

Treasury's Response to Perceived Abuse of the Paycheck Protection Program



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Ruth's Chris Steak House and Shake Shack obtained millions of dollars of loans from the Paycheck Protection Program. Both companies, as well as others, have now said they will repay the loans. The U.S. Department of Treasury, through the Small Business Administration, issued two statements concerning eligibility for the loans, especially as it relates to hedge funds, private equity groups, and publicly-traded companies. Treasury's statements are premised on the certification every loan applicant must make, which is "[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant."

Treasury's first official statement was through the Fourth Interim Final Rule published mid-day on Friday, April 24, 2020. The IFR addresses the eligibility of hedge funds and private equity firms and provides a "limited safe harbor" for borrowers that obtained a loan "based on a misunderstanding or misapplication of the required certification standard." The IFR states that neither hedge funds nor private equity firms are eligible for a loan because the organizations are "primarily engaged in investment or speculation." Treasury also makes clear that the affiliation rules may prohibit a portfolio company of a private equity fund from being eligible for a loan, and reiterates that "all borrowers should carefully review the required certification on the Paycheck Protection Program Borrower Application."

Under the safe-harbor provisions, borrowers that have been approved for or received a loan and determine perhaps the loan is not as "necessary to support the ongoing operations" as originally thought, may repay the loan in full by May 7, 2020 and the SBA will deem the certification on the application to have been made in "good faith." Stated otherwise, no harm will come to those that decide to repay the loans by May 7, 2020.

Later the same afternoon, Treasury and the SBA updated the Program's Frequently Asked Questions to address "large companies with adequate sources of liquidity."

That Q&A is as follows:

Question 31: 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.

The answer to Question 31 ends with a restatement of the safe harbor.

In light of these statements, companies should carefully analyze their needs and the availability of liquidity or credit elsewhere before proceeding with a loan from the Program.

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