



PPP: DID YOU REALLY QUALIFY & WHAT ARE THE RISKS IF YOU GOT THE MONEY ANYWAY?

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Quick caveat

- PPP rules are a function of:
 - The CARES Act
 - 8 sets of interim rules published by the Treasury
 - An ever-evolving FAQ with questionable force of law
 - Lender requirements
 - Pre-existing SBA rules, as modified by CARES and subsequent guidance
- Many questions are necessarily fact-intensive
 - We may not be able to address your particular circumstances
- This program is not legal advice: important factual questions not covered in detail may lead to a different outcome. Seek and follow legal advice tailored to your situation!

How will you be targeted if you get it wrong:

- Government:
 - Size/affiliation rules
 - Certification of Need
 - Certification of Use
 - Re-certification for loan forgiveness
- Whistleblowers:
 - All of the above
 - Politically / financially motivated

Size/affiliation rules (certification of eligibility)

- To qualify you must meet certain size standards
 - Most common: number of employees.
- Typically you must aggregate with your “affiliates”
- Affiliation is a question of control:
 - Affiliation means one “concern” controls or has the power to control the other, or they’re under common control.
 - It does not matter whether control is exercised, so long as the power to control exists.

Size/affiliation rules

- Four tests for affiliation based on control apply to participants in the PPP. 13 CFR 121.301(f)
 - (1) Affiliation based on ownership
 - E.g., over 50% of your stock owned by another entity
 - (2) Affiliation arising under stock options, convertible securities, and agreements to merge.
 - (3) Affiliation based on management.
 - E.g., your CEO is CEO of another company
 - (4) Affiliation based on identity of interest.
 - E.g., a family member runs a business in the same industry/ geography

Affiliation exceptions

- **Religious Exemption.** Common religious teaching or belief or exercise of religion does not mean affiliation.
- **Waivers.** Affiliation rules are waived for businesses:
 - with NAICS code 72 and not more than 500 employees
 - assigned a franchise identifier code by the SBA; or
 - receiving financial assistance from an SBIC

Certification of Need

- Borrowers must certify that “Current economic uncertainty makes this loan request necessary to support ... ongoing operations....”
- FAQ 31 asked: what about large companies with adequate sources of liquidity?

A little background of FAQ 31

- The first allocation of PPP money went very quickly
- Some large, public companies legally qualified, but got flack:
 - Shake Shack:
 - \$1.6B market cap. \$100M on hand.
 - Was able to raise \$75M in the public markets.
 - 189 restaurants, 8,000 employees.
 - Ruth's Chris:
 - \$250M market cap. \$87M of cash on hand.
 - 150 restaurants
- SBA said the usual requirement that no other funds be available was waived, but still, “think about ‘necessary’”

FAQ 31's answer

- Reminded borrowers they must certify “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.”
- “[Take] into account ... current business activity [/] access other sources of liquidity sufficient to support ... ongoing operations in a manner ... not significantly detrimental to the business.”

More on FAQ 31

- “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 [extended to May 14] will be deemed by SBA to have made the required certification in good faith.”
- “a public company with substantial market value and access to capital markets” unlikely to be able to certify
- FAQ 37 says the same rationale applies if you’re private

We recommend you document:

- Employee headcount / hours requirements, both before and after COVID
- Alternative sources: cost of and access to capital
 - if you tried, what the response was
 - whether any available options would have been “significantly detrimental”
 - How quickly you could have gotten it (fast enough to keep people)
- Cash on hand–revenue drops by themselves may not be enough if you have other resources
- “Current business activity”: budget forecasts and other metrics of financial performance; expected variability
 - if your business benefits from COVID you may not have a need

More to document

- Expected ability to maintain payroll both with and without the loan
 - if you did not get this loan, would you have had to have made substantial personnel reductions or business office closures/adjustments (what this program was designed to prevent).
- Specifically conclude with the language of the FAQ: "[c]urrent economic uncertainty makes this loan request necessary to support ... ongoing operations...."
- Any third party concerns:
 - Going concern comment in our financials?
 - Concerns of sureties?

On the fence about necessity?

