Understanding the PPP Loan Need Certification Requirement and the May 7, 2020 "Safe Harbor"

Shortly after the results of the first round of funding for the Paycheck Protection Program (PPP) were reported, there was widespread criticism that numerous large and well-funded companies had obtained loans while truly needy small businesses were shut out. In response, the SBA has taken several steps since then to significantly tighten its guidelines regarding borrower need and eligibility. The SBA has now indicated that borrowers must carefully consider, or reconsider, the required certification that the "**[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.**" These guidelines are retroactive, and the SBA may ask the borrower to demonstrate the good faith basis of its certification. Borrowers who have already received a PPP loan but who cannot demonstrate their economic need for the loan under the SBA's clarified guidelines may repay the loan by May 7, 2020, with no penalty (i.e., the "Safe Harbor").

Specifically, the SBA issued FAQ #31 on April 23, 2020, which provides:

> 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?
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> **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.
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> 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 enforce the certification requirement, the SBA also issued FAQ #39 on April 29, 2020, indicating that it will "review" (i.e., audit) every PPP loan in excess of $2 million, and other loans "as appropriate" following the borrower's loan forgiveness application. Borrowers that are found to have failed the good faith certification requirement may be subject to loss of forgiveness, personal liability for the owners, fines/penalties and even criminal liability for knowingly misleading the SBA. Accordingly, all businesses that received a PPP loan in excess of $2 million should be especially cautious.

This increased scrutiny may ultimately be limited to public companies, private companies owned by larger companies and truly abusive situations. However, all borrowers should be prepared to demonstrate their economic need to the SBA, if required. It is not yet clear how the SBA will interpret "current business activity," "other sources of liquidity," "ongoing operations" or "not significantly detrimental to the business." There is no bright-line test. In determining a business's need, the business should consider, among other relevant information:

- Current cash reserves
- Current and projected revenue
- Current and projected net income
- Cash flow projections
- Other sources of liquidity/available loans, including current loan documents and restrictions on additional debt

It is important to note that if a borrower has any doubt whether its certification that "current economic uncertainty makes this loan request necessary to support the ongoing operations" was appropriate, it may repay the loan in full **by May 7** and will be deemed to have made the certification of necessity in good faith.

Many borrowers have realized that the amount of their PPP loan (based on the standard application formula of 2.5 times average payroll) is more than actually needed to cover allowed costs (e.g. payroll, rent, mortgage interest, utilities) during the 8-week "covered period" after loan origination. Not spending all of the loan proceeds during this period *may* be a red flag to the SBA that the loan was not "necessary" and may trigger an audit. Ideally, borrowers could partially repay a loan within the Safe Harbor to avoid this, but so far the SBA guidance seems to apply only to full repayment. Nonetheless, borrowers in that situation should immediately inquire with the lender about partial repayment by May 7.

This memo is intended only as a summary and general overview. If you have any questions or would like legal advice regarding the above or any other employment issue, please contact David Lawrence or Sarah Gidley.