Akin Gump
STRAUSS HAUER & FELD LLP

Ep. 42: What You Need to Know About the Paycheck Protection Program

February 24, 2021

Jose Garriga: Hello, and welcome to *OnAir with Akin Gump*. I'm your host, Jose Garriga.

The Paycheck Protection Program is one of the most visible components of the Coronavirus Aid, Relief, and Economic Security Act, also known as the CARES Act. Overseen by the Small Business Administration, the program is designed to provide small businesses with the resources to maintain their payroll and hire back laid-off employees, among other purposes.

We have with us today Akin Gump government contracts partner Angela Styles, who has written extensively on the Paycheck Protection Program and its workings. And we'll be looking today at some interesting topics regarding administration of the program and the risks and rewards of the PPP that will be especially relevant to business audiences.

Welcome to the podcast.

Angela, welcome to the show. This is an interesting and a very timely topic. Let's start by giving the audience some context. Could you describe some of the salient elements of the Paycheck Protection Program?

Angela Styles: Absolutely. In many ways, it was a brilliant way to get money out very quickly to small businesses at the beginning of the pandemic, starting in about April through August of 2020. Congress actually took a pre-existing program called the 7(a) loan program that resided at the Small Business Administration—it had rules and regulations behind it; it had processes for processing loans—and put into place a forgivable loan for small businesses amounting to about two and a half times monthly payroll.

If you don't want to forgive the loan, it's actually just a 1 percent loan that would be payable back over five years. But what makes the Paycheck Protection Program different is the fact that it's a forgivable loan if you follow some of the requirements, including rehiring people, maintaining employment for a certain period of time, and using at least 60 percent of the proceeds of the loan on payroll. Although you can use the proceeds for other important requirements that you need to stay in business: from your lease to PPE or changes you've had to make to your business.

So, in many ways, brilliant idea in order to get the money out quickly. But in order to get the money out quickly to small businesses, they had to rely on small businesses self-certifying that they were actually eligible for the program. And the problem with that is the underlying program it was embedded in, the 7(a) loan program, was very complex in terms of who's eligible. The intent of the 7(a) loan program was to keep large businesses out. Very few nonprofits were ever eligible for the 7(a) loan program. And, so, there was a whole swath of new requirements for small businesses to be able to look at and say, "Oh, yes. I'm eligible. Let me have the money."

And the problem is they're so complex that a lot of companies unintentionally got it wrong. And then, I think there's probably a lot of companies that maybe intentionally just took advantage of it, the self-certification process, got the money and will probably be eventually found by investigators, the Hill, the Department of Justice, and inspector generals.

Jose Garriga: I remember there was a fair amount of media concerning who and who wasn't eligible and who and who wasn't taking advantage of this. As I mentioned, the Small Business Administration implements the PPP. So, beyond these people's self-certification, how has the SBA administered the program? And do you see any risks inherent in the approach that it chose to take?

Angela Styles: I think there were lots of risks inherent in the approach they took, although getting the money out expeditiously at that point in time was critical. It was more important than having the SBA itself verify eligibility. I think you add to that that this is now an $840 billion program. It is hundreds of times more money—and I mean hundreds of times more money—than the SBA has ever handled for a program in a particular year.

SBA is a small agency. They have great civil servants there, but you can only shove so much additional requirements into their agency and expect this to go smoothly. I will say that, given all that, it did go smoothly. But in order to make it go smoothly, they had to allow these companies to self-certify that they were eligible. And there was no check required at the SBA level, at the lender level, to verify that these companies were actually eligible for the money. And, so, now we're finding all kinds of companies that weren't eligible. There were things that were simple certifications such as, have you ever defaulted on a federal loan? Have you been suspended or barred by the government?

And the Inspector General for SBA has already found $3.6 billion that, if SBA or the lender had simply gone and checked the publicly available database for that particular company that had applied for the PPP, they would have known that they weren't eligible. So, there's some simple steps that weren't taken to verify the lender, at the SBA level, to verify eligibility. I mean, those are fairly simple questions. You should know if your company has defaulted on a prior federal loan or has made underpayments on a prior federal loan or is prohibited from doing business with the federal government for one reason or another. I mean, obviously, $3.6 billion of an $840 billion program is a small percentage, but that's a lot of money.

Jose Garriga: No, certainly it is. Let's look, then, let's drill down a bit on an interesting topic inside all this. And it's something I know you've discussed/written about: acquisition of companies that have taken out PPP loans. What can you tell us about this process? And what sorts of risks are attendant on it?

Angela Styles: Well, the first thing to think about, which is, if the loan's still active, if it's still an outstanding loan, then it has to be approved by either the lender or the Small Business Administration. So, if you want to acquire a company that has a pre-existing PPP loan that has not been forgiven or paid off, you're going to have to put into your acquisition process, time for that approval, particularly if it has to go to the SBA. Now, there are ways to put the money in escrow, but you're still going to need that approval under certain circumstances. And a lot of people just aren't actually used to, when acquiring a company, they're not used to having to get a government approval and realizing that this small agency takes some time to process the approval of such a transaction if you're acquiring a company with an active PPP loan. That's the first piece of it, is to understand that. And that's a technical piece.

