Steve Leimberg's Business Entities Email Newsletter - Archive Message #189

Date: 12-May-20
From: Steve Leimberg's Business Entities Newsletter
Subject: Alan Gassman & Brandon Ketron on the Necessity of Determining Necessity by May 14: The SBA's Recent Change in Position Throws Thousands of Struggling Businesses into a Short-Fused Quandary - Partially Forgivable Government Loan to Avoid Layoffs or Possible Fines and Even Jail Time

"The shortness of the May 14 deadline, as well as the lack of guidance and inconsistency of communications, probably makes this the most profound and largest example of vague legislation and Federal agency activism as we have seen in the history of our nation, as millions of jobs, and thousands of lives, hang in the balance."

In Business Entities Newsletter #186, **Alan Gassman**, **Brandon Ketron** and **John Beck** reported that PPP Loans Must Be Necessary to Avoid Fines and/or Imprisonment, but What Does Necessary Mean? The newsletter reported on several ways to define the term "reasonable" and a number of reasons that businesses with positive cash flow or material reserves may nevertheless find it necessary to have the benefit of a PPP loan given the risk of running out of capital in the months to come.

The SBA originally provided for a May 7th amnesty deadline, giving borrowers only a few days to repay what they had received. This was later extended to May 14th, giving most borrowers not much time to consult with legal and financial counsel, given the disarray that many legal and accounting firms are in, and the lack of available guidance.

More information can be found on Alan Gassman's Forbes Blog posting of May 4th entitled *Was Your PPP Loan "Necessary"? If Not, There Could Be Horrific Repercussions,* where they noted that:

> *Individuals and businesses that received PPP loans and are determined to not qualify if the loan is found to have not been "necessary to support the ongoing operations of the business," based upon recently issued and surprising SBA FAQ's and tweets from Marco Rubio, now have until May 14th to return the monies in order to receive full amnesty for all civil and criminal exposures associated therewith. If they do so, they may qualify for the "up to $5,000 per employee" payroll credit, but if they return the loan after May 14th, they not only lose the right to certain amnesty and avoidance of civil fines, but also the right to payroll credits.*
>
> *At least two separate lawsuits have been filed to have this "necessity" requirement not apply based upon the strict and arguably unsupportable standard that has been set forth in the FAQ's published by the SBA. The first case argues that the SBA exceeded its statutory authority and violated a Federal Bankruptcy Code provision which prevents governmental agencies from imposing requirements that discriminate against individuals or businesses in bankruptcy. The borrower in the second case asserts that the SBA violated Congress' intent by restricting PPP loans from being available to large or small companies that have the ability to borrow or obtain capital.*

Now**, Alan Gassman** and **Brandon Ketron** return to provide members with timely commentary on the SBA's extending the deadline for PPP loan amnesty. Members who wish to learn the latest about this topic can watch Alan and Brandon in their exclusive **LISI** Webinar on Friday, May 15th @ 3PM ET titled: "**PPP Loan Forgiveness, Permitted Use And Repayment Rules: What to Do after You Got What You Asked for, Including the Latest PPP Loan Rule Developments And Strategies.**" Click this link to learn more: Alan/Brandon

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Here is their commentary:

EXECUTIVE SUMMARY:

Individuals and businesses that received PPP loans and are determined to not qualify if the loan is found to have not been □necessary to support the ongoing operations of the business,□ based upon recently issued and surprising SBA FAQ□s and tweets from Marco Rubio now have until May 14th to return the monies in order to receive full amnesty for all civil and criminal exposures associated therewith. If they do so they may qualify for the □up to $5,000 per employee□ payroll credit, but if they return the loan after May 14th, they not only lose the right to certain amnesty and avoidance of civil fines, but also the right to payroll credits.

At least two separate lawsuits have been filed to have this □necessity□ requirement not apply based upon the strict and arguably unsupportable standard that has been set forth in the FAQ□s published by the SBA. The first case argues that the SBA exceeded its statutory authority and violated Federal Bankruptcy Code provision which prevents governmental agencies from imposing requirements that discriminate against individuals or businesses in bankruptcy. The borrower in the second case asserts that that the SBA violated Congress□ intent by restricting PPP loans from being available to large or small companies that have the ability to borrow or obtain capital.

FACTS:

The SBA announced that individuals and businesses that received PPP loans and did not qualify by having the loan be □necessary to support the ongoing operations of the business□ now have until May 14th to return the monies in order to receive full amnesty for all civil and criminal exposures associated therewith.[i] The previous short deadline was May 7th, and PPP borrowers have insufficient time to secure legal counsel to know how this very vague legislation and administrative agency guidance, which can result in a $1,000,000 fine and 30 years in prison, apply to them.

