

New requirement for Paycheck Protection Program borrowers

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On October 26, 2020 the Small Business Administration (“SBA”) issued a notice proposing two new forms that will be used by SBA loan reviewers to evaluate the good faith certification made by borrowers that economic uncertainty made Paycheck Protection Program (“PPP”) loan funds necessary. Every borrower who applied for a PPP loan had to certify in the application process that economic uncertainty brought on by the COVID-19 pandemic made the PPP borrower’s loan request necessary to support its ongoing operations. The new proposed forms—SBA Form 3509 (Loan necessity questionnaire for for-profit borrowers) and 3510 (Loan necessity questionnaire for non-profit borrowers)—will be used to collect supplemental information from borrowers who received US\$2 million or more in PPP funds.

As noted in prior Frequently Asked Questions (“FAQ”) published by the SBA regarding the PPP, the SBA intends to closely examine whether the PPP borrower’s good faith certification that economic uncertainty made the PPP borrower’s loan request necessary to support the ongoing operations was justified. An automatic audit process will be triggered for all borrowers who received US\$2 million or more, and the new SBA forms make clear that a review of the good-faith necessity certification will be a critical part of that audit process.

The instructions for the proposed forms make clear that the questions asked and information requested will only be a starting point for the necessity certification review. The instructions state that SBA may request additional information, and its evaluation will be based on the “totality of your circumstances,” and not just the answers to these questions. At the same time, the new forms also provide that failure to complete the form or the failure to provide the requested supporting documents may in itself provide a basis for the SBA to determine that a borrower was ineligible for the loan and/or deny the forgiveness request.

Below we provide a brief overview of the information requested in the new SBA forms. While the majority of the requests are not surprising given prior SBA guidance, there are a few notable items that illustrate how the SBA reviewers will evaluate the necessity question. For example, the new forms seek data on the number of employees and owners of the borrower who were compensated in an amount over US\$250,000 on an annualized basis during the loan forgiveness covered period. For those employees who received such compensation, the borrower is asked to provide documentation to show how much was actually paid to those employees during the covered period. The SBA form also asks whether a private equity, venture capital, or hedge fund owned more than 20 percent of a borrower’s equity securities on the date of the application. This suggests a continued focus on whether a borrower had the ability to obtain the requested loan proceeds from other sources.

The requested information is divided into two categories—“Business Activity Assessment” and “Liquidity Assessment”—and summarized as follows.

Business activity assessment

- Documentation showing PPP borrower's gross revenue in Q2 of 2020 as well as its gross revenue in Q2 2019 (or Q1 2020 if not in existence in Q2 2019);
- Information on COVID-19 pandemic effects on the PPP borrower's operations, including information whether the PPP borrower was ordered to shut down during the COVID-19 pandemic, continued operating or was required to significantly alter its operations, i.e. (in)voluntarily ceasing, reducing or altering its operations due to the COVID-19 pandemic, and if so how, as well as the corresponding economic impact of these decisions.

Liquidity assessment

- Documentation showing the PPP Borrower's cash and cash equivalents at the time the application for the PPP loan was submitted;
- Documentation showing payment of dividends, distributions, capital contributions, prepayment of debt made between March 13, 2020 and the loan forgiveness covered period of the PPP loan;
- Documentation identifying the number of employees whose annualized compensation exceeded US\$250,000 during the covered period, along with information about how much those employees were actually paid during the covered period;
- Documentation for any capital improvement projects initiated by the PPP borrower that were not caused by or required due to COVID-19;
- For public companies, the market capitalization on the date of the PPP loan application;
- For private companies, the book value of the borrower as of the last day of the calendar quarter preceding the loan application;
- Information on ownership of the borrower, including whether any publicly traded company, private equity, hedge fund, or venture capital firm owned 20% or more of the borrower's equity securities; and
- Information regarding receipt of any other funds from programs established under the Coronavirus Aid, Relief and Economic Stability Act ("CARES Act").

In reviewing this list, it is apparent that the SBA will request information and documents previously not discussed in any of the FAQs or the interim final rules published in connection with the PPP. This information will reflect the PPP borrower's ownership and economic status before and after the PPP loan application was filed. It is likely that the SBA will require detailed information and documentation relating to items such as expenditures for capital improvement projects, dividends, and prepayment of debt during the relevant period. A close evaluation of the borrower's business decisions on these expenditures, as well as the treatment of highly compensated employees during the claimed period of necessity will be part of the review process. All of this suggests that the SBA will use multiple factors not previously considered in the PPP rules or regulations in fact some factors, e.g. the evaluation of dividends or the employee compensation, that were outlined in the CARES Act in connection with other loan programs but were not brought in connection with the PPP until now to evaluate the PPP borrower's necessity to apply for the PPP loan.

From a process standpoint, once approved the new SBA forms will be distributed by lenders to the PPP borrowers. Upon receipt of the questionnaire, the borrower will have ten (10) days to complete the questionnaire, provide the ancillary documentation requested, sign and certify the SBA form, and return it to the lender. The lender will have five (5) days following receipt to upload the complete form with all responses, supporting documents, signatures and certifications to the SBA PPP forgiveness platform. The SBA further reserves the right to request additional information following its review of the information provided by the PPP borrower.

For recipients of PPP loans in excess of US\$2 million, there can be little doubt that the review process will involve close scrutiny of the original necessity certification made on the PPP loan application. In anticipation of this, borrowers must engage in a careful collection and compilation of the information and documents that support their good faith necessity certifications. Failure to provide the required information can result in a denial of loan forgiveness, and false certifications may be punishable by civil and criminal penalties.