

To Our Clients and Friends

Memorandum

May 7, 2020

Further PPP Loan Developments—Including a New May 14 Deadline for Givebacks

The most recent developments and issues relating to the CARES Act Payroll Protection Program (PPP) loans to small businesses (including Frequently Asked Questions guidance provided as of May 6, 2020) are as follows:

- **Giveback deadline has been extended to May 14, 2020.** Following a wave of negative publicity about PPP loans being obtained by companies that are public and/or are not financially struggling, the federal government announced that, even if these companies were eligible for PPP loans under the terms of the program, the receipt of loans by these types of companies is inconsistent with the intent of the program. The government issued guidance stating that “a public company with substantial market value and access to the capital markets” likely would be unable to make in good faith the required certification on the application for a PPP loan that obtaining the loan is “necessary to support the ongoing operations [of the company] in light of current economic uncertainty.” The government advised that there could be criminal penalties for providing a false certification, and that in making the certification, applicants should “take 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 government advised all companies to consider whether they should return the PPP loans they obtained and stated that any company that returned a loan by May 7, 2020—now extended to May 14, 2020—would be deemed to have provided the certification in good faith (in other words, no government action would be taken against it for having provided a false certification). The government also stated that it intends to provide additional guidance prior to May 14, 2020 as to how it will review the certifications.
- **42 public companies (out of a total of about 350) have returned their PPP loans.** Based on public filings, as of May 6, 2020, PPP loans totaling almost \$1.2 billion had been issued to about 350 public companies. Of these, 42 companies had returned loans totaling about \$337 million. In a number of cases, the decision to return the loans followed intense social media campaigns calling for the company to return the loans or urging a boycott of the company. In several high-profile situations, the decision to return loans followed public statements initially made by the company that it would *not* be returning its loans. (We note that, unlike private companies, public companies generally may be required to disclose that they obtained a PPP loan; thus, the negative publicity and the government’s comments in response were directed primarily at public companies.)
- **Loans (over \$2 million) will be “fully audited” before forgiveness is granted.** The federal government announced that every PPP loan over \$2 million will be “fully audited” prior to forgiveness of the loan being granted. While the audit concept was prompted by concerns about whether the

required certifications relating to necessity for the loan were provided in good faith, an audit may not be limited to a review of that issue alone. (About 1.6% of the PPP loans issued to date were above \$2 million, which represented about 28% of the total dollars.) Also, the government has stated that it will audit other loans (*i.e.*, those not \$2 million and above) “as appropriate.” For borrowers that return a portion of their loans, it is not clear from the guidance whether the \$2 million amount refers to the original loan size or to the loan balance at the time of a loan forgiveness application.

- **At least one lawsuit has been filed by a PPP borrower against the government claiming detrimental reliance with respect to the giveback issue.** In *Zumasys, Inc. v. U.S. Small Business Administration, U.S. Dept. of Treasury, et al* (a case filed May 4, 2020 in a federal district court in California), the plaintiff is suing the government based on its issuing regulations relating to PPP loans that, allegedly, contradict the CARES Act legislation itself. The plaintiff is seeking judicial review of the agency action and injunctive relief.
- **Issues when determining whether a good faith certification as to necessity of the loan can be made:**
 - ***Would the ability of a privately-held company’s equityholders to make equity contributions negate “necessity” of the loan?*** Arguably, no. Although Treasury Secretary Mnuchin stated that businesses with access to other sources of capital should not obtain PPP loans, his emphasis was on “access to the capital markets” (*i.e.*, apparently, the public markets) and his comments in general were directed at public companies. In addition, importantly, the PPP regulations expressly make inapplicable to PPP loans the usual prerequisite for Small Business Administration business loans that the applicant does not have other available sources of capital (including from its equityholders).
 - ***What happens if a company is found by the government to not have made its certification of necessity for the loan in good faith?*** The borrower’s application for forgiveness of the loan would not be granted. Therefore, the principal and interest on the loan would have to be repaid in accordance with the loan terms (which provide for 1% interest, deferred for six months, and repayment of the loan after 2 years). Also, the government has stated that criminal penalties against the applicant for a fraudulent certification could be pursued. As discussed above, the government has stated that, for all PPP loans over \$2 million, the government will conduct an “audit” prior to forgiveness of the loan being granted. However, the government could decide at any time to look into whether a certification was made in good faith.
 - ***Does a company that received a loan before the government issued guidance issued April 23, 2020 that raised the issue of givebacks have to give back the loan or take other action?*** No, but the borrower would be subject to losing forgiveness of the loan if the government determines that its certification as to necessity for the loan was not made in good faith. In the May 6, 2020 FAQ guidance, the government stated that “[b]orrowers and lenders can rely on the law, regulations, and guidance available at the time of the relevant application.” The FAQ provides the following example: if a loan was applied for or approved based on the version of the PPP Interim Final Rule published on April 2, 2020, then no action needs to be taken based on the updated guidance in the May 6 FAQs. We note, however, that the good faith certification as to necessity for the loan has been required from the outset; and a loan must be returned by the May 14, 2020 deadline to obtain the safe harbor of no government action for having made a false certification. Thus, a borrower can rely on the rules that were in place when it applied for the loan, but the

good faith certification issue could be reviewed at any time (and the borrower would not have the benefit of the safe harbor with respect to good faith and therefore might have to substantiate that the certification was made in good faith).

- ***What will constitute “good faith” certification of necessity for the loan?*** There is not existing guidance from the government that addresses this question, but the issue may be addressed in the new guidance that the government has said will be issued by May 14, 2020. Arguably, an applicant would have acted in good faith (particularly before the April 23, 2020 guidance that first raised the issue about access to other capital) by relying on the stated rules of eligibility—including, specifically, the removal of the usual SBA requirement that other capital not be accessible and the fact that public companies were not excluded and financial condition criteria were not imposed—and the government’s emphasis initially on the ability and willingness of employers to retain or rehire employees (rather than the financial status of the borrowers).
- ***Do funds received in a PPP loan have to be spent by a certain date?*** No, but they must be spent within eight weeks following the first disbursement of the loan for the loan to be eligible for forgiveness. While some have interpreted the reference to “covered period” in Section 1102(a) of the CARES Act (which is defined as February 15 through June 30, 2020) as requiring that all loan proceeds be spent by June 30, 2020 (even if forgiveness is not requested and/or granted), this does not appear to be a correct interpretation and companies are not generally operating on that basis.
- ***Can an employer who returns its PPP loan by the safe harbor deadline of May 14, 2020 obtain the Employee Retention Credit?*** Yes, if it is otherwise eligible for the credit. According to the May 6 FAQ guidance, an employer that repays its PPP loan by the safe harbor deadline will be treated as if it had not received a PPP loan for purposes of the Employee Retention Credit. Therefore, the employer would be eligible for the Employee Retention Credit if it is otherwise an eligible employer for purposes of the credit.
- ***For purposes of the PPP’s 500-employees-or-fewer standard (when applicable), under the affiliation rules, are employees of foreign (non-U.S.) affiliates counted?*** Yes (as clarified in the May 6 FAQ guidance). It appears, however, based in part on the PPP loan application form and some of the regulations and guidance, that it is only those employees of foreign affiliates whose primary residence is in the U.S. that are to be counted for this purpose (although there is some remaining ambiguity on this issue).

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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:

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