Applicants who return these loans by May 14th are eligible to receive the Employee Retention Payroll Tax credit, if their businesses have been sufficiently impacted by lost revenues or disruption to qualify for the credit, but those who miss the deadline are ineligible, even if PPP loans are later returned. Senator Rubio, in a town hall event on May 11th, seemed to backtrack from previous statements made on his twitter account to the effect that no business presently having sufficient revenues to cover its expenses should apply or would qualify, and provided the following insight:

> On the vaccine side, I think it's the safest thing to assume, and I'm not saying this is going to be the actual date, but □ we need to think in terms of there isn't going to be a widely available vaccine until December of 2021. □not because I know that to be the target date, but because we need to prepare in those terms, sort of thinking in the worst case scenarios□

Taking the above into account, it certainly appears that businesses should be considering the possible impact of a prolonged period of time before operations, and frankly our way of life, return to normal in determining whether the loan was □necessary.□

The SBA has recently provided an FAQ to clarify their intentions for PPP loans. Question 31 asks, □Do businesses owned by large companies with adequate sources of liquidity to support the business□s ongoing operations qualify for a PPP loan?□ The SBA answer states that □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.□ They also elaborated by stating 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.□

At first many thought that Question 31 would only apply to □large corporations, but then a week thereafter the SBA issued Question 37, which asked, □Do businesses owned by private companies with adequate sources of liquidity to support the business□s ongoing operations qualify for a PPP loan?□ The SBA□s answer to this is □See response to FAQ #31.□

The entire list of FAQs can be viewed by clicking here.

The full text of FAQ #31 reads as follows, and took many of us by surprise. It was issued within two days of when President Trump and Treasury Secretary Mnuchin □shamed□ certain public companies for obtaining PPP loans that they may have been perfectly qualified to receive:

> 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.

COMMENT:

This □necessity□ requirement was set forth in the CARES Act to require that only businesses with the reasonable need for additional money would apply for and receive funding. The decision of the SBA to define the term necessity to have a meaning that is much more stringent than what previous judicial interpretations of the word have been is causing significant hardship and confusion and has led to a series of lawsuits. The complaints filed allege that the SBA has acted outside of its authority in promulgating FAQ□s which define the terms of necessity far beyond normal interpretations of the word.

In the case of *Hidalgo County Emergency Service Foundation v. Jovita Carranza, in Her Capacity as Administrator for the U.S. Small Business Association*, the bankruptcy court for the Southern District of Texas issued a Temporary Restraining Order, finding that the plaintiff had shown a substantial likelihood of success on the merits of both its claims. The first claim is that the SBA has exceeded its statutory authority, and the court did not go into great detail on this. The court issued an injunction against the SBA based upon the second claim which was that the SBA violated Federal Bankruptcy Code Section 525(a) which prevents governmental agencies from imposing discriminatory requirements on individuals or businesses in bankruptcy, and reads as follows:

> ***(a)*** *Except as provided in the Perishable Agricultural Commodities Act, 1930, the Packers and Stockyards Act, 1921, and section 1 of the Act entitled □An Act making appropriations for the Department of Agriculture for the fiscal year ending June 30, 1944, and for other purposes,□ approved July 12, 1943, a governmental unit may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to, condition such a grant to, discriminate with respect to such a grant against, deny employment to, terminate the employment of, or discriminate with respect to employment against, a person that is or has been a debtor under this title or a bankrupt or a debtor under the Bankruptcy Act, or another person with whom such bankrupt or debtor has been associated, solely because such bankrupt or debtor is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, has been insolvent before the commencement of the case under this title, or during the case but before the debtor is granted or denied a discharge, or has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act.*

The second case, *Zumasys, Inc. et al v. United States Small Business Administration et al*, was filed to enjoin the SBA from denying loans to individuals or businesses who do not have the need for additional capital.

The complaint describes that the CARES Act specifically prevents the SBA from following Section 3(h) of the Small Business Act, which has in the past required that pre-CARES Act SBA loans only be given if the borrower can prove that they are not able to get credit elsewhere, based upon Congress□s obvious intent to provide PPP loans to businesses and qualified individuals and entities who could borrow the money from other sources.

