# Paycheck Protection Program and Updated Guidance on the Economic Necessity Test

April 28, 2020

While the Small Business Association (SBA) re-opened their doors for Paycheck Protection Program (PPP) loan applications on the morning of April 27, they were busy in the days leading up to this second rollout providing additional clarification about the "economic necessity" certification all applicants are required to make - namely, that "current economic necessity makes the loan request necessary to support ongoing operations of the applicant".

The first rollout of the PPP was rocky to say the least with technical difficulties, confusion around the application process and the quick exhaustion of the funds. However, one of the biggest criticisms was that companies like Shake Shack and Ruth's Chris received these loans. The Treasury Department issued new guidance on April 23 in FAQ #31 regarding the "economic necessity" certification. The new guidance provides as an example that it's unlikely that a "public company with substantial market value and access to capital markets" would be able to make this economic necessity certification in good faith.

Now, all PPP applicants (including those that already received PPP funds) must review and carefully consider whether they can make this certification in good faith in light of this new guidance. **If not, loan funds should be paid back in full by May 7, 2020** to avoid penalties for making the certification in bad faith.

While at first blush this new FAQ #31 appeared to target large, public companies who received PPP loans, the Treasury Department and SBA also issued a new Interim Final Rule on April 24 that included the following loan eligibility clarifications:

- Hedge funds and private equity firms are NOT eligible for PPP loans
- Portfolio companies of private equity funds MAY be eligible for PPP loans, however, they must apply the SBA's affiliation rules (linked below) and must also carefully review the economic necessity certification

Ultimately, all PPP loan applicants (regardless of when you applied) should confirm that they meet the required criteria for the economic necessity certification, taking into account their particular economic situation and facts surrounding their business. We recommend that clients take the following action:

1. A PPP borrower should document the financial analysis it made to support its conclusion that its PPP loan request was necessary to support its ongoing operations. This should take account of both the revenue and expense sides of the business, with a particular focus on how current economic conditions will impact *cash flow* (since the focus of FAQ 31 is on the need for liquidity).
2. A PPP borrower should illustrate how its financial analysis would lead the company, in the absence of the PPP loan, to terminate workers and/or miss mortgage interest, rent or utility payments. The use of PPP funds for payroll expenses is the primary element of the CARES Act loan forgiveness program.
3. A PPP borrower may wish to document whether its owners were/are willing to contribute additional capital to the company. In the case of most small businesses, this post-application documentation will be largely self-serving, but it may help address the question whether the company had "access" to liquidity from sources other than credit.
4. A PPP borrower who had substantial liquid net working capital and/or liquid reserves at the time of its application

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should consider whether it properly made the good faith certification in light of the new guidance, and determine if it should return its PPP funds by the May 7, 2020, "amnesty" date. While consultation with financial and legal advisors may be helpful, the lack of clarity in the law ultimately makes this a business judgment for the company.

*LP continues to monitor this situation and will continue to update our publications as more information is released.*

**Links to:**

- Department of Treasury FAQs
- SBA Affiliation Rules

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