Davis Wright Tremaine LLP
CARES Act

PAYCHECK PROTECTION PROGRAM LOANS – BEST PRACTICES

General Considerations

- We caution borrowers to be conservative with respect to their eligibility determinations and use of Paycheck Protection Program (PPP) loan proceeds. Especially where there is ambiguity or a lack of guidance, borrowers should take a more conservative approach in their analysis as more liberal interpretations may not withstanding scrutiny and/or may be contradicted by future guidance from SBA.
- Borrowers should proceed cautiously and diligently in responding to requests for information relating to PPP loans, in consultation with counsel when appropriate, in order to provide accurate and timely information.
- Borrowers should review all company statements, press releases and public disclosures to avoid comments that could inadvertently cast a negative light on borrower's use of the PPP loan funds or participation in the PPP.
- Borrowers should understand that some information, especially the identity of PPP loan recipients, and details regarding PPP loans may be subject to public disclosure under the Freedom of Information Act (FOIA). It is anticipated that news outlets, watchdog groups and even private individuals may exercise their FOIA rights with the goal of identifying specific businesses that have received PPP loans.

Application Process and Eligibility for PPP Loan

- The PPP loan application requires, among other things, that borrowers certify that the current "***economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant***." SBA has not provided any specific metrics or quantitative standards to determine "necessity" but it has recently provided the following additional guidance in the form of updated FAQs (as of April 24, 2020):
    - Borrowers must make a reasonable, good faith determination of necessity.
    - Borrowers must assess "***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***".[1]
    - As an example, SBA indicated that "***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.
    - Any borrower that applied for a PPP loan prior to the issuance of this SBA guidance (i.e. prior to April 24, 2020) and repays the loan in full by May 7, 2020 will be deemed by SBA to have made the required certification in good faith.

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[1] While the CARES Act specifically waives the typical SBA requirement that a borrower show it is unable to obtain credit elsewhere, the updated FAQs appear to cut back on this waiver.

- As a matter of prudent practice and particularly in light of recent SBA guidance regarding the "necessity" determination, we recommend the following:
  - To the extent borrowers did not specifically consider alternate sources of liquidity in connection with their initial PPP application, SBA says in the updated FAQs that they should do so. Although this language was not incorporated into the new Interim Final Rule published April 24th, the guidance is likely to be used by SBA in any review of the "necessary" certification.
  - If other sources of liquidity are available, borrowers should consider whether capital is available on terms or otherwise in a manner that is not "***significantly detrimental***" to the business. We anticipate that borrowers may consider, among other factors, the following: the likelihood of closing, timing concerns and potential employee or other cutbacks or suspension of business operations, the terms of any such financing arrangements (including repayment term, if applicable), and the potential dilutive effect of any equity financing arrangements.
  - Borrowers should substantiate the financial damage their business has suffered due to the economic uncertainty surrounding the COVID-19 pandemic, including cash flow projections, estimates of losses and comparison to 2019 income, if feasible. We anticipate that borrowers may consider, among other items, the following: decline in revenues, increases in costs of supplies, unavailability of supplies or raw materials, reduced need for employees (which would have resulted in layoffs or furloughs but for the PPP loan), cancellation of revenue generating events and activities, customers' breach or non-fulfillment of contracts, and additional operating expenses relating to COVID-19 pandemic (e.g., remote working and/or cleaning and sanitizing facilities).
  - Borrowers should maintain documentation demonstrating that borrower meets the criteria for receiving the PPP loan as well as documentation supporting borrower's certifications made in connection with applying for the PPP loan.
- Borrowers should confirm that their methodology for calculating the PPP loan amount is accurate and maintain documentation concerning determination of the PPP loan amount.
- Borrowers should have PPP loan application and/or PPP loan documents approved or ratified by their boards of directors or other governing bodies with supporting documentation concerning eligibility (including the "necessity" determination) and amount of PPP loan.
- Borrowers should consider returning a PPP loan if it is determined that the eligibility requirements were not satisfied and/or the PPP loan amount was incorrectly calculated. Borrowers considering repaying a PPP loan should consider doing so prior to May 7, 2020, as SBA has introduced a "no fault" return policy for some borrowers.

