

The Paycheck Protection Program: New SBA Questionnaires Require Borrowers of \$2 Million or More to Provide Justification for Economic Necessity of Loans

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Key Points

- On October 26, 2020, the SBA announced its intent to require a Necessity Questionnaire for borrowers that received PPP loans of \$2 million or greater.
- The SBA intends to use the Necessity Questionnaire as part of its promised review of the economic necessity certification required on PPP applications for loans greater than \$2 million.
- While the certification on the PPP loan application attested only to economic necessity at the time of the loan application, these new forms indicate that the SBA will also consider the borrower's economic situation after receipt of a PPP loan.
- The SBA has not yet provided guidance on how it will review and evaluate the information requested in the Necessity Questionnaire or how it will determine whether a borrower properly certified economic necessity. Companies should become familiar with the information that the SBA is requesting and pay close attention to any new guidance the SBA may release regarding the Necessity Questionnaire or the loan forgiveness forms.

The Paycheck Protection Program: Good Faith Certification of Economic Necessity

The Paycheck Protection Program (PPP), contained within the CARES Act signed by President Trump on March 27, 2020, provided forgivable loans of up to \$10 million to qualifying small businesses. The CARES Act imbedded the PPP into the pre-existing 7(a) loan program administered by the Small Business Administration (SBA). The 7(a) loan program is limited to "applicants for whom the desired credit is not otherwise available on reasonable terms from non-Federal, non-State, and non-local government sources." 13 C.F.R. 120.101. This limitation was removed by the CARES Act for PPP loans, instead requiring applicants to make the following good faith certification in order to qualify for a PPP loan: "the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient."

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The SBA, in an Interim Final Rule (IFR) and the PPP loan application, repeated the certification language from the statute without alteration or additional regulatory explanation of the standard. 85 Fed. Reg. 20811, 20814 (Apr. 15, 2020).

On April 23, 2020, the SBA released additional, retroactive sub-regulatory guidance in the form of an FAQ which stated that before PPP applicants certified economic “necessity” of the loan, the applicant must consider its access to other sources of liquidity. See SBA PPP FAQs, available [here](#), at No. 31. The FAQ appeared to be the SBA’s first attempt to place an additional restriction on loan eligibility for businesses owned by entities with adequate funds, such as private equity firms and hedge funds. On April 29, 2020, SBA announced that it would “review all loans in excess of \$2 million” to further ensure loans were limited to “eligible borrowers in need,” and specifically reminded borrowers of the SBA’s guidance regarding the “important certification” of economic necessity addressed in FAQ 31. See FAQ 39. Subsequently, the SBA provided a safe harbor provision that allowed borrowers to repay their loans by May 8, 2020 if they determined that their certification of “economic necessity” was no longer valid in light of the SBA’s new guidance. The safe harbor repayment deadline was extended to May 18, 2020. See FAQ 47.

On May 13, 2020, the SBA released FAQ No. 46, which provided an additional safe harbor for borrowers with loans **of less than \$2 million**, stating that the SBA will deem such borrowers “to have made the required certification concerning the necessity of the loan request in good faith.” However, borrowers that received PPP loans greater than \$2 million were still subject to the SBA’s audit and review as previously provided in FAQ 39. See FAQ 46. The SBA also stated in FAQ No. 46 that if the SBA determines during a review of a forgiveness application that the company lacked an adequate basis for the required certification, the SBA will seek repayment of the outstanding PPP loan balance. *Id.* Importantly, however, the SBA provided that if “the borrower repays the loan after receiving notification from SBA, SBA will not pursue administrative enforcement or referrals to other agencies based on its determination with respect to the certification concerning necessity of the loan request.” *Id.*

Finally, on October 26, 2020, the SBA announced its intent to require a loan necessity questionnaire (“Necessity Questionnaire”) relating to the certification of “economic necessity” for both for-profit borrowers (SBA Form 3509, available [here](#)) and non-profit borrowers (SBA Form 3510, available [here](#)) (together, the “Necessity Questionnaires”). As of November 10, 2020, Forms 3509 and 3510 have not been published on the SBA’s website.

Since the April 15, 2020 issuance of the first IFR, the SBA has issued an additional 24 IFRs, 22 of which were issued after the posting of FAQ 31 on April 23, 2020, but has not altered the certification requirement or provided additional explanation in regulation regarding the standard of proof for the certification.