- Good news (but make sure to see the next slide, UPDATED):
 - “current uncertainty” means SBA *shouldn’t* be looking at this with 20/20 hindsight
 - Showing you used the funds to keep people will go a long way
 - Enforcement will be hard: SBA funded \$28B in loans in 2019; they will be policing >\$600B
 - \$120B of the 2nd tranche still available.
- Bad news:
 - Qui tam / gross negligence (Rob to discuss). 10 year SOL for criminal matters
 - Facts and circumstances driven—no safe harbors
 - This will be political, and optics will matter
 - All loans over \$2M and others “as appropriate” reviewed
 - Your reviewer may not be seasoned in business realities
 - We’re on notice to give back the money by Thursday if there’s a question

More good news (UPDATED!)

- While we can't update everything, there was one big development the day after our presentation:
- On May 13 the SBA released new FAQ 46, saying (paraphrased):
 - A borrower and its affiliates receiving loans under \$2M in total will be in a “safe harbor” and the certification of necessity will be deemed made in “good faith.”
 - Loans over \$2M can just be repaid (and won't be forgiven) if the SBA finds, after review, the certification “lacked an adequate basis.”
 - “SBA will not pursue administrative enforcement or referrals to other agencies”
- This significantly reduces the risk surrounding the necessity certification

Certification of Use

- You will likely be asked to certify you used the loan only for permitted uses (other uses *not* permitted):
 - 75% for payroll costs over the “covered period” (salary capped @\$100K)
 - Group health care, insurance,
 - Interest on mortgages,
 - Rent,
 - Utilities payments
 - Inventory, supplies, working capital.
- Also, be mindful of the underlying certification of average monthly payroll costs in determining loan amount initially.
- Documentation?

Re-Certification

- Re-certification for loan forgiveness.
- Amount forgiven must be 75% for payroll costs
- Other permitted costs (smaller universe than permitted use):
 - Rent
 - Mortgage interest
 - Utilities
- Forgiven amount reduced for comp and headcount reductions
- Forgiven expenditures must be within 8 weeks of funding
 - Starts as of “first disbursement” (sent, not received?)

Possible claims, charges, and penalties

- Bank fraud (18 U.S.C. § 1344)
- Mail and Wire Fraud (18 U.S.C. §§ 1341, 1343)
- False statements (15 U.S.C. § 645; 18 U.S.C. § 1001; 18 U.S.C. § 1014)
- Conspiracy (18 U.S.C. § 371; 18 U.S.C. § 1349)
- False Claims Act (31 U.S.C. §§ 3729 – 3733)

Bank fraud (18 U.S.C. § 1344)

- Whoever knowingly executes, or attempts to execute, a scheme or artifice—
- (1) to defraud a financial institution; or
- (2) to obtain any of the moneys, funds, credits, assets, securities, or other property owned by, or under the custody or control of, a financial institution, by means of false or fraudulent pretenses, representations, or promises;
- **shall be fined not more than \$1,000,000 or imprisoned not more than 30 years, or both.**

Wire fraud (18 U.S.C. § 1343)

- Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both. **If the violation** occurs in relation to, or involving any benefit authorized, transported, transmitted, transferred, disbursed, or paid in connection with, a presidentially declared major disaster or emergency (as those terms are defined in section 102 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (42 U.S.C. 5122)), or **affects a financial institution, such person shall be fined not more than \$1,000,000 or imprisoned not more than 30 years, or both.**

False statements

- 15 U.S.C. § 645 – 2 years/\$5,000 fine
- 18 U.S.C. § 1001 – 5 years/\$250,000 fine
- 18 U.S.C. § 1014 – 30 years/\$1,000,000 fine

False Claims Act (31 U.S.C. §§ 3729 – 3733)

- Damages and Penalties
 - Treble (3x) the amount of government damages (amount sought)
 - Penalty of \$5,500 to \$11,000 per false claim
- Knowledge of the falsity
 - § 3729(b)(1) defines knowledge as being (1) actual knowledge, (2) deliberate ignorance of the truth or falsity of the information, or (3) reckless disregard of the truth or falsity of the information.

False Claims Act (31 U.S.C. §§ 3729 – 3733)

- “[T]here are various civil and administrative remedies that the Government can pursue to address such misrepresentations or false statements even though it is not clear that the misrepresentations or false statements were made knowingly. For example, the Government can bring a claim under the False Claims Act if false statements are made in order to obtain money from the Government with a reckless disregard as to the accuracy of the statements. This has sometimes been equated with a gross negligence standard.”
- https://www.sba.gov/sites/default/files/sops/SOP_90_01_5_final.pdf, at pp.8-9.