I think, from a public relations/legal fraud standpoint, the other issue, and probably more important, is verifying that the company was actually eligible at the time they applied for the loan.

I can certainly tell you, aside from the simple issues we were talking about, many companies got some of the more-complex issues just very wrong when they self-certified that they were eligible. And, so, if you're acquiring the company, you really need to look into those issues. I mean, some of them are as simple as a company certified that they had less than 500 employees, but they were certifying that for a subsidiary and didn't count their employees in China. And they might have had another 500 employees in China. So, if you have 500 at a U.S. subsidiary, and a parent company in China with 500 employees, you weren't eligible. Not because the parent was in China, but because you had 1,000 total employees when you add it together. I mean, that's a simple one. There's much more complex eligibility requirements that people didn't even know existed.

So, if at the time the company was applying for the PPP loan, you were in the middle of discussions to acquire them, there may be what's called a "present effect" rule. So, if you're in the middle of discussions to acquire a company, it may be that your employees, the company that's acquiring it, the small business, are counted towards that 500 because you're so far along in a certain point in negotiations that the Small Business Administration, under these preexisting rules I'm talking about, consider you to be affiliated with a company that's acquiring you because they have enough control over you at a certain point in time in the acquisition process that you're considered affiliated. And, so, the employees of both companies should count, and you're not eligible. And that's probably the most troubling scenario when a company's acquiring another one with a PPP loan, particularly since the Paycheck Protection Program is reopened, right?

So, it went from March, late March/early April of last year to early August. And then at the beginning of this year, it opened up, and it'll be open through March. So, if you're in the middle of acquiring a company that may be taking out a PPP loan, you have to be really careful about this issue because it could be the simple fact of you negotiating to acquire them makes the company ineligible for the PPP loan. And that could come back to haunt the acquirer eventually, if they actually receive the loan, and if they actually acquire the company, and it turns out that because of these actions, they weren't eligible.

The other issue that's come up, and it's probably what you were talking about seeing in the press, in about late April, early May, was this certification of need. And, so, in order to be eligible for a PPP loan, a company on their loan application had to certify that the current economic circumstances require them. They need this loan in order to support their operations under the current economic circumstances. And, so, what you saw for some companies, particularly some of the larger restaurants, which, actually, would otherwise be eligible under the PPP, the Small Business Administration and the Department of the Treasury very publicly started to question whether a publicly traded company or a very large company or a company owned by private equity really needed the loan. And, so, there's a whole process after May of last year that's built up around whether a company really needed the loan. And if you have taken out a loan, or if a company you're acquiring has taken out a loan in excess of $2 million, and you go to seek forgiveness for that loan, the SBA is thinking really hard about whether you needed that loan. There's a whole loan necessity questionnaire with some pretty extensive questions about whether you issued dividends, how much money you had in cash on hand at the time of the loan, whether you had access to credit. So, a very complex look, I will say, at whether you needed a loan and whether you're eligible. So, when you're looking at acquiring a company, understanding what their economic situation was at the time that they were applying for the loan is a really important part of due diligence for the acquisition.

Jose Garriga: That's a really great point. Thank you. A reminder, listeners, we're here today with Akin Gump government contracts partner Angela Styles, discussing the Paycheck Protection Program.

Let's go back to something that you talked a bit about and see if you can expand a bit on it, and that's eligibility. You've talked a bit about people mischaracterizing or misclassifying themselves as being eligible. Are there other areas you think may prove to be problematic in the sphere of eligibility?

Angela Styles: Well, I think the areas that are going to be most problematic are going to be number of employees, ownership. So, what a lot of people didn't realize is you're sitting there, you have 300 employees, you believe you're eligible, but somebody has a 10 percent ownership interest in you, and they have what's called “negative control,” so they have some controls over how the business is run even though they only have 10 percent ownership, you're probably going to have to count their employees too. It's called “affiliation.” And, so, a lot of businesses didn't realize that. They didn't look at their ownership structure and say, "Oh, does this owner that owns X percentage..." Obviously, everybody would look at somebody that owns 51 percent and say, "That controls us; we probably need to count their employees," but for an entity that owns 10, 20, 30 percent, they could actually control your company through what's called negative control, even though they don't own a majority of your company.

And the SBA, under pre-existing rules, pre-existing case law would say, "You've got to count that 10 percent owner's employees with yours as well." So, really, incredibly complicated for some of these small companies that are owned by private equity, hedge funds, larger businesses, pension funds, you name it, right? A lot of companies didn't look into the more-complex issues behind whether they were eligible or not. There's simple issues like, have you defaulted on a federal loan? And then there’s these more-complex issues: Did you count your employees correctly? Foreign employees and all of that. And then you have the certification of need as well, so there’s a lot of elements to eligibility that the SBA allowed entities to self-certify to. And then the SBA and the lenders really just didn't check anything. And, so, now, we're left out here with what is probably a decent amount of fraud, you know, intentional fraud, accidental fraud. There's going to be a lot of enforcement coming up. There's going be a lot of investigations. There are going to be investigations on the Hill. The Department of Justice has already prosecuted a number of people. And you're going to see a lot of reports from the SBA Inspector General as well.

