

Paycheck Protection Program: Creating Certainty Out of Uncertainty from the Rearview Mirror

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Corporate Alert

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SBA's Proposed Loan Necessity Questionnaires Provide Scrutiny for PPP Loans in Excess of \$2 Million

The Small Business Administration ("SBA") is accepting comments until November 26, 2020 (Thanksgiving) on two proposed loan necessity questionnaires for Paycheck Protection Program ("PPP") loans in excess of \$2 million: [SBA Form 3509 For-Profit Borrowers](#) and [SBA Form 3510 for Non-Profit Borrowers](#). The questionnaires, once finalized, will likely be the first step in the SBA's review process of PPP loans in excess of \$2 million to evaluate whether necessity certificates contained in these PPP loan applications were made in good faith.

The proposed questionnaires seek supplemental information regarding how a borrower's business activities were affected by COVID-19 and a limited liquidity assessment. The SBA does not elaborate on how that new information will be used or how it fairly will apply across industries and companies within the same industry that were not impacted equally.

This alert is focused on the questionnaire for for-profit borrowers. An alert regarding the questionnaire for non-profit borrowers is forthcoming. Affected PPP borrowers would be wise to discuss these developments with their professional advisers and obtain professional advice when completing the questionnaire, as an adverse determination can result in the forfeiting of the PPP loan and its forgiveness feature and potentially subject the borrower and its controlling owners to civil and criminal liability.

Background

The CARES Act, which created the PPP, required a PPP loan applicant to certify in good faith that "the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible PPP loan recipient." In April 2020, less than a month after the creation of PPP, there were widespread public reports of privately held companies owned by billionaires (for example, the Los Angeles Lakers) and publicly-traded companies receiving large multiple-million-dollar PPP loans, often while those public companies had substantial untapped borrowing capacity under their existing bank loan facilities, or while they were raising massive amounts of capital in oversubscribed follow-on public offerings of their stock or debt securities. In response, on April 23, the SBA informed PPP borrowers that before providing their good-faith necessity

certificates, they needed to consider “their ability to access other sources of liquidity.” See [FAQ Answer 31](#). While such guidance is sensible, it appears to be in conflict with the CARES Act, which specifically eliminated the SBA loan requirement that a PPP applicant demonstrate that it was “unable to obtain credit elsewhere.” How to reconcile these seemingly contrary positions is no easy task.

In any event, the SBA encouraged loan recipients to return their PPP loans if, based on the SBA’s guidance, they were unable to establish necessity by creating a safe harbor through May 15. The SBA also announced on April 29 that “it will review all loans in excess of \$2 million, following the lender’s submission of the borrower’s loan forgiveness application and that additional guidance implementing this procedure will be forthcoming.” See [FAQ Answer 39](#).

However, but for establishing a safe harbor in which borrowers of PPP loans of up to \$2 million are deemed to have made necessity certificates in good faith, the SBA has been silent on this matter for about six months, resulting in speculation regarding the review that would be conducted by the SBA given its limited resources.

To illustrate the enormity of the undertaking to review PPP loans greater than \$2 million, the SBA disclosed in August 2020 after new PPP loans could no longer be originated that approximately 25,000 out of 5.2 million borrowers (less than one-half of 1% of all PPP borrowers) received PPP loans in an amount greater than \$2 million that in the aggregate exceeded \$105 billion, or 20% of the \$525 billion of total PPP loans originated. Finally, the SBA is turning to the gargantuan task.

The For-Profit Borrower Loan Necessity Questionnaire

The questionnaire introduces two new periods: (1) the period from March 13, 2020, the date on which the President issued the COVID-19 National Emergency Declaration, until the date on which the borrower submits its completed questionnaire with the required supporting documentation (the “Relevant Period”), and (2) the period from March 13, 2020, to the end of the applicable 8-week or 24-week covered period (the “Modified Covered Period”).

Business Activity Assessment

To assess the effect of COVID-19 on the business activity of the borrower, the borrower must disclose:

1. Its gross revenues for the 2020 second calendar quarter (April 1 to June 30) or the 2020 third calendar quarter (July 1 to September 30) if the business is seasonal, and either (i) the gross revenues for the applicable 2019 calendar quarter or (ii) if the borrower did not exist in 2019, the gross revenues for the 2020 first calendar quarter (January 1 to March 31).
2. Whether during the Relevant Period the borrower was ordered to shut down by a state or local authority due to COVID-19 and the details thereof.
3. Whether during the Relevant Period the borrower was ordered to significantly alter its operations by a state or local authority due to COVID-19 and the details thereof, including the approximate additional cash outlays for these mandatory alterations.
4. Whether during the Relevant Period the borrower voluntarily ceased or reduced its operations due to COVID-19, including supply chain disruptions, and the details and reasons therefor.
5. Whether during the Relevant Period the borrower voluntarily altered its operations due to COVID-19 and the details thereof, including the additional cash outlays for these voluntary alterations.
6. Whether during the Modified Covered Period the borrower began any new capital improvement projects not due to COVID-19 and the approximate cash outlays for these projects.

