

# Client Alert

May 2020

## Economic Need, Liquidity and Safe Harbors: Keep your Eye on the Bouncing PPP Certification Ball

The Small Business Administration (the “SBA”) has added a new item to its Frequently Asked Questions (“FAQs”) for the Paycheck Protection Program (the “Triple P”). This welcome new guidance clarifies the approach the SBA will take in reviewing borrowers’ good-faith certifications concerning the necessity of their loan requests. Significantly, the new FAQ clarifies that a borrower who, together with its affiliates, received Triple P loans with an original 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. This client alert reviews the new guidance and addresses additional considerations for lenders and their borrowers.

### Background:

On March 27, 2020, the President signed into law the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”).<sup>1</sup> The CARES Act allocated \$349 billion in funding for the creation of the Triple P and directed the SBA to issue rules for, and administer, the Triple P. The purpose of the Triple P, as fleshed out by the SBA, is to assist small businesses, including nonprofit and faith-based organizations, that have been adversely affected by Covid-19.

The SBA requires borrowers to self-certify that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant” (the “Necessity Certification”).<sup>2</sup> The CARES Act eliminated the standard requirement for SBA section 7(a) loans that an applicant be unable to obtain credit elsewhere.<sup>3</sup>

In response to publicly-traded companies’ receiving Triple P loans, the Treasury Department and SBA sought to modify the Necessity Certification through the FAQs posted on April 23, 2020.<sup>4</sup> Specifically, FAQ number 37 states that “[b]orrowers 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.” (Emphasis added). This assessment has two elements: current business activity and the ability to access other sources of liquidity.

The SBA’s FAQ question 31 states that: “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

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<sup>1</sup> Public Law No: 116-316, available at: <https://www.congress.gov/bill/116th-congress/house-bill/748/text?q=%7B%22search%22%3A%5B%22cite%3APL116-136%22%5D%7D&r=1&s=1>

<sup>2</sup> We note that this certification is mandated by the CARES Act: “(G) BORROWER REQUIREMENTS.— “(i) CERTIFICATION.—An eligible recipient applying for a covered loan shall make a good faith certification... (I) that the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient...” CARES Act Section 1102(2) (amending 15 U.S.C. 636(a) to add a new subsection (36)).

<sup>3</sup> CARES Act Section 1102(2) (amending 15 U.S.C. 636(a) to add a new subsection 36)(“I)...During the covered period, the requirement that a small business concern is unable to obtain credit elsewhere, as defined in section 3(h), shall not apply to a covered loan.”).

<sup>4</sup> See Question 31 at Triple P [FAQ](#)

certification.” (Emphasis added). The Treasury Department and the SBA provide that a Triple P loan applicant must evaluate whether, under the current guidance, it can in good faith certify that the current “economic uncertainty” makes the loan request “necessary to support the ongoing operations” of the company based on an assessment taking into account its “current business activity” and its ability “to access other sources of liquidity sufficient to support” its ongoing operations “in a manner that is not significantly detrimental to the business.”

The SBA underscored this concept with those FAQs.<sup>5</sup> Question 37 of the FAQs states further that businesses owned by private companies with adequate sources of liquidity to support the business’ ongoing operations might not qualify for a Triple P loan under the same “adequate liquidity” test for public companies. Despite the continued validity of question 17 of the FAQs (which provides that lenders and borrowers may rely on the laws, rules, and guidance available at the time of the relevant application) the combination of questions 31 and 37 create tremendous uncertainty.

### **New SBA Guidance:**

In response, the SBA issued a new FAQ to try to heal its self-inflicted wound. The SBA’s latest guidance in FAQ question 46 creates a safe harbor to the SBA’s review of Triple P loans with respect to the “economic uncertainty” certification. The FAQ provides that “**Any borrower that, together with its affiliates received [Triple P] 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.**” Absent misrepresentation or intentional wrongdoing, any borrower with a loan below \$2 million should no longer be subject to scrutiny by the SBA about their funding needs (note that such borrowers may still be subject to SBA review with respect to other program requirements, such as whether the borrower is in an eligible industry). If a borrower with a loan under \$2 million has repaid its loan due to concerns of uncertainty with the SBA guidance, it may be possible to have the loan reinstated.