Managing PPP Loan Proceeds

In managing the use of PPP loan proceeds, we note and/or recommend the following:

- According to SBA, at least 75% of PPP loan proceeds ***must*** be used for "***payroll costs***" (as specifically defined under the CARES Act).[2]

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[2] This mandate is included in the Interim Final Rule issued April 2, 2020, which states the following: "However, at least 75 percent of the PPP loan proceeds *shall be* used for payroll costs" (emphasis added).

- Borrowers are required to maintain and provide evidence of their use of PPP loan proceeds, including, for example, IRS payroll tax filings; state income, payroll, and unemployment insurance filings; and documentation including cancelled checks and payment receipts, together with certifications of accuracy.
- While not required, it is strongly recommended that a borrower set up a separate bank account for the PPP loan proceeds so that the funds are not comingled with other accounts and the use of PPP loan proceeds can be readily tracked.
- Borrowers should ensure that PPP loan funds are used for payroll costs and other allowable expenses (i.e., mortgage interest, rent, utilities, interest on other debt)[3] ***of borrower only*** and not to satisfy obligations of any other party (including, any affiliate of borrower). Any payment of third party obligations should be carefully reviewed in light of current and continuing SBA guidance.[4]
- Borrowers should consider appointing a responsible person or committee to oversee the management and use of the PPP loan funds.
- The role of the person/committee should include creating specific plans for the use of the PPP loan funds that outline steps for complying with any specific statutory restrictions imposed on borrower and/or plans for ensuring maximum forgiveness of the PPP loan.
- Borrowers should maintain detailed records to substantiate the disbursement of any PPP loan funds (i.e., invoices of authorized costs matched up with records of payments from the PPP loan account or cancelled checks, payment receipts, transcripts of accounts or other documents verifying payments from the PPP loan proceeds).
- Borrowers should consider coordinating matters with their payroll provider to make sure they use PPP loan funds for qualified payroll costs (i.e., having payroll provider utilize separate PPP loan bank account for qualified payroll costs). Alternatively, borrowers that utilize a separate bank account for PPP loan funds should consider transferring qualified payroll costs to an operating account for payroll as needed.
- The following items do not constitute "payroll costs" under the CARES Act and borrowers should avoid using PPP loan funds to pay the following items: (i) any compensation of an employee located outside of the United States; (ii) compensation of an individual employee in excess of an annual salary of $100,000,[5] prorated as necessary; (iii) the employer's share of payroll taxes (payroll costs are calculated on a gross basis without regard to (i.e., not including additions or subtractions based on) federal taxes imposed or withheld such as FICA or income tax withheld from employees); and (iv) qualified sick and family leave wages for which a credit is allowed under the Families First Coronavirus Response Act.
- To date, SBA has focused on providing guidance on PPP loan eligibility and the application process. As the forgiveness feature is central to the PPP, it is expected that SBA will soon provide detailed guidance on the forgiveness process, including relevant forms and documentation requirements for submission. In particular, and of great importance, is further clarification on how the forgiveness reductions for failure to maintain employee headcount and pay rates are computed.

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[3] For loan forgiveness purposes, mortgage interest, rent, and utilities should be pursuant to agreements / services in place prior to February 15, 2020. Note that interest on other debt is a permissible use but not forgivable.
[4] SBA guidance does however recognize that borrowers may contracts with a third-party payroll provider or a Professional Employer Organization (PEO) to process payroll and report payroll taxes.
[5] SBA guidance is currently unclear as to whether the payment of salaries in excess of $100,000 is a permissible use of PPP loan proceeds but clearly salaries in excess of such amount will not constitute "payroll costs".