

To Our Clients and Friends

Memorandum

April 28, 2020

Considerations on Returning PPP Loans

Under the federal CARES Act Payroll Protection Program (PPP), which provides forgivable loans to small businesses, more than 1.6 million loans were provided before the initial \$349 billion of funding was depleted. An additional \$310 billion of funding for the program has been authorized and the processing of applications has resumed.

Negative publicity and new governmental guidance. Immediately following the end of the first round of funding, there was a wave of negative publicity based on PPP loans allegedly having been provided to larger, public and/or non-struggling companies, contrary to the announced purpose of aiding small businesses without access to capital. On April 23, 2020, the Small Business Administration and U.S. Department of the Treasury issued new guidance that emphasizes that the PPP loan application process requires that a borrower certify that, “in light of current economic uncertainty” the loan is “necessary to support the ongoing operations” of the business. The new guidance states that a company must make this certification “in good faith” after “taking into account [its] current business activity and [its] ability to access other sources of liquidity sufficient to support [its] ongoing operations in a manner that is not significantly detrimental to the business.” The new guidance also states that “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.” Finally, the new guidance states that the government will not take action against a company for a false certification if the loan was obtained before the new guidance was issued and the loan is returned by May 7, 2020. In addition, on April 28, 2020, Treasury Secretary Steven Mnuchin stated in a news interview with CNBC that the government will “do a full audit of every [PPP] loan over \$2 million,” apparently before providing forgiveness of the loan.

A focus on public companies with other available sources of capital. The negative publicity focused on the fact that more than 200 applicants for PPP loans were public companies, in most cases with significant market capitalizations and in some cases without significant financial hardship. In particular, it was noted that a number of large, publicly-traded restaurant and hotel chains had obtained PPP loans. We observe that the CARES Act, and the regulations and guidance issued initially, did not exclude public companies, did not measure the size of a business based on market capitalization, expressly waived the usual SBA requirement that the borrower have no other source of capital, and did not require any measure of the hardship suffered due to the COVID-19 pandemic. Indeed, the legislation singled out restaurant and hotel chains for certain preferential treatment in obtaining PPP loans (by providing exceptions for them to the applicability of the SBA’s affiliation rules).

Announcement by eighteen companies of an intention to return the loans. As of the time we are issuing this memorandum, it is reported that eighteen companies have publicly announced that they are returning PPP loans that they received (totaling over \$16 million). The companies include six publicly-

traded restaurant chains and three automobile dealership chains. The companies generally have announced that they are returning the loans to make more funds available for more distressed companies; that they believe that they were eligible for the loans based on the guidance available at the time they applied; and, in some cases, that they have suffered significant financial difficulties due to the pandemic and furloughed employees as well as taking other cost-cutting measures such as cutting salaries, reducing advertising outlay, and deferring capital expenditures.

If a company is considering a return of its loans, the following factors should be taken into account:

- **Financial condition.** What is the company's financial condition? Is capital needed to prevent the company from falling into bad condition? While the company may have the necessary resources to retain and pay its workforce, in light of the fungible nature of money, what other aspects of the company's business would suffer if the loan proceeds are returned?
- **Sources of capital.** How much cash availability does the company have and how much does it need? Are other sources of necessary capital available to the company? If the loan is repaid, is there enough cash available to effectively run the business? Does the company have cash; reserve capital; drawdown availability under existing loan facilities; or the potential for obtaining new loan facilities, issuing equity or debt, cancelling capex or other projects, etc.? On what terms and at what expense would the capital from these sources be available (*i.e.*, to what extent would the terms and/or expense vary from those in the past and thus, while it may be possible to obtain capital from these sources, would it be practical or sensible)? How volatile is the business--such that cash needs may be difficult to predict and could be needed urgently on short notice?
- **Public relations.** Is negative publicity or reaction likely to result from retention of the PPP loan? We note that the obtaining of a PPP loan or the ultimate forgiveness of the loan may create a disclosure obligation for certain companies and, based on these disclosures, there are a number of consumer groups providing online "tracking" of the public companies that have received PPP loans. Although the SBA currently is refusing to provide information as to who has received a PPP loan, that could change. The SBA's previous protocol with respect to disclosure of its business loan recipients was to provide the information if it was requested (although sometimes only if a FOIA request was made). Companies should consider not only the potential for public exposure but also possible reactions among the company's various constituencies (owners, directors, investors, employees, customers, analysts, etc.). The potential for a negative reaction may depend on:
 - the nature of the business (for example, there may be more acceptance for a loan to a healthcare or critical manufacturing company than other companies);
 - whether the company appears to be of the type that the program ostensibly was targeting (*i.e.*, financially struggling, not a public company, and without access to the capital markets);
 - the size of the loan that was obtained (presumably, larger loans may be subjected to more scrutiny and may be more likely to invoke negative reaction);
 - the timing of any required or planned upcoming corporate disclosure, earnings release, annual shareholder meeting, approval of executive compensation, etc. (any of which could be a vector for publicity);

- the likelihood of public expression of opposition by employees or others (based on past practice, other issues that may be a stimulant for opposition, etc.); and
 - the company's expectations as to its vulnerability to possible coercive takeover activity or shareholder activist challenges given declines in or volatility of its stock price.
- **General trend.** Have more companies generally announced an intention to return PPP loans or does it continue to be the case that only a very few companies have indicated that they will return the loans? Is there a sense that most or many companies in the relevant industry did not obtain PPP loans or are returning them?
 - **Tolerance for reputational risk.** What is the company's overall public profile and tolerance for reputational risk? What is the company's (and its directors' and management's) general approach toward issues related to its public image? Is the company currently (or was it recently, or does it expect to be) subject to significant or negative public scrutiny or criticism for other reasons?

Companies that will not be returning their loans. We expect that most companies that obtained PPP loans will not choose to return them. While a company need not be defensive about having obtained a PPP loan for which it was eligible and which is being used in accordance with the terms of the program, it should be prepared to provide an explanation of the need that prompted the company to obtain the loan and the benefit that the loan provided to the company, particularly with respect to retaining or rehiring employees.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below:

Authors and Contacts:

Gail Weinstein (COVID-19 Task Force Co-Head)	+1.212.859.8031	gail.weinstein@friedfrank.com
Michael T. Gershberg	+1.202.639.7085	michael.gershberg@friedfrank.com
William J. Breslin	+1.202.639.7051	william.breslin@friedfrank.com
Jessica Forbes	+1.212.859.8558	jessica.forbes@friedfrank.com
Steven M. Witzel (COVID-19 Task Force Co-Head)	+1.212.859.8592	steven.witzel@friedfrank.com
Joshua D. Roth (COVID-19 Task Force Co-Head)	+1.212.859.8035	joshua.roth@friedfrank.com
Jennifer A. Yashar (COVID-19 Task Force Co-Head)	+1.212.859.8410	jennifer.yashar@friedfrank.com