Borrowers that received Triple P loans for amounts greater than \$2 million will still be subject to review by the SBA for compliance with all program requirements, including the economic necessity certification. Specifically, FAQ #46 states, “[i]f [the] SBA determines in the course of its review that a borrower lacked an adequate basis for the required certification concerning the necessity of the loan request, SBA will seek repayment of the outstanding Triple P loan balance and will inform the lender that the borrower is not eligible for loan forgiveness.” The FAQ still did not contain any information on what criteria the SBA will use to determine that these borrowers had an adequate basis for the economic uncertainty certification.

### **Ambiguities in Enforcement and Liability:**

This new FAQ explicitly provides that the SBA will no longer pursue administrative enforcement or referrals to other agencies if the borrower pays back the loan after the SBA advises it to do so, or if the aggregate loan amount of any borrower is less than \$2 million.

A compelled return of the loan proceeds, however, does not resolve all exposure for a certification later determined to be inaccurate or false. The FAQ does not protect borrowers from potential civil and criminal claims from other parties. It simply states that the SBA will not pursue the borrower, and the SBA will not refer the case to another agency. The borrower may still be subject to liability and enforcement actions from other agencies and individuals, as described above, although the new FAQ might tend to discourage any such.

The SBA is now ceding to practical reality and trying to resolve the uncertainty and backlash it created. Because banks do not have the obligation to police the loans and the SBA lacks the resources to do so,

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<sup>5</sup> See Question 37 at Triple P [FAQ](#), published on April 28, 2020.

lenders would not have participated in the Triple P program unless the SBA provided a hold harmless. The SBA also recognized that the uncertainty they had created for borrowers was causing perverse effects. For example, we had heard that doctors were considering giving the money back and laying off personnel rather than face audit and enforcement risk. The SBA has dramatically ratcheted down those concerns for 99% of the Triple P borrowers.<sup>6</sup>

Still, borrowers should be certain they can provide sound reasoning for the economic necessity of the Triple P loan, regardless of whether the SBA will audit their homework. Borrowers should still perform the analysis required to evaluate the necessity certification. If they decide in good faith that they met the requirements as to the necessity certification after that evaluation, the new FAQ does not affect their analysis—of course. If they believe that there is substantial doubt about whether they will be able to muster sufficient documentation and support for making the necessity certification, they should consider taking advantage of the May 18 safe harbor<sup>7</sup>, for while repayment may later avoid SBA sanctions, it will not shield them from actions by the Justice Department or plaintiffs under the FCA. Again, we believe lenders should be encouraging borrowers to contact their own counsel, accountants, and tax advisors.

We recommend that lenders deliver a letter to all borrowers informing them of this new information.

## Other Triple P Updates

The SBA also released a new [interim final rule](#) at the end of the day on Wednesday, May 13, 2020. The new rule authorizes all lenders to increase existing Triple P loans to partnerships or seasonal employers to include appropriate amounts to cover partnership compensation in accordance with the [interim final rule](#) posted on April 14, 2020, or to permit the seasonal employer to calculate its maximum loan amount using the alternate criteria outlined in the [interim final rule](#) posted on April 27, 2020. Some Triple P loans were approved and funded prior to the additional guidance being issued, so this new rule ensures those businesses are able to receive the maximum amount for which they are eligible. The rule also clarifies that lenders may make additional disbursements of the loan proceeds without violating the requirement that loans be disbursed in one lump sum so long as the second disbursement is prior to the submission of the yet to be released SBA Form 1502.

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<sup>6</sup> <https://www.wsj.com/articles/u-s-says-it-will-trust-small-business-owners-when-they-say-they-need-loans-11589400077>

<sup>7</sup> Note: The safe harbor deadline was originally May 7<sup>th</sup>. The SBA extended to May 14<sup>th</sup> in item 43 of the FAQ and then later to May 18<sup>th</sup> as item 47 in the FAQ.