

Navigating “Necessity” Under the Paycheck Protection Program: Avoiding Risky Business

"Trust, but verify." This has gained new currency in the context of the U.S. Department of Treasury and the Small Business Administration's (SBA) April 23 and April 28 guidance concerning "necessity" certification of Paycheck Protection Program (PPP) loans and a new interim final rule issued April 30 limiting loans to corporate groups.

From here on out, accessing business critical cash from PPP loans, while concurrently navigating the potential minefield of public scrutiny and government enforcement, requires a heightened level of planning and procedures.

The good news is that corporate leaders now have an opportunity to more thoroughly document, and even go back and reconsider, their PPP loan certifications.

PPP Loan Opportunities: A Much-Needed Source of Liquidity During Desperate Times

There is no doubt that access to over \$650 billion in PPP loans offers a potential lifeline for qualifying businesses severely affected by COVID-19. The CARES Act also suspended the ordinary requirement that borrowers must be unable to obtain credit elsewhere, with the goal of streamlining the application process to get these funds distributed as quickly as possible for all the right reasons.

The message appropriately heard by many was to "hurry up and apply" and "first-come, first-served." The net result was a rush to take advantage of this government program and its immediate source of added liquidity.

Understanding the Fine Print: Getting it Right When Certifying "Economic Necessity"

From the start, companies applying for PPP loans had to certify in good faith that "[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant." But without any specifics, companies were left on their own interpreting this vague standard.

That all changed on April 23 when the SBA issued guidance in the form of a FAQ declaring that, in making the "necessity" certification, borrowers must take into account "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."

Hitting home this not-so-subtle warning, the SBA offered that any borrower who repays a prior loan by May 7, will be deemed by SBA to have made the required certification in "good faith." By creating this de facto safe harbor, many will rightly view the SBA's actions as encouragement to carefully analyze and potentially re-evaluate their applications.

Going further, the SBA issued additional guidance on April 28 in the form of another FAQ directed at private companies that may have adequate sources of liquidity, followed by a new interim final rule on April 30 capping

total loans to corporate groups at \$20 million. Companies with private owners, such as private equity and venture capital backed entities, must now carefully assess—and, critically, be prepared to justify their need—for PPP loans, and confirm they are not exceeding the new \$20 million limit applicable to funds not yet fully disbursed to a single corporate group.

Treasury Secretary Steven Mnuchin proclaimed that PPP loans of more than \$2 million will be audited, with anyone seen as exploiting the program with false certifications being criminally prosecuted. Setting aside for now whether the federal government is capable of auditing potentially millions of loans, as well as the considerable burden of proof on the government to prove a criminal false statement beyond a reasonable doubt, the take-home point here is that every company's self-certification may be scrutinized in ways that were not originally anticipated.

Understanding the Enforcement Playbook—Then and Now

The government has seen this movie before (most recently in the aftermath of the 2008-2009 financial crisis) and is taking fewer chances in this go-around. It, in fact, has already begun to position its anti-corruption sentinels. Treasury has created the position of special inspector general for pandemic recovery, and Congress has created the Pandemic Response Accountability Committee to detect and prevent fraud, waste, and abuse involving the \$2 trillion in pandemic-related funding. U.S. attorney's offices and FBI field offices around the country are similarly prioritizing COVID-19-related investigations.

Adding to the mix, the federal False Claims Act creates opportunity and incentives for whistleblowers to bring private qui tam lawsuits alleging that companies made false claims to federal funds at the expense of taxpayers. These suits carry the specter of treble damage awards (potentially equating the government's "damage" to the entire value of the loan), plus penalties.

Whatever the avenue, the enforcement playbook all but guarantees that PPP loans will be scrutinized with 20/20 hindsight rather than through the eyes of stressed corporate decision-makers pushed to make quick decisions with potentially imperfect information.

PPP Compliance: Practical Tips for Staying Above the Fray and Out of Trouble

The time to implement a PPP loan compliance and due diligence structure that objectively analyzes and documents the "necessity" certification is now. While specifics will vary, the following common-sense steps provide an appropriate starting point:

- **Document** in specific terms the impact of COVID-19 on the company
- **Identify** the cost-saving measures undertaken, including layoffs, salary cuts for top executives, recruiting slowdowns, etc.
- **Evaluate** all other sources of liquidity using objective criteria and determine whether accessing such sources would be significantly detrimental to the business
- **Analyze** economic necessity using the latest SBA guidance
- **Include** board oversight and approval
- **Be prepared** to defend and demonstrate the company's criteria and process to enforcers skeptical by nature and charter
- **Practice** "smart communication" by reminding employees of the dangers inherent in casual or flippant emails that are subject to misinterpretation
- **Monitor** changed circumstances and new information

Whatever the process, it may be helpful to view decisions to apply for a PPP loan through the eyes of a future skeptical prosecutor. Memorialize current decision-making (or have outside counsel assist with a review) using an appropriate level of objective details to help avoid having the legitimacy of the "necessity certification" second guessed later.

PPP loans can be a lifeline to many companies, and there are incredibly persuasive reasons for all eligible businesses to apply for these loans and put them to good use. This is good for the companies, good for their employees, and good for the country. Doing so without practical and thoughtful front-end due diligence, however, unnecessarily risks potentially devastating—and eminently avoidable—longer-term impacts.

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