



It's Back - Loan Necessity Certification Part II

The Small Business Administration (SBA) recently announced that it will use two forms of questionnaires in its review of certain loans made under the Paycheck Protection Program (PPP) pursuant to the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), as modified by the Payroll Protection Program Flexibility Act of 2020 (Flexibility Act). The SBA indicates that it is using these forms to collect information to evaluate the certification by the borrower that the economic uncertainty at the time made the borrower's loan request necessary to support its ongoing operations (Loan Necessity Certification). See our previous alert on this Loan Necessity Certification [here](#).

This latest announcement will require larger PPP borrowers to revisit the Loan Necessity Certification issue once again. There are two forms of questionnaires, with one being used for the review of for-profit borrower's loans and the other being used for a not-for-profit borrower's loan review. It appears that both of these forms are limited to PPP loans of \$2 million or more, or for a borrower who, with its affiliates, received \$2 million or more of PPP loan proceeds. The focus of this alert is the for-profit borrower questionnaire, but both of the forms can be found below:

[Non-Profit Borrower's Questionnaire](#)

[For-Profit Borrower's Questionnaire](#)

Requirement to Respond

Setting aside analysis of whether these questionnaires are proper under the PPP, which borrowers might be saving for another day, each questionnaire provides that a borrower's failure to complete the form and provide supporting documents may result in the SBA's determination that the borrower was not eligible for the loan or that the borrower is not eligible for forgiveness of the loan. Further, the SBA reserves the right to seek repayment of the loan or pursue other available remedies in the event the borrower does not respond. Per the questionnaire, the borrower is to respond within 10 business days after its receipt of the document from the lender (or directly from the SBA).

Loan Necessity Certification

As a refresher, the PPP loan documents required the applicant to make the Loan Necessity Certification as part of the loan process. Later, guidance was issued by the SBA on this certification that suggested that borrowers making this certification must take into account their current business activity (Business Activity Assessment) 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 (Liquidity Assessment). Most of the items in the questionnaire aim towards gathering information with respect to the Business Activity Assessment and the Liquidity Assessment.

A. Business Activity Assessment

The first section of the questionnaire asks for information that explores the business activities of the borrower in and around Q2 and during the loan forgiveness period, including the following:

1. Borrower's gross revenues for the Q2 of 2020 and comparison to the same information for Q2 of 2019; if an early stage company (e.g. not in existence in Q2 of 2019), the comparison is back to Q1 of 2020
2. Any shut down or material alterations of the business due to federal, state or local orders, and any voluntary cessation or reduction, or other material alterations, in the

- business operations, since March 13, 2020
3. Identifying new capital improvements, if any, undertaken by the borrower between March 13, 2020 and the end of the loan forgiveness period

B. Liquidity Assessment

The other major section of the questionnaire focuses on obtaining information from the borrower that might speak to the borrower's access to other sources of liquidity, including the following:

1. The amount of cash and cash equivalents as of the last day of the calendar quarter immediately before the loan application
2. Any dividends or capital distributions made to owners, or prepayment of debt, between March 13, 2020 and the end of the borrower's loan forgiveness period
3. Employee or owner compensation in amounts that exceed \$250,000 on an annualized basis during the loan forgiveness period
4. Public markets for the borrower's securities, or ownership of the borrower by a public company, as of the loan application date
5. For non-public companies, or companies without publicly owned stakeholders, the shareholders' equity of the borrower as of the last day of the calendar quarter immediately before the date of the loan application
6. 20% or more equity ownership of the borrower by a PE or VC firm, or a hedge fund, as of the loan application date
7. Affiliation of borrower with a foreign enterprise
8. Receipt of funds from any other CARES Act programs

Takeaways and Open Issues

While the SBA may review several aspects of a borrower's loan forgiveness application, including the calculation of the loan amount, the appropriate spend of PPP loan proceeds, and eligibility based on the borrower's size, the Loan Necessity Certification appears to be an area that the SBA will target more systematically in the review process.

- In both the Business Activity Assessment and Liquidity Assessment sections of the questionnaire, the borrower is given the opportunity to provide additional comments on any of the questions in that particular section. The response is limited to 1,000 characters, however.
- Receipt of the questionnaire does not mean a borrower's Loan Necessity Certification is necessarily being challenged, and the forms are set up so that it is possible that any loans at or above \$2 million will generate an automatic distribution of the applicable questionnaire to the borrower.
- Whether the guidance on the Business Activity Assessment and the Liquidity Assessment is controlling or dispositive of the question of loan necessity remains unanswered. This is especially true for early borrowers of PPP loans who had applied for and received loans before the guidance was even issued. At a minimum, these appear to be criteria that the SBA believes are appropriate to evaluate in the determination of need. However, they are just guidance, and are not expressly set forth in the CARES Act, the Flexibility Act, or the rules promulgated thereunder.
- Further, the focus on Q2 business activity or activity during the loan forgiveness period brings into question why and how actual business results should be part of the analysis of the Loan Necessity Certification. By the certification's definition, the uncertainty speaks to that which existed at the time of loan application, which could have been in Q1 or very early in Q2 for some borrowers, and a borrower most likely would not know what the several weeks in the future would hold. Whether the SBA can use the actual performance of activities against a borrower to challenge a good faith certification regarding uncertainty existing at the time of loan application seems ripe for controversy.

If you have any questions about the Paycheck Protection Program or Loan Necessity Certification, please contact a member of Hill Ward

Henderson's [COVID-19 Attorney Response Team](#) below.



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