

## Enhanced Scrutiny for +\$2 Million PPP Loans: What Borrowers Need to Know about the SBA's New Necessity Questionnaires

Each Paycheck Protection Program (“PPP”) loan of \$2 million or more is subject to a mandatory review/audit of the borrower’s need for the loan. The SBA filed a notice on October 26, 2020, indicating that it plans to use two new forms to collect information to verify such need:

- 1) SBA Form 3509 — Loan Necessity Questionnaire (For-Profit Borrowers); and
- 2) SBA Form 3510 — Loan Necessity Questionnaire (Non-Profit Borrowers) (collectively, the “Questionnaires”).<sup>1</sup>

These Questionnaires are not yet officially available to the public from the SBA’s forms database; however, we have reviewed them and confirmed with PPP lenders that they are presently in use by the SBA.

The Questionnaires provide long-awaited, yet potentially problematic, preliminary insight into how the SBA will evaluate the subjective concept of need. Of course, the forms are subject to change and any related guidance that may be issued.

### 1) What is the Need Certification and why is it important?

The CARES Act and each PPP loan application require that borrowers certify in good faith that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the [borrower]” (the “Need Certification”).

After the launch of the PPP program, the SBA issued several updates through its [Frequently Asked Questions publication](#) (the “FAQ”), placing a renewed (and arguably augmented and unclear) emphasis on cautioning borrowers that PPP loans must be necessary to support ongoing operations. That guidance added that the Need Certification requires an assessment of the borrower’s ability to “access other sources of liquidity sufficient to support ... ongoing operations in a manner that is not significantly detrimental to the business.”<sup>2</sup> As an example, the FAQs suggest 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

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<sup>1</sup>[85 FR 67809](#).

<sup>2</sup> FAQ #31.

in good faith, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification.”<sup>3</sup> With no clear or bright lines, the applicable guidance creates a difficult standard to apply and possibly defend.

The Questionnaires provide additional insight into what the SBA will consider when reviewing Need Certifications. Unfortunately for some borrowers, the Questionnaires may seek information that drastically differs from what the borrower actually considered when making its Need Certification. A primary reason for this is that many of its questions are hindsight-based, yet the Need Certification was based on economic uncertainty at the time of the loan application. As one example, the forms seek information about actual revenue performance and operations post loan closing but inexplicably fail to ask a single question about economic uncertainties considered, detriments to the business for accessing other sources of liquidity, or the liabilities of the borrower. Referencing the US stock market’s steep decline at the end of the first quarter of 2020 and steep recovery during the second quarter of 2020, one could argue that there were many impactful economic uncertainties to begin the second quarter that were resolved or ended up being far less impactful than predicted. However, the Questionnaires may not allow borrowers to offer much by way of explanation or analysis. The Questionnaires do include a few sections where borrowers may provide other/additional information not specifically requested, but each of those is limited to 1,000 characters. In short, the forms seek information, which may not have been anticipated and which, if not well and succinctly explained in the limited space available, could easily paint a negative picture and lead the SBA to an inaccurate and detrimental conclusion.

## **2) Will all PPP loans over \$2 million be reviewed for necessity?**

Yes. The Questionnaires state that each “[b]orrower that, together with its affiliates, received PPP loans with an original principal amount of \$2 million or greater is required to complete [the] form.” That statement is consistent with prior guidance which provides that all loans to borrowers (together with all loans to affiliates) of \$2 million or greater are subject to mandatory review.<sup>4</sup> Borrowers with lesser loan amounts are deemed to have made their Need Certification in good faith.<sup>5</sup> In this regard, receipt of a Questionnaire during an SBA loan review should not be seen as an indication that the SBA is challenging a particular loan.

## **3) When will applicable borrowers receive a Questionnaire?**

Borrowers with loans of \$2 million or more (together with all loans to affiliates) will most likely receive a Questionnaire after submitting a forgiveness application.<sup>6</sup> Nevertheless, official guidance reserves the SBA’s right to “undertake a review at any time in SBA’s discretion.”<sup>7</sup> Notably, the SBA’s forgiveness application forms ask borrowers to report whether the “[b]orrower (together with affiliates, if applicable)

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<sup>3</sup> *Id.* In addition, FAQ #37, clarifies that such guidance is not limited to large or publically traded companies.

