Insights

PPP Safe Harbor for Loans Under $2M and Helpful Guidance for Loans $2M+

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[UPDATE MAY 13, 2020] - Welcome guidance was issued today by the Small Business Administration (SBA) in the form of FAQ #46 regarding a borrower's certification of the necessity of a loan under the Paycheck Protection Program (PPP). The guidance provides a safe harbor for PPP loans with an original principal balance of less than $2M and adds some helpful guidance for those that do not satisfy this safe harbor based on the size of the principal balance.

The prior guidance of the SBA found in FAQ #31 and FAQ #37 seemed to create more uncertainty over a borrower's ability to certify necessity for the loan proceeds. Borrowers with cash resources and available lines of credit had readily made this certification in their applications. With the guidance from FAQ #31, applied to all private businesses in FAQ #37, borrowers have been reconsidering their ability to confirm the necessity linkage. As stated in FAQ #31, the certification of a borrower must be made 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."

With the degree of uncertainty caused by the COVID pandemic being confirmed by the length and extensions of the "stay at home" orders and the impact of the reality of the economic slowdown, borrowers felt confident in their certification but were apprehensive about the consequences of being challenged by the SBA. The risk of sanctions has prompted many businesses to repay the PPP loan rather than face these risks. Some may have then made decisions to reduce headcount or wages in reaction to the economic slowdown, in direct contrast to the policy objectives of the PPP to keep people employed with money in their pockets.

This new guidance from the SBA should help minimize those concerns. For those who borrowed under $2M (inclusive of the borrower's affiliates), the SBA will presume that the borrower made its certification of necessity in good faith. The SBA indicated that these borrowers would likely not have access to other sources of liquidity to the same degree as those borrowing more would likely have. In addition, the SBA indicated that this would help preserve scarce resources that would be needed for the audits of those who had borrowed $2M or more.

For those who borrowed more, the guidance remains substantially the same, but FAQ #46 also provides some helpful insights. This FAQ reminds borrowers of the $2M target audit level and confirms the requirement that a borrower had to make its certification in good faith.

However, FAQ #46 provides helpful language to this group of borrowers in a couple of places. First, borrowers of more than $2M "may still have an adequate basis for making the required good-faith certification based on their individual circumstances in light of the language of the certification and SBA guidance." This confirms that necessity certifications will be reviewed on a business by business basis, allowing each business to evaluate (and defend) its own situation. This also indicates that no particular factor will be controlling in all

circumstances and that merely having cash and lines of credit available will not negate the ability to establish a good faith belief that the PPP funds were necessary.

The second helpful guidance relates to the remedy that is available in the event the SBA disagrees with the borrower's certification. FAQ #46 clarifies that, even if the SBA determines that the loan is not eligible for forgiveness, the SBA will not pursue administrative enforcement against a borrower if the loan is repaid after receiving notification from the SBA of that determination.

Unfortunately, this FAQ does not provide further guidance about what is considered a source of liquidity for these purposes. The guidance from FAQ #31 remains in place, with FAQ #37 making the same standards applicable to all private companies and not just public companies with substantial market value and access to capital markets used as examples in FAQ #31.

Borrowers of $2M or more will still need to consider if, at the time of their certification when making application for a PPP loan, the uncertainty they felt existed made the PPP loan necessary to support ongoing operations even if the borrower had cash and credit resources available to it. With the safe harbor for returning PPP funds expiring on May 14, borrowers need to act promptly.

Borrowers should document their decision process at that time they made their certification. Consider including the following:

- A thorough discussion of the uncertainties that had been identified
- The impact on the business anticipated over the short term and the long term
- An assessment of the reserves of cash and available lines of credit (as well as other sources of liquidity relevant to a particular business): E.g. will the slowdown in receivables affect availability of those other funds? When does the line of credit renew? Will the business be able to renew the line of credit?
- The length of the anticipated impact
- The impact on the industry generally
- The reality of the impact on customers and the supply chain: are orders slowing down or being cancelled? Will suppliers be able to support the needs?
- The need for financial resources over the course of that timeframe
- An assessment of the possible detriment to the business operations from utilization of those resources at the current time and possible decreased availability if needed during the continuation of the uncertainty
- The likely change in the business operations and the cost of establishing a safe work place when the “stay at home” orders are lifted
- The decisions regarding reductions in headcount and wages that were in play if the PPP funds were not available
- An analysis of financial projections focusing on cash flow to support operations

These factors provide examples of some likely relevant considerations, but they may not be relevant to all businesses. Also, other considerations may be appropriate for a particular business.

For some discussion about additional considerations, click **here** for our earlier Alert on this issue.

Krieg DeVault is committed to helping you and your business during these unprecedented times. With your

needs in mind, we have established a **COVID-19 Resource Center** to assist you through this process.

If you have any further questions, comments or concerns, please feel free to contact **Robert A. Greising**, **Corben A. Lee** or a member of our **Business, Acquisitions & Securities team**.