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Client Alert: PPP Loan Applicants Directed to Assess (or Reassess) the Necessity for Loan Funds; SBA Imposes May 7th Deadline to Return Loans for Borrowers that Cannot Meet the New Standard

BY RORY Z. FAZENDEIRO • MAY 4, 2020

The U.S. Department of the Treasury recently issued additional guidance in the form of Frequently Asked Questions (“FAQ”) for businesses that have received or are still seeking PPP loans. The critical piece of the FAQ is the so-called “necessity certification,” which now requires a more particularized, good faith assessment of a borrower’s financial need and their access to alternative sources of liquidity.

On April 23, 2020, the SBA and Treasury Secretary changed direction with the publication of a new FAQ (Question 31) stating that the certification each borrower makes in its application that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant” must be made “in good faith,” and must take into account current business activity and the ability to access other sources of liquidity sufficient to support ongoing operations in a manner not significantly detrimental to the business.

The April 23rd guidance placed an emphasis on large public companies and private companies with available sources of liquidity from parent company affiliates or other sources. Question 31 notes 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 the SBA the basis for its certification.

Borrowers have now been given a grace period until May 7, 2020 to repay loans obtained based on a certification standard that did not include a good faith assessment of liquidity and alternative sources of funding.

The relevant Q and A language is as follows:

37. **Question:** *Do businesses owned by private companies with adequate sources of liquidity to support the business’s ongoing operations qualify for a PPP loan?*
Answer: *See response to FAQ #31.*
31. **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. Lenders may rely on a borrower’s certification regarding the necessity of the loan request. Any 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.

To ensure PPP loans are limited to eligible borrowers in need, the SBA and the Department of the Treasury have indicated that loans in excess of \$2 million will be reviewed, **in addition to other loans as appropriate**, following the lender’s submission of the borrower’s loan forgiveness application. This demonstrates an audit and review process focused on loans above \$2 million, but other loans, depending on the circumstances, are also subject to scrutiny.

In response to this new guidance, PPP borrowers should revisit the certification to make a good faith assessment of the economic uncertainty surrounding the business and whether the funds are necessary. In doing so, borrowers should analyze a host of factors, including the following:

- current and projected impact of COVID-19 to the business, including any uncertainties surrounding those projections.
- general economic conditions, and any specific threats to or actual reductions in the level of business with critical customers.
- existing levels of cash reserves.
- the ability to access other sources of capital, and the terms and conditions of such sources.
- current and projected plans for reduction of workforce and payroll costs, and/or the projected ability to retain and reinstate workforce.
- other measures that the borrower will implement to address the economic uncertainty.

Ultimately, PPP borrowers should devise and document, in board minutes or other official records of the company, the process for determining the need for the loan. Whether a borrower can make the certification, in light of the new standard, will depend on the particular facts and circumstances of that borrower, its resources, and its business.

Should you have any questions or would like assistance with implementing the guidance and question of whether the necessity certification can be properly given, please contact Bowditch’s COVID-19 Response Team or your primary contact at the Firm.