<sup>4</sup> See FAQ #39 (providing that “following ... submission of the ... [applicable] forgiveness Application” the SBA will review all loans in excess of \$2 million, in addition to other loans as appropriate.)

<sup>5</sup> See FAQ #46 (“Any borrower that, together with its affiliates, received PPP loans with an original principal amount of less than \$2 million will be deemed to have made the required certification concerning the necessity of the loan request in good faith.”)

<sup>6</sup> *Id.*

<sup>7</sup> IFR #15 ([85 FR 33010](#)).

received PPP loans in excess of \$2 million.” Answering that question in the affirmative will likely trigger a review.

#### **4) How much time will a borrower have to respond to a Questionnaire?**

The Questionnaires provide that borrowers must respond within ten (10) business days of receipt and that failure to respond may result in an adverse determination by the SBA.

#### **5) Will Borrowers have an opportunity to provide additional information?**

As discussed above, the Questionnaires seek specific information that, when aggregated, may not paint an accurate and complete picture of what a particular borrower appropriately considered in making its good faith Need Certification. The forms state that the SBA can request additional information but are silent as to whether borrowers have an opportunity to supply information not requested. Accordingly, it is presently unclear whether borrowers will have any opportunity to provide additional information prior to an adverse decision by the SBA.

#### **6) What happens if the SBA makes an adverse determination, and what are the risks?**

FAQ #46 provides that “[i]f SBA determines ... that a borrower lacked an adequate basis for the [Need Certification], SBA will seek repayment of the outstanding PPP loan balance and will inform the lender that the borrower is not eligible for loan forgiveness.” That same guidance further provides that if the borrower then repays the loan, the “SBA will not pursue administrative enforcement or referrals to other agencies based on its determination with respect to the certification concerning necessity of the loan request.” This potential safe harbor is important because such enforcement and referrals could subject a borrower and any individual that made certifications on behalf of a borrower to criminal liability, including prison terms ranging from two (2) to thirty (30) years and fines ranging from \$5,000 and up to \$1,000,000, and non-criminal financial liability. Separate guidance provides that borrowers may appeal an adverse decision;<sup>8</sup> however, it is unclear if an appeal of an SBA decision will jeopardize a borrower’s opportunity to take advantage of the safe harbor.

#### **7) What information does the for-profit Questionnaire seek?**

The for-profit Questionnaire is split into two sections: (i) a Business Activity Assessment and (ii) a Liquidity Assessment.

The Business Activity Assessment focuses on:

- A comparison of second quarter 2020 gross revenue to a prior quarter;
- *Non*-COVID-19 capital improvement projects since the loan; and
- Any shutdowns, restrictions or alteration to operations (required and voluntary) since March 13, 2020.

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<sup>8</sup> IFR #15 ([85 FR 33010](#)).

Documentation is required to support the gross revenue responses, and start and end dates are required for any applicable governmental orders that affected the operations of the borrower. Borrowers have the option, again limited to 1,000 characters in each instance, to describe (i) how services were altered due to a governmental order; (ii) why the borrower voluntarily reduced or ceased operations; (iii) how operations were voluntarily altered, if applicable; and (iv) additional comments to any question in the Business Activity Assessment Section.

The Liquidity Assessment focuses on:

- Cash or equivalents at the time of loan application;
- Dividends and distributions since March 13, 2020;
- Prepaid debts since March 13, 2020;
- Employees and owners paid at a rate exceeding \$250,000 annually during the covered period;
- Listing of equity securities on a national exchange and, if so, market capitalization;
- 20% or greater ownership by any publicly traded company;
- Book value of shareholder equity before the loan application;
- 50% or greater ownership by another company and, if so, whether that company is a US company and whether it is listed on a securities exchange;
- 20% or greater ownership by any private equity firm, venture capital firm or hedge fund (or a fund managed by such a firm);
- Affiliation or subsidiary relationship with a foreign, state-owned enterprise or a department, agency or instrumentality of a foreign state; and
- Receipt of other CARES Act Funds (other than tax benefits).