False Claims Act (31 U.S.C. §§ 3729 – 3733)

- Initiated by the government
- Qui tam – whistleblowers (plaintiffs’ bar cultivating these)
 - Under seal
 - Government investigates, intervenes
 - Recovery – portion to whistleblower – 15-25% or 25-30%
 - Expenses, legal fees, and costs to whistleblower
 - If government does not intervene, whistleblower proceeds and fails, then defendant can seek fees and expenses if court finds plaintiff’s action was frivolous, vexatious, or meant to harass.

Investigative authorities

- U.S. Department of Justice/ U.S. Attorney's Offices/FBI
- SBA
 - Audit all loans above \$2 million, spot check remaining loans
 - Expect audit of every request for forgiveness
- Special Inspector General for Pandemic Recovery
 - Created to oversee Treasury Department's disbursement of CARES Act funds

First prosecution for PPP loan fraud – filed May 5

- Application for \$500,000 to cover payroll costs
- Money was never provided
- Certification indicated numerous employees, but none existed
- 2 applicants charged with bank fraud, conspiracy to commit bank fraud, making false statements to influence the SBA, and aggravated identity theft.

Other non-criminal scenarios that may result in enforcement

- Failure to consider affiliation rules
- Miscalculating monthly payroll / overstating loan amount.
- Necessity.
- Use of funds for other than payroll, mortgage interest, rent or utility payments.
- Use of funds outside of prescribed timeframe, even if for approved expenditures?

Best practices for keeping the money

- Document, document, document
- Will help undermine allegations of fraud, recklessness, and gross negligence.
- Document analysis done for:
 - Size/affiliation rules (certification of eligibility)
 - Certification of Need
 - Certification of Use
 - Re-certification for loan forgiveness

How to return the money

- One (large) bank told us:
 - No fees or charges for full or partial payoff
 - Renegotiating loan docs for a different amount may be tougher
 - Make your request in writing with key info and your bank contact handles it from there
- Another (smaller) bank:
 - None of their customers is returning the money
 - No special requirements

Specific questions

- Q: Are companies that provide asset and investment management but not property management to real estate special purpose entities eligible for PPP?
- A: This is a fairly sophisticated analysis. SBA loans are intended for operating companies. The SBA said in a recent FAQ that investment companies that control one or more SPVs that own commercial or residential properties and lease those properties are likely passive and not eligible.

How do I maximize forgiveness?

- Spend it:
 - During the 8 weeks after receiving the money
 - 75% on payroll and 25% on other permitted expenses
 - Only on obligations existing as of 2/15/20
- Remember payroll limited to first \$100K
- Remember reductions in headcount / comp reduce your forgiveness amount
 - Rehire people you laid off
- More guidance to come...

What additional guidance is coming?

- How SBA will review necessity (theoretically by 5/14)
- Forgiveness process / standards
- Review of loans / audit procedures

Spending more than 25% on “other”

- Q: What if my current payroll won't meet the 75% mark within 8 weeks due to workshare and layoffs?
- A: From the interim rule: “If you use PPP funds for unauthorized purposes, SBA will direct you to repay those amounts. If you knowingly use the funds for unauthorized purposes, you will be subject to additional liability such as charges for fraud.”

Money in the bank

- Q: What amounts of cash (%) can the company have on hand that would negate the need of PPP loans in these uncertain times?
A: Very difficult to say. All we have is the general “necessity” guidelines, but they do allow for “current uncertainty”
- Q: Will cash held to be used for an yet unidentified acquisition negate the need of PPP loans?
- A: Quite possibly. It may be difficult to say a loan was “necessary” if there was cash available, even if set aside for another purpose, if you have discretion to spend that money as you wish.

What parts of payroll count?

- Q: Do payroll costs include state and federal taxes and workman's comp payments?
- A: “State or local tax assessed on the compensation of employees,” yes. Federal tax and worker's comp, no.

Thank you!

Questions or follow-up? Please feel free to contact us any time for guidance.



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