

# SBA's New PPP Loan Necessity Questionnaire Adds Detail to Loan Review Process for Borrowers of Over \$2 Million

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In late October, the Small Business Administration ("SBA") released two new Paycheck Protection Program ("PPP") Loan Necessity Questionnaires ([Form 3509](#) for for-profit businesses and [Form 3510](#) for nonprofit entities). These questionnaires relate to PPP loans in excess of \$2.0 million. Office of Management and Budget approval processes for these forms are underway. *See OMB notice [here](#).* (*See also*, 85 Fed. Reg. 67809 (Oct. 26, 2020)).

The new forms are designed to collect supplemental information SBA loan reviewers will use in evaluating the good-faith certification borrowers made on their PPP applications that economic uncertainty made their loan request necessary to support ongoing operations. These forms will be used by the SBA to determine a borrower's eligibility for a PPP loan forgiveness. These questionnaires add detail to the SBA's development of an administrative review layer for the largest PPP loans (\$2-10 million). They are to be distributed to borrowers by their PPP lenders. Borrowers are to complete the questionnaire within ten business days of receipt.

If a borrower's loan is subject to SBA review, the SBA will request the lender to transmit to the SBA the borrower's PPP loan and loan forgiveness files, along with any requested or required documents, including the questionnaire response. (As explained below, the SBA has stated it will review forgiveness applications for all loans of \$2 million or more, plus other loans, at its discretion.) Borrowers must retain required documentation.

Understanding the relevant context provides valuable insight into the Loan Necessity Questionnaires and the processes SBA appears poised to follow for the 40,000 or so for-profit and non-profit borrowers that obtained PPP loans of \$2 million or more. This Client Advisory will provide that context, describe the questionnaire, and then offer insights into the loan forgiveness process and recommended next steps.

## The Original Certification Process under the CARES Act

To obtain a PPP loan, the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") required each borrower to make a series of certifications, one of which was that "[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant." That certification's meaning is far from clear, even months after the PPP's implementation. Despite SBA's issuance of several FAQs related to the issue as well as a series of Interim Final Rules, borrowers, lenders and others have largely been left to conjecture to determine how SBA would interpret the certification requirement. The questionnaire helps to show SBA's current posture on this

issue.

Before delving into the specifics of the questionnaire, it is important to bear in mind the PPP's overriding purpose: to provide an economic backstop to persuade small businesses, as defined by Congress under the CARES Act, to maintain employment and pay levels during COVID-19. Congress's intent was to provide an incentive to private sector employers to prioritize struggling to pay their employees given the massive dislocations and uncertainties that COVID-19 was causing. The PPP loan program did succeed in stopping many businesses from laying off or reducing the hours or pay of their employees, at least for the PPP loan's covered period (eight or twenty-four weeks, depending on the borrower's election).

Notably, the questionnaire's evaluation of the borrower's "business activity" generally looks what happened to the borrower after it applied for the PPP loan, in terms of comparable revenues generated year-over-year and the duration and impact of any governmental shutdowns and other business restrictions the borrower may have experienced. The SBA states that it will evaluate the "totality of the circumstances" in evaluating a borrower's economic necessity, but a question remains whether SBA will fall prey to using 20-20 hindsight to second-guess legitimate uncertainties that businesses were experiencing at the time they applied for their PPP loans. After all, as explained above, if a borrower is legitimately applying for forgiveness, the borrower did, to a large extent if not completely, maintain its payroll and pay scales as intended under the CARES Act.

The SBA did explain that, "Importantly, borrowers with loans greater than \$2 million ... may still have an adequate basis for making the required good faith certification, based on their individual circumstances in light of the language of the certification and the SBA guidance."

## Background on the Loan Necessity Certification and Related Guidance

Seven-plus months of administrative and political developments preceded these questionnaires' release. The PPP was one of the signature elements of the CARES Act that was signed into law on March 27, 2020. To qualify for a loan, a borrower was required to meet the CARES Act size standard for small entities (an expansion of SBA's traditional size standards and qualifying entities). Most notably, due to the COVID-19 crisis, the CARES Act created a unique size standard of 500 employees for a business to be deemed "small" that captured businesses that would otherwise not qualify as small under the SBA's traditional lending programs.