Similar to the Business Assessment Section, most of these subjects are focused on actual performance and actual impacts after the loan application and the ownership of the borrower, instead of the economic uncertainties at the time of the loan application that justified need for the loan. Documentation is required to support the amounts of cash on hand, distributions to owners, debt prepayments and compensation to employees and owners paid at a rate exceeding \$250,000 per year. Borrowers have the option, limited to a single response not exceeding 1,000 characters, to provide additional comments to the questions asked in the Liquidity Assessment Section.

## **8) What are the primary differences between the for-profit and non-profit Questionnaires?**

For the most part, the non-profit Questionnaire is similar to the for-profit Questionnaire. The primary differences are that the non-profit Questionnaire:

- Includes grants, gifts, and contributions in its section on revenue comparisons; and
- Seeks information on:
  - Short-term investment positions and non-cash investments;
  - Whether the borrower has restrictions on using net income, cash, savings, or investments for payroll and non-payroll costs otherwise eligible for PPP forgiveness;
  - Whether the borrower holds assets in endowment funds;
  - Whether the borrower provides healthcare services, and if so, its program service revenue relating to patient care;

- Whether the borrower is a school/college/university, and if so, whether it offered additional financial assistance to students or had declines in tuition revenue due to COVID-19; and
- Whether the borrower offered a discount on services due to COVID-19.

## **9) What are lenders' responsibilities with respect to the Questionnaire?**

The process presently in use by the SBA places the lender in the important position of an intermediary between the SBA and the borrower. When the SBA undertakes a review of the Need Certification, it sends the Questionnaires to the lender along with a cover letter providing instructions to the lender. The letter advises the lender to (i) notify the borrower within five (5) business days that the SBA has undertaken a review and (ii) request that the borrower (a) complete and return the applicable Questionnaire and (b) provide the lender with all documents listed under the heading of "Documents that Each Borrower Must Maintain but is Not Required to Submit" in the instructions to the borrower's Loan Forgiveness Application. Then, within five (5) business days of receipt of the borrower's submission, the lender must upload the borrower's Questionnaire and documentation to the SBA PPP Forgiveness Platform and key in the borrower's responses to each question in the Questionnaire. The letter also instructs the lender to, within five (5) days of receipt of the letter, provide the following to the SBA:

- The Borrower Application Form (SBA Form 2483 or the lender's equivalent form) and all supporting documentation provided by the borrower;
- All documentation that the borrower was required to submit with its Loan Forgiveness Application;
- A signed and certified transcript of account;
- A copy of the executed note evidencing the PPP loan; and
- Any memorandum or other analysis that the lender prepared in making its decision on the borrower's Loan Forgiveness Application.

As with the Questionnaires, the content of the SBA's lender instruction letter is subject to change and any future guidance. Lenders must review each letter and any related guidance.

## **10) What can a Borrower do now to prepare for a review of its Need Certification?**

There is no reason to await notice from a lender or the SBA to begin preparing for an eventual review and then scramble to recall or recreate reliable supporting information. Also, because submission of a forgiveness application will usually precipitate a review, it may behoove borrowers to reevaluate their Need Certification in light of the newest guidance and questions asked in the Questionnaires before submitting a forgiveness application.

In addition, borrowers should consider whether they would benefit from the assistance of experienced government-backed lending counsel. With potential criminal liability on the line, this is clearly an instance where what a borrower says can and will be used against it. The Questionnaires seek information that likely was not anticipated by most borrowers when they made their initial Need Certification and provide an extremely limited opportunity to explain what was considered. If not well and succinctly explained, responses to a Questionnaire can easily paint a negative picture and lead the SBA to the wrong conclusion.

Borrowers do not need to handle this alone. Jaffe's PPP Audit and Compliance Services Team is actively engaged in representing PPP borrowers and lenders and continues to closely monitor the evolving guidance and related developments. You can learn more about our related service offerings [here](#). In addition, please feel free to contact us with any questions.

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