Jose Garriga: Speaking of oversight and investigations, so, from what I understand, the Treasury Department drafted and implemented most of the Paycheck Protection Program. Either as a function of the change of administration or any other factor, to what extent will Treasury, do you think, continue its leading role on, and support of, PPP?

Angela Styles: Well, I certainly hope they continue. I will say that, as confusing as some of the regulations were, they got them out quickly. They corrected them where they needed to, and before this last administration left, they made sure that the new money that had come on December 27th was clean in terms of there were regulations there, there was an understandable process, but there's still unanswered questions. There are still issues from a regulatory perspective that need to be dealt with.

So, I'm hopeful that the relationship is really among the civil servants at the Department of the Treasury and the Small Business Administration, and that support will continue, because as I said at the beginning, it's a program that's hundreds of times larger than anything the Small Business Administration has ever done. And, so, they need that support of Treasury. I mean, the reason it was able to function and the reason the money was able to get out the door was because the Department of the Treasury pulled some of their best people together and really got that done.

Now we can second guess how they did it. We can second guess whether they should have allowed self-certifications and all of that, but at the end of the day, it was the Department of the Treasury that got the money out the door; got this into an understandable, programmatic, regulatory place; and left it in a position that it reopened in early January and will be open through March. But I still think it needs the support from Treasury.

Jose Garriga: Following up a bit on that and something that you said, there's this now second phase for PPP. Are there any new entities eligible, or has it been expanded in any way now for this second phase?

Angela Styles: Yes, it has. So, the second phase includes two elements. So, if a company didn't take out a first-draw loan in the opening from April to August of last year, then all the companies that were previously eligible and two new categories of companies are eligible for a first-draw loan, which would mean up to $10 million.

And the new entities that are eligible are newspapers, news organizations, TV and radio stations, and 501(c)(6)s, which are, generally, trade associations. Now, there's a lot of restrictions on trade association eligibility, limited to 300 employees. But it definitely opened it up to two new categories of companies as well as all of the old companies that were eligible and hadn't yet taken out a first-draw loan. And then it also opened up second-draw loans, so if a company took out a $10 million first-draw loan, and they're still struggling, they are probably eligible for an additional $2 million in this second round through March 31st.

Jose Garriga: Okay. And is there going to be a PPP 3?

Angela Styles: I wouldn't be surprised. As many problems as there are in terms of concerns about fraud, it's been an excellent program. It's worked well. It's gotten money out the door to small businesses. They've been able to continue to employ people or rehire people. I certainly know a lot of small businesses that it really made all of the difference in the world at a time when they were going to go under or were going to go bankrupt. The program was a lifesaver, which means in many ways, it was successful the way that you would hope government funds would work. So I would not at all be surprised if there's a PPP 3 if the pandemic continues. Although, if things are able to open up more than they have in the past, and there's not a need, and the economy's doing well, maybe there won't be one.

Jose Garriga: So, just to wrap up, I think this is a program that has a particular interest for business audiences, small business and otherwise, what takeaways could you offer listeners regarding the Paycheck Protection Program? If you could just pick out one or two things that you think people should really be able to both absorb and share regarding what you know and what you've learned about the program.

Angela Styles: I think, for a small business in need, it's an excellent government program. It really helps in areas where businesses need help, and companies that need it shouldn't be worried about the press or the forms or fraud. They can do this right. They can do it on their own with the assistance of their lender. Sometimes, accountants and lawyers, depending on the complexity of it. So, I'd say don't be afraid of it. I think some people were afraid of it because of all the press that was out in late April and early May.

But I would warn people, it's government money. It's a forgivable loan. So, it's like a grant, and, with that, comes some strings. It's the government, so it allows them to get into your books and records. It allows them to investigate you. If you don't take the loan, they're not going to be able to do that. And, so, it is important to consider that it gives government access to your business that it would not otherwise have.

Jose Garriga: Thank you. Listeners, you've been listening to Akin Gump's government contracts partner Angela Styles. Angela, thank you so much for making the time to bring the audience up to speed on the real-world workings and implications of this program that very possibly will be impacting their professional lives in one way or another.

And thank you, listeners, as always, for your time and attention. Please make sure to subscribe to *OnAir with Akin Gump* at your favorite podcast provider to ensure you do not miss an episode. We're on, among others, iTunes, YouTube and Spotify.

To learn more about Akin Gump and the firm's work in, and thinking on, government contracts and litigation matters, search those terms on the Experience or Insights & News sections on akingump.com, and take a moment to read Angela's bio on the site as well.

Until next time.