Also, unlike the SBA's traditional lending programs, a borrower was not required to demonstrate it could not obtain credit elsewhere to qualify for a PPP loan, but rather that the borrower needed the loan because of the COVID-19 crisis. The CARES Act required the borrower to make a "good faith certification -- ... that the uncertainty of current economic conditions makes necessary the loan request to support the on-going operations of the eligible recipient." The necessity certification was one among several borrower certifications that CARES Act implemented.

The SBA is now seeking information from the 40,000 or so largest PPP borrowers to test the "good faith" of the borrowers' certifications of exigent circumstances. The SBA will not require PPP lenders to assess independently whether borrowers reasonably needed to access funds from the PPP, but to undertake more of a good faith review to ensure the borrower's loan forgiveness substantiation and related paperwork is in order. Regarding forgiveness (as well as other PPP forms borrowers are required to submit), certifications will be required from borrowers, subject to criminal and civil penalties for false statements. The SBA appears poised to undertake a more detailed review, at least

in certain instances.

Public calls for the SBA to conduct such reviews began early in the PPP program. Soon after lenders began funding PPP loans, public and political controversy arose over some of the businesses that qualified for and received loans. Because the CARES Act dramatically expanded SBA loan eligibility, some businesses with a national reach and/or that were publicly traded were able to qualify for PPP loans, either directly or via affiliates, or both. Quite a few generally well-known PPP borrowers returned their loans, which the media also reported.

Significant for the necessity questionnaire recently released, the SBA responded almost immediately by adding guidance regarding the necessity standard contained in the CARES Act.

## Relevant FAQs

Within weeks of CARES Act loans first being disbursed, the SBA began issuing a series of FAQs regarding a wide range of topics, including loan necessity and the review process to be expected.

- **FAQ 31 addressed the borrower necessity issue on April 23, 2020.** The SBA provided significant extra-statutory gloss to the original CARES Act certification. It explained 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.” Notably, the SBA then observed, “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 of good faith, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification.” Then, on April 28, in FAQ 37, the SBA expanded this requirement to “businesses owned by private companies with adequate sources of liquidity to support the business’s ongoing operations ....”

As part of FAQ 31, SBA further explained two items of note: “Lenders may rely on a borrower’s certification regarding the necessity of the loan request;” and, “[a]ny borrower that applied for a PPP loan prior to the issuance of this guidance and repays the loan in full by May 7, 2020, will be deemed by SBA to have made the required certification in good faith.” The SBA then extended this “safe harbor” date twice, first to May 14 (FAQ 43 (May 5, 2020)), and then to May 18 (FAQ 47 (May 13, 2020)). These extensions provided more time to borrowers being forced to react with little advance warning, but also allowed the SBA to continue to provide additional guidance.

- **FAQ 39, published April 29, addressed the question whether “SBA will review individual PPP loan files.”** After reminding borrowers of FAQ 31, the SBA informed borrowers that it planned to evaluate the economic necessity certifications for “all loans in excess of \$2 million, in addition to other loans as appropriate, following the lender’s submission of the borrower’s loan forgiveness application.”
- **FAQ 46, published May 13, 2020, foreshadowed the borrower necessity questionnaire and the process that SBA will undertake to review loans.** In that FAQ, SBA explained how SBA “will review borrowers’ required good faith certifications concerning the necessity of their loan request.” First, SBA created a safe harbor for necessity certifications for loans with an original principal amount of less than \$2 million, deeming these borrowers to “have made the required certification concerning the necessity of the loan request in good

faith.” The threshold also was designed to “promote certainty” and allow “SBA to conserve its finite audit resources and focus its reviews on larger loans.”

The SBA in FAQ 46 also provided some reassurance to borrowers regarding the potential impact of the SBA’s *post hoc* necessity review, stating, “If the SBA determines in the course of its review that a borrower lacked an adequate basis for the required certification concerning the necessity of the loan request, SBA will seek repayment of the outstanding PPP loan balance and will inform the lender that the borrower is not eligible for loan forgiveness. 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 the necessity of the loan request.”

## The For-Profit Borrower Questionnaire

More than five months after FAQ 46, borrowers are getting their first real look at what the SBA intends to review as to a borrower’s economic uncertainty certification. The For-Profit Borrower Questionnaire is broken into two main components – the Business Activity Assessment and the Liquidity Assessment. The questionnaire also provides space for the PPP borrower to provide optional commentary and additional information to be considered in connection with the Necessity Certification.

