



BUSINESS & CORPORATE CLIENT ALERT

Paycheck Protection Program Loan Borrowers Should Document Justification for Loan

As part of the CARES Act signed into law at the end of March, small businesses, nonprofits, and sole proprietors could apply for an SBA Paycheck Protection Program (PPP) loan. An overview of the PPP can be read [here](#).

The initial \$349 billion appropriated for the program diminished quickly, and on April 24, the President signed the Paycheck Protection Program and Health Care Enhancement Act, which provides an additional \$310 billion for PPP loans.

Certain large and publicly held companies have come under scrutiny for obtaining a PPP loan. In an [Interim Final Rule](#) released on April 24, the SBA clarified that “hedge funds and private equity firms” and companies currently involved in bankruptcy proceedings are ineligible to participate in the PPP. Further, in [public comments on April 28](#), Treasury Secretary Mnuchin stated, “We’re going to do a full audit of every loan over \$2 million. This was a program designed for small businesses. It was not a program that was designed for public companies that had liquidity.”

To this end, in updated [Frequently Asked Questions \(FAQs\)](#) released on April 29, the SBA announced “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.”

All companies who received, or are in the process of receiving a PPP loan, regardless of size, should assume they too will be audited. As part of any audit, Treasury will seek to verify the information provided by PPP applicants. Among other things, the PPP application requires applicants to certify that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” For ease of reference, this certification will be referred to as the “Necessity Certification.”

If your company applied for a PPP loan before April 24, and after assessing how your business has been affected by COVID-19 and the guidance regarding the Necessity Certification, you feel unsure whether your business should keep the loan you may return it to your lending institution by May 7, 2020 without fear of potential audit or False Claims Act (FCA) liability (discussed at the end of this alert).

What are the guidelines for the assessment? In FAQs released on April 23, the SBA provided its first glimpse of partial guidance on this certification. The answer to Question 31 of the FAQs states:

Borrowers must make [the Necessity 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.

The answer also provides an informative example of the above guidance:

[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.

In the FAQs released on April 28, the SBA clarified the answer to Question 31 also applies to businesses owned by private companies. Fortunately for lenders, they may rely on a borrower’s Necessity Certification without seeking verification of the necessity. Unfortunately for borrowers, the SBA will likely seek such verification in the coming months.

What should my business do now? Document. Document. And document.

If you applied for a PPP loan, you should document how you justified making the Necessity Certification. If your loan was for more than \$2 million, the need to document your justification is even greater given the impending audit by the SBA.

In particular, your leadership team (management or board of directors) should assess (or reassess) your rationale and justification for applying for the PPP loan and draft an internal memorandum or other document (*i.e.*, minutes from a board or executive committee meeting) describing how the PPP loan was necessary in light of current economic uncertainty due to the COVID-19 pandemic.

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Because there is little official guidance to date, at minimum, you should document your understanding of “current economic uncertainty”; how your operations have been impacted to date; the risks and reasonable expectations for your business if the economic uncertainty does not cease; and an analysis of your access to (or lack thereof) sources of capital beyond the PPP loan. Remember to include in your documentation information you would typically consider in making a similar business decision and also assess and document:

- (1) How ongoing operations have been directly impacted due to the pandemic. For example, a drop in production due to slowdowns in the supply chain, disruptions by impacted employees having to miss work, or those working from home or caring for others who are unable to produce at typical rates.
- (2) Uncertainties your business faces presently and what may lie ahead if effects on the economy persists. This includes uncertainties about the supply chain and deliverables, when you may reopen for customers and if customers will return, whether customers will have the same buying-power or will be unable to afford your product, and whether another wave of the virus will come in the fall or winter and how that may impact your business.
- (3) Reductions in sales or other metrics to show lost revenue.
- (4) Requests received to reduce orders or charges from customers or delayed or missed payments from customers.
- (5) Access to other sources of capital and any limitations on your ability to use working capital. Here, include any inability to borrow from other sources or how doing so would cause a substantial detriment on a going-forward basis. Also address how using working capital could breach a current contract or covenants on existing loans.
- (6) Business risks to take on new debt or lower available working capital.
- (7) Inability to tap investor funding. For example, your ordinary investors are unable or unwilling to provide additional financing, or the practical effects of the pandemic have halted R&D or clinical trials and new, would-be financiers are inaccessible.
- (8) If a public company, how your market value compares to other public companies and how the PPP loan was necessary regardless of being on a public market.
- (9) Plans for reducing current staff and wages and how the PPP loan (and potential forgiveness) puts these on hold.

