incentive. Qui Tam could be a method for reporting PPP loan misuse and assisting the government in recovering funds lost to fraud. The Freedom of Information Act will make the names, loan amounts and approval date publicly available information. Therefore, others external to your organization such as competitors, vendors, subcontractors can also be a source of information to the government on fraudulent activity related to these loans.

FCA damages and penalties can include civil penalties as well as three times the amount of damages sustained by the government. Penalties can be imposed even if the government has not suffered damages and *qui tam* plaintiffs can receive anywhere from 15-30% of the recoveries as well as any reasonable expenses and attorney's fees. In 2019, $2.1 billion in settlements and judgements were paid to the government related to *qui tam* cases and whistleblower awards totaled $60 million.

If those receiving PPP loans, who seek payment forgiveness, take some time upfront to make sure all pertinent documentation is in hand at the time of application then a governmental audit should go smoothly and the prospect of civil or criminal prosecution will decrease.

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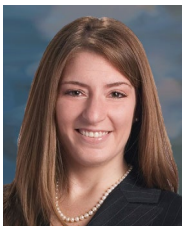

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