



Timothy Crisp

Partner
303.295.8000
Denver, Salt Lake City, Santa Fe
TSCrisp@hollandhart.com

Shifting Sands: SBA Issues New Guidance on Paycheck Protection Program Loans

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Many businesses have followed with interest the news of public companies like Shake Shack and Ruth's Chris Steak House taking out multi-million-dollar Paycheck Protection Program (PPP) loans guaranteed by the U.S. Small Business Administration (SBA), and Shake Shack's later promise to promptly return the loan proceeds. In the aftermath of this news, smaller, privately held businesses may now be in a much more untenable position as PPP borrowers.

On April 23, 2020—a week after the first tranche of \$349 billion in PPP loans were fully allocated—the SBA issued additional guidance on a vague certification required by the CARES Act to be made by borrowers:

Question: *Do businesses owned by large companies with adequate sources of liquidity to support the business's ongoing operations qualify for a PPP loan?*

Answer: *In addition to reviewing applicable affiliation rules to determine eligibility, all borrowers must assess their economic need for a PPP loan under the standard established by the CARES Act and the PPP regulations at the time of the loan application. Although the CARES Act suspends the ordinary requirement that borrowers must be unable to obtain credit elsewhere (as defined in section 3(h) of the Small Business Act), borrowers still must certify in good faith that their PPP loan request is necessary. Specifically, before submitting a PPP application, all borrowers should review carefully the required certification that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” Borrowers must make this 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. For example, 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.*

Lenders may rely on a borrower's certification regarding the necessity of the loan request. Any borrower that applied for a PPP loan prior to the issuance of this guidance and repays the loan in full by May 7, 2020 will be deemed by SBA to have made the required

certification in good faith.

For borrowers with good current liquidity and who are owned or controlled by large public companies, such as Shake Shack and Ruth's Chris Steak House, this provides meaningful direction: they are not eligible, but will face no consequences for false claims if the loans are repaid by May 7.

However, the SBA's guidance is much less clear for many other companies, such as privately held companies who have not yet suffered significant losses of liquidity, and portfolio companies of private equity sponsors and venture capital funds. In fact, the latest guidance may make these borrowers significantly more uneasy about continuing as borrowers under the program or accepting their allocations.

The SBA is now requiring applicants and borrowers, after the fact, to reconsider whether the certification in their application is correct; and for the first time explicitly requires them to take into account not only their current business activities, but other sources of liquidity from revenues and lines of credit. Risk averse companies may now view the PPP loans as loans of last resort. The CARES Act suspended the previous requirement for Section 7(a) loans that credit cannot be obtained elsewhere. By effectively requiring businesses to demonstrate they are unable to obtain needed liquidity elsewhere, the Guidance creates the perverse effect of weakening that intended relief. This Guidance will likely lead many companies whose condition and prospects have worsened (but are not yet dire) to reluctantly consider repaying the loans in the next two weeks, frustrating the goals set by Congress, and possibly putting more jobs and paychecks at risk.

These businesses may not be in Shake Shacks' position, but their brightened short-term prospects (and those of their current, laid off and furloughed employees) may now have been inadvertently shaken.

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