While FAQs 31, 37, and 39 provide insight into the SBA and Department of Treasury’s thoughts about the certification, an agency FAQ is not usually considered binding law. As explained by the US Department of Justice (DOJ): “Guidance documents cannot create binding requirements that do not already exist by statute or regulations.” Memorandum from Rachel Brand, Associate Attorney General, to Civil Litigating Units (Jan. 25, 2018). DOJ may not (1) “use its enforcement authority to effectively convert agency guidance documents into binding rules”; or (2) “use noncompliance with guidance documents as a basis for proving violations of law.” *Id.* Indeed, with more

than 22 opportunities since the posting of FAQ 31 to place the guidance into a binding IFR, it is fairly clear that the SBA and Department of Treasury do not intend to make FAQ 31 a binding rule. In addition, SBA, IFRs and the PPP application have been clear that the SBA only intends to apply the rule or guidance applicable at the time of loan application, which for many companies preceded the posting of FAQ 31.

Who needs to complete the Necessity Questionnaires and when?

Any borrower, for-profit or non-profit, “together with its affiliates, [that] received PPP loans with an original principal amount of \$2 million or greater” must complete a Necessity Questionnaire and submit it within 10 business days of receipt from the borrower’s lender. Within 5 business days of receipt, the lender must upload the form to the SBA PPP Forgiveness Platform and separately input the responses to each question into the platform. A borrower’s failure to submit the form and associated documentation within 10 business days could result in the SBA’s determination that the borrower was “ineligible for either the PPP loan, the PPP loan amount, or any forgiveness amount claimed, and SBA may seek repayment of the loan or pursue other available remedies.”

What information is requested in the Necessity Questionnaires?

SBA Form 3509 is divided in two “assessment” sections: (I) business activity; and (II) liquidity. Many of the questions related to the borrower’s business activity address the borrower’s situation **after** receiving a PPP loan. These include, but are not limited to: (a) whether a state or local authority ordered the borrower to “significantly alter its operations” because of COVID-19 and any cash outlays related to those changes; (b) voluntary changes in business operations as a result of COVID-19 and any cash outlays related to those changes; (c) whether the borrower began any new capital improvement projects not due to COVID-19, and if so, how much it spent on such projects; (d) whether, between March 13, 2020 and the end of the PPP loan forgiveness period, the “[b]orrower paid any dividends or other capital distributions (other than for pass-through estimated tax payments) to its owners”; (e) whether, between March 13, 2020 and the end of the PPP loan forgiveness period, the borrower “prepaid any outstanding debt”; and (f) whether, between March 13, 2020 and the end of the PPP loan forgiveness period, any of the borrower’s employees were “compensated in an amount that exceeds \$250,000 on an annualized basis.”

The Necessity Questionnaire also asks questions related to liquidity, which include, but are not limited to: (a) whether [the borrowers] are publicly-traded; (b) whether their parent companies are publicly traded; and (c) whether any publicly traded company or private equity firm, venture capital firm, or hedge fund owns 20 percent or more of any class of their securities. Form 3509 also requests that borrowers represent the value of their shareholders’ equity.

Although the SBA has yet to provide any guidance on how it will review and evaluate the information it has requested in the Necessity Questionnaires, the questions described above indicate that there may be additional scrutiny of borrowers that had significant cash on hand at the time of application, compensated employees or owners in an amount that exceeds \$250,000 on an annualized basis over the forgiveness period, or are publicly-traded or owned by publicly-traded companies. There may also be additional scrutiny of borrowers owned by private equity firms, venture capital firms

or hedge funds. It has not been announced when the Necessity Questionnaires will go into effect or when they will be sent to borrowers.

While the relevant certification on the PPP loan application attested only to the “current” economic necessity of the loan at the time of the application, the Necessity Questionnaires indicate that the SBA will also consider economic necessity after the borrower received a PPP loan, which comes as a surprise and leaves borrowers wondering how the SBA will treat such information and what consequences can result. This is particularly unusual because the accuracy of certifications are generally only assessed at the time a certification is made. While post-certification information can inform the accuracy of a certification, the extraordinary uncertainty in April and May 2020 must be an important consideration weighed against actual post-certification experience.

Recommendation: Borrowers should collect the required documentation, review and complete the new form before submitting a forgiveness application, and confer with counsel regarding whether the Necessity Questionnaires alter their strategy related to loan forgiveness or repayment. Importantly, do not submit the form before requested by your lender.

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