The Necessity Certification questionnaire requires disclosure of the facts below:

### Business Activity Assessment

1. What were the business’s gross revenues during the pandemic as compared to the same time a year ago (the second quarter 2019 compared to same period in 2020)?
2. Was the business impacted by mandatory state and local shutdown orders? If so, how?
3. Did the pandemic cause the business to cease, reduce or otherwise alter business operations, either involuntarily or voluntarily, and what are the related costs? If so, how?
4. Did the business make capital improvements during the covered period?

### Liquidity Assessment

5. What was the business’s liquidity/access to other sources of capital during the covered loan period? At least as a screening matter, this requires disclosure of:

- the amount of the borrower’s cash and cash equivalents at the end of the calendar quarter before the PPP application (apparently without regard to any offsetting liabilities);
- dividends and distributions (other than for pass-through estimated tax payments) during the covered loan period;
- debt repayments during the covered loan period;
- compensation paid (gross salary, gross wages, gross tips, gross commissions, and allowances for dismissal or separation) above an annualized rate of \$250,000 during the covered loan period;

- publicly traded borrowers, including their market capitalization, their affiliates, and their affiliates' market capitalization;
- for non-publicly traded borrowers, the book value (shareholders' equity value) at the end of the calendar quarter before the PPP application;
- whether the borrower was more than a 50% subsidiary of another company, whether that parent company was organized and incorporated outside the U.S., and if publicly traded, the market capitalization of the parent company;
- whether a private equity firm, venture capital firm, or hedge fund owned 20% or more of the borrower's outstanding equity securities;
- whether the borrower was a 50% or more affiliate or subsidiary of a 50% or more foreign state-owned enterprise; and
- whether the borrower received any other CARES Act program funds, excluding tax benefits.

The questionnaire requires the signatory to attest to its authority to sign the questionnaire, that the information provided in the certification is true based on a reasonable inquiry of available people, systems and other information, and that the signatory recognizes that representations contained in the questionnaire are subject to significant criminal and/or civil penalties for false statements. The instructions on the new forms warn borrowers that "failure to complete the form and provide the required supporting documents may result in SBA's determination that you were 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."

## Timing

The OMB Paperwork Reduction Act approval of the Necessity Certification forms is still pending. Ordinarily, under the Paperwork Reduction Act, an agency such as the SBA is not permitted to require an answer to a government form if the form has yet to be approved by OMB. However, Forms 3509 and 3510 are already available. Some lenders already have started sending the forms to borrowers. Businesses that need additional time to respond beyond the allotted 10 days should consult with their lenders and advisors in identifying the proper deadline to respond.

## Consequences of the Review Process

The parameters of any repayment the SBA might require following the review is not yet clear. The SBA has not explained whether repayment would be in accordance with a PPP loan's terms (such as a low interest rate and prescribed repayment period), whether the SBA would instead require repayment immediately, or whether SBA will exercise administrative discretion following the loan review process.

If the SBA takes a doctrinaire approach, it could contend that a borrower for which the agency rejects an economic necessity determination should pay the loan back immediately because the borrower was ineligible for the loan in the first place. That is obviously a stern remedy, especially in a close factual case and given the on-going public health crisis, and the economy's overall fragility.

A borrower is thus well-advised to take the opportunity to explain the basis for its necessity determination in the questionnaire, especially if it performed better than expected in 2020. As we have explained in a prior [Advisory](#), moreover, a borrower should have compiled a contemporaneous

record of the uncertainty to which it was subject at the time it applied for the loan. Now is the time to review these diligence files and to finish gathering supporting documentation.

Notably, the SBA, by Interim Final Rule, 85 FR 52884 (Aug. 27, 2020), provides for appellate rights—albeit on narrow grounds—for borrowers aggrieved by an SBA determination regarding PPP loan eligibility and forgiveness. The review will be administrative, based on a pre-established documentary record containing the loan application, forgiveness application, and necessity review materials, together with other prescribed documents. Accordingly, to the extent that a borrower has assembled documentation for its economic necessity determination (or any other relevant information), the borrower should seek the opportunity to provide that information to the SBA during the loan review process, so it can be included in the appellate record. SBA has a two-layer administrative review process, and then judicial review should be available. Borrowers with concerns regarding forgiveness should understand this process before submitting their applications.

A client's response to the new questionnaire could impact important legal rights and should be guided by proper legal advice and supported by appropriate documentation, especially given the loan amounts at stake and the personal certifications provided at each step of the PPP process.