(10) Employee retention risks, especially if required to reduce pay or put in place temporary layoffs.

(11) Industry trends that forecast disruption for your business. For example, your competitors or suppliers are facing economic challenges that are likely to affect you in the near term.

(12) Known reductions undertaken and other cutbacks by other businesses in your industry.

(13) Any other steps you are taking or considering taking to preserve capital and reduce risk. Here, address cutting budgets, limiting fringe benefits and other expenditures, hiring freezes, delaying capital expenditures, earnings guidance provided to owners or shareholders, accessing existing lines of credit.

Though your PPP application has been submitted and you are now memorializing your justifications, it is prudent to continue documenting the pandemic’s impact on your business as developments arise.

Ultimately, keep in mind the PPP was created to incentivize employers to pay workers even though their business has been hurt by the pandemic and its ramifications. Borrowers were not required to prove credit unworthiness to access the PPP loan, and it was not required that PPP funds were necessary for your survival. When drafting your internal documentation, remember these points and do your best to justify the Necessity Certification.

What potential liability is there? Though back-end enforcement may be light on those with PPP loans under \$2 million, frightening potential liabilities for failing to justify your Necessity Certification include penalties under the False Claims Act (FCA), *qui tam* actions, and losing the ability to contract with the federal government, not to mention potential public relations fallout, which is only heightened due to the fact that SBA loan applications are likely subject to Freedom of Information Act (FOIA) requests.

Under the False Claims Act (31 U.S.C. § 3729, *et seq.*), an entity or individual may be held liable for submitting a false claim to the government for payment or for causing the submission of such claim. Therefore, both the company and the authorized representative could be held responsible.

Further, the FCA prohibits knowingly making, using, or causing to be made or used, a false record or statement in connection with such claim for payment. Failure to

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comply with eligibility or regulatory requirements may trigger liability under the FCA. If found liable, you may face treble damages (possibly triple the amount of actual/compensatory damages), civil penalties, and the plaintiffs' attorneys' fees and expenses. As mentioned, liability under the FCA may also lead to the loss or ineligibility of contracting with the government.

A claim under the FCA may be brought by the Department of Justice or by a private individual (called a "realtor") in a *qui tam* action on the government's behalf. A realtor who brings a *qui tam* action may receive a percentage of the recovery—ripe for whistleblowers or those looking to cause harm to your company.

These potential liabilities only heighten the need to review the information provided and certifications made in your PPP application and to document the justification for any information or certifications made that may be reviewed in the future.

What can I do if I am uneasy about my business keeping the PPP loan in light of this guidance?

The Interim Final Rule provides a limited safe harbor whereby "[a]ny borrower that applied for a PPP loan prior to the issuance of this regulation and repays the loan in full by May 7, 2020 will be deemed by SBA to have made the required certification in good faith."

If you have any questions about the Necessity Certification or what steps you can take to minimize potential liability, or if you want assistance putting together a memorandum for your company, please contact us.

The attorneys at Woods Rogers are continuously updating our legal blog with topics relating to the COVID-19 coronavirus outbreak. You can find these articles at [woodsrogers.com/covid19](https://www.woodsrogers.com/covid19).

In addition, Woods Rogers has created a Pandemic Response Group of attorneys who are available to answer any specific questions or concerns about your obligations or potential liabilities in a range of different practice areas, such as contract law, labor & employment, construction law, cybersecurity, and commercial litigation. We stand willing and able to assist you during these difficult times.
