

UPDATE: Did Your Business Need a PPP Loan? Borrowers May Return Funds by May 14 Without Fear of Civil or Criminal Enforcement

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This blog post may contain information that was accurate at the time of publication but could become outdated over time. We strive to provide relevant and timely content, but circumstances, facts, and data can change. Users are encouraged to verify the current status of any information presented and seek updated guidance where necessary.

Originally posted on 5/6/2020, no content changes.

UPDATE: On May 6 the SBA extended the safe harbor deadline to return PPP funds from May 7 to May 14 in FAQ #43. FAQ #43 also noted this is an automatic extension of the safe harbor and that borrowers do not need to apply for the extension. The safe harbor applies to any borrower who applied for a PPP loan prior to April 24, 2020 and repays it in full by May 14, 2020. As the SBA has provided little guidance on what it means to “need” a PPP loan, the SBA has promised to provide additional guidance on this issue prior to May 14, 2020.

**All May 7th deadlines have been extended to May 14th*

In response to adverse publicity, a number of high-profile entities, including listed companies, that had received loans in recent weeks under the Paycheck Protection Program (PPP), announced that they were returning the money. The decision by these entities was prompted in part by the SBA’s publication on April 23, 2020 of FAQ 31, emphasizing that loan applicants should think carefully before certifying, as required, that the loan was really necessary to support ongoing operations considering the uncertainty of economic conditions. The stakes were raised even further on April 28, 2020, when Treasury Secretary Steven Mnuchin announced that all companies receiving more than \$2 million of PPP money, and other loans as appropriate, would be audited and could face criminal prosecution if their certification of “need” was false and they did not return the money by May 14th.*

Predictably this sudden scrutiny of “need” by businesses that received loans has created uncertainty and anxiety among business owners who had applied in good faith, had been able to check all the qualification boxes on the application, and felt fortunate to have received the quick infusion of capital. However, the same business owners who a few weeks ago asked their attorneys and accountants for help in applying, are now asking these same advisors, with trepidation, should they keep the money?

The problem of course is that the CARES Act legislation, and supporting regulations, were hastily drafted and did not provide clarity, especially with respect to “need”. Facing a hard May 14th* deadline, what should a business owner do now if he has any concerns regarding entitlement to the loan?

Certainly, this requires a case-by-case analysis, beginning with making certain that the proceeds of the loan will be put to use as Congress intended: putting workers back on the payroll promptly, i.e., within the first eight weeks of receiving the loan. If a business is in an industry that cannot function during the lockdown, e.g., hospitality, the need for PPP money is difficult to justify.

Second, businesses that have access to other sources of capital through, the public securities markets, private equity or hedge funds, should take a closer look at their “need”.

On a more subjective basis, any company that would consider the scrutiny of a federal audit to be bad optics, e.g., a defense contractor, should carefully consider the consequences of not being able to support the need for the money.

These special circumstances aside, what should the owners of a business that received a significant PPP loan be thinking about, and doing, in the next few days before the May 14th* deadline?

If a borrower decides to retain the PPP Funds, affirmative steps must be taken now, if they have not been taken already, to document in writing the need for the loan. Put differently, in the event of audit by the SBA, the borrower must demonstrate that it had a good faith belief that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” While the Treasury and SBA have provided very little guidance on the interpretation of this borrower certification, documentation to establish a good faith belief should examine all issues the borrower faces as to economic uncertainty and necessity of the funds. Projections of revenue and cash flow under various scenarios should be made, with the margin of solvency resulting from each scenario closely analyzed. Further, the borrower should focus on issues specific to its business and also in the industry/region in which the borrower operates. Specifically, the borrower should review and document, among other items:

- Financial stability - budgets and projections, including payroll shortfall projections;
- Liquidity - cash on hand and alternative sources of funds;
- Geographic Location – will the area and region in which the borrower operates open first or last;
- Risks – is the borrower a favored “mom and pop” business;
- Employee Availability – cost to train, find and replace staff;
- Materiality of the Loan Amount – will the business be able to operate without the loan and for how long;
- Sensitivity to Public Scrutiny – what is the impact of an audit on prospective business opportunities; and
- Projected Uses of the Funds – when and how.

Although the absence of clarity in the PPP legislation and rules makes good faith compliance challenging and uncertain for all, business owners should address these issues with a team of advisors including their attorneys and accountants.