The complaint states the following:

> *The □credit elsewhere□ restriction imposed by the Small Business Act is specifically made **inapplicable** to PPP loans. The CARES Act specifically provides □[d]uring the covered period, the requirement that a small business concern is unable to obtain credit elsewhere as defined in section 3(h), **shall not apply to a covered loan**.□ 15 U.S.C. § 636(a)(36)(I) (emphasis added).*

The complaint states that the SBA and Treasury Department interpretation of the CARES Act in FAQ□s 31 and 37 inappropriately □purports to re-impose the □credit elsewhere□ requirement normally applied to SBA loans in direct contravention of 15 U.S.C. § 636(a)(36)(I).□

Citing the Administrative Procedures Act (□APA□), which states that a reviewing court shall □hold unlawful and set aside agency action, findings, and conclusions found to be . . . □not in accordance with the law□ or □in excess of statutory authority,□□ the Plaintiffs argue that FAQ 31 and 37 are □not in accordance with the law□ and the promulgation of these FAQs □exceed[s] Defendant□s authority under the CARES Act.□

Further, the Plaintiffs argue that the Defendants□ lack of authority to □preclud[e] borrowers from being eligible recipients of PPP loans if they arguably have access to other sources of credit□ was an action that □constituted an improper, and legally impermissible, underground regulation.□

The fact that Congress deleted the "unable to obtain credit elsewhere" requirement, and did not give the SBA the authority to issue legislative regulations is good evidence that Congress did not intend for the SBA to restrict PPP loans from being available to large or small companies that have availability of capital.

The complaint also notes that many Plaintiffs have already used PPP funds, □and if they are now required to repay those funds pursuant to the □guidance,□ they will have to go into debt, thereby damaging their financial stability.□

Mona Hanna of the law firm of **Michelman & Robinson, LLP** provided the following commentary:

> The guidance is demanding that PPP loans be returned if there is any □other source of liquidity.□ The problem is that loan proceeds have already been spent, and to repay them now would require our clients to use debt. But that would put them in a worse position than had they furloughed employees in the first place□as opposed to keeping them on payroll which is the very purpose of the PPP. What we□re left with is something of a □bait and switch,□ all based on an □underground regulation.□
>
> By adding in a requirement that directly contradicts the purpose and intent of the CARES Act, Treasury and the SBA are endangering small businesses and American employees.
>
> A key feature of these loans is that they□re forgivable given the intent to keep □America working.□ The net effect is that PPP loans, if spent properly, are akin to grants critical to the survival of small businesses. For this reason, any □guidance□ that unlawfully places an obstacle in the way of PPP loan eligibility is unacceptable, especially given the dire circumstances that prompted the passage of the CARES Act in the first place.

For these reasons, the complaint ends with the Plaintiffs seeking that the following judgments be rendered against the Defendants:

1. Preliminary and permanent injunctive relief the SBA and its lending banks from enforcing or utilizing in any fashion or manner whatsoever, FAQ 31 and FAQ 37 in regard to eligibility for loans or loan forgiveness under the Payroll Protection Program of the CARES Act.

2. Ordering the SBA to notify, as expeditiously as possible, all SBA lending banks to immediately discontinue utilizing FAQ 31 and FAQ 37 as criteria for determining PPP loan eligibility, and to fully process all PPP loan applications without reference to FAQ 31 or FAQ 37;

3. For a judgment setting aside FAQ 31 and FAQ 37;

4. For a judgment declaring FAQ 31 and FAQ 37 unlawful;

5. All costs of suit;

6. Such other and further relief as the court deems just and proper; and

7. Attorneys fees.

Conclusion

Why is the SBA using such a short deadline, after waiting so long to provide guidance which seems to greatly exceed what was intended by Congress, and what we believe it was authorized to do? While we hope that there will be further guidance from the SBA before midnight May 14th, and a further extension of the deadline, it is likely that businesses and sole proprietors will have to decide whether to risk running out of money to stay open in the worst economic crisis since the Great Depression, or to risk possible fines, penalties, or even criminal prosecution for trying, in good faith, to save their businesses and the jobs of those who work for them.

Small businesses will also have less funds available to provide greater safety for their workers and customers, with consequent deaths to occur as a result of this confusion.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Alan Gassman

Brandon Ketron

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CITATIONS:

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[i] The Paycheck Protection Program Borrower Application Form requires applicants to make a certification, in good faith, to the following statement: I further certify that the information provided in this application and the information provided in all supporting documents and forms is true and accurate in all material respects. I understand that knowingly making a false statement to obtain a guaranteed loan from SBA is punishable under the law, including under 18 USC 1001 and 3571 by imprisonment of not more than five years and/or a fine of up to $250,000; under 15 USC 645 by imprisonment of not more than two years and/or a fine of not more than $5,000; and, if submitted to a federally insured institution, under 18 USC 1014 by imprisonment of not more than thirty years and/or a fine of not more than $1,000,000.

Submit comment by Alan S. Gassman