The borrower must submit with its completed questionnaire documents supporting the gross revenues reported in response to 1 above.

Liquidity Assessment

To assess the effect of COVID-19 on the liquidity of the borrower, the borrower must disclose:

1. The borrower's cash and cash equivalents as of March 31, 2020, or as of June 30, 2020, if the PPP loan application was submitted after June 30, 2020.
2. Whether during the Modified Covered Period the borrower paid any dividends or other capital distributions (other than certain pass-through estimated tax payments) to its owners and the details thereof.
3. Whether during the Modified Covered Period the borrower paid any outstanding debt before its contractual due date and the details thereof.
4. Whether during the relevant 8-week or 24-week covered period there were any employees compensated in an amount in excess of \$250,000 on an annualized basis (comprised of cash compensation and separation payments) and the total amount of such compensation during the applicable 8-week or 24-week covered period.
5. Whether during the relevant 8-week or 24-week covered period there were any owners who worked for the borrower compensated in an amount in excess of \$250,000 on an annualized basis and the total amount of such compensation during the applicable 8-week or 24-week covered period.
6. Whether as of the date of the loan application there were any equity securities of the borrower listed on a national securities exchange and the market capitalization thereof as of such date.
7. Whether as of the date of the loan application any publicly traded company owned 20% or more of any class of the borrower's outstanding equity securities and the details thereof.
8. If the borrower did not have any equity securities listed on a national securities exchange, the book value of the borrower as of March 31, 2020, or June 30, 2020, if the loan application was submitted on or after July 1, 2020.
9. Whether as of the date of the loan application the borrower was a subsidiary of (at least 50% owned by) another entity and information about the parent, including whether the parent entity has publicly traded securities or is a foreign entity.
10. Whether as of the date of the loan application any private equity, venture capital or hedge fund held 20% or more of any class of the borrower's equity securities.
11. Whether as of the date of the loan application the borrower was an affiliate or subsidiary of a foreign, state-owned enterprise or a department, agency or instrumentality of a foreign state.
12. Whether the borrower received funds from another CARES Act program other than tax benefits and the details thereof.

The borrower must submit with its completed questionnaire documents supporting its cash and cash equivalents (1 above), dividends (2), debt prepayments (3), and compensation of employees or owners in excess of \$250,000 on an annualized basis (4 and 5).

Process

Once approved, the questionnaires will be distributed by lenders to borrowers that received loans greater than \$2 million. The borrowers must submit the completed questionnaires to lenders within 10 business days of receipt along with required documentation. Lenders will have five business days following receipt to upload their questionnaire and supporting documents to the SBA Paycheck Protection Forgiveness Platform (forgiveness.sba.gov).

The instructions state that "SBA may request additional information" and that "determination will be based on the totality of your circumstances." The instructions also state that failure to

complete the questionnaires and provide the required supporting documents can result in a denial of loan forgiveness and false certifications are punishable by fines or imprisonment.

Key Takeaways

- Business activity shutdowns or significant alterations, whether mandatory or voluntary, are useful starting points to assess the effect of COVID-19; however, this merely scratches the surface of the difficult considerations facing a business when it submitted its PPP loan application.
- It is certainly helpful in an assessment of liquidity to determine whether a business had access, directly or through a significant owner, to the public capital markets or the financial resources of a parent or significant owner such as a private equity, venture capital or hedge fund, but that information is merely a starting point. Just because a borrower has publicly traded securities does not mean that it could have raised capital in the public markets.
- The significance of seeking information about annual cash compensation in excess of \$250,000 is unclear. Perhaps the SBA will unilaterally take the position that a business should have saved cash resources by curtailing cash compensation above that threshold.
- As with the business activity assessment, a liquidity assessment based on a baseline of a single-quarter ending cash balance greatly simplifies the situation faced by businesses when seeking PPP loans.
- The inherent uncertainty that existed in the economy because of COVID-19 at the time when the PPP applications were submitted was palpable and undeniable. Many of the largest public companies withdrew their guidance because of limited to no visibility as to the extent and duration of the COVID-19 pandemic. Indeed, much of that uncertainty continues to this day as we are experiencing an increase in the levels of cases and continued talk of future shutdowns.
- The questionnaire contains opportunities for borrowers to provide additional information with respect to their particular business activity and liquidity assessment. Since it is not clear as to exactly how the SBA will use these questionnaires, borrowers should consult their professional advisers to determine the extent to which, if at all, they should supplement their questionnaire responses with optional disclosures.

McCarter & English, LLP, can assist you with maximizing loan forgiveness, and in completing the loan necessity questionnaires and gathering the documentation necessary to provide to the lender.