

SBA Questions Borrowers About the Necessity of Their PPP Loans

Over the course of the last week, the Small Business Administration (SBA) has reportedly begun quietly questioning borrowers who had received Paycheck Protection Program (PPP) loans about the "necessity" of their loans. On October 26, 2020, the SBA filed in the Federal Register a [notice](#) (the Notice) seeking approval from the U.S. Office of Management and Budget (OMB) for two forms of questionnaires, starting a 30-day comment period. Form 3509 is intended for for-profit borrowers, and Form 3510 is intended for nonprofit borrowers.

The body of Form 3509 is divided into a "business activity assessment" and a "liquidity assessment," each of which require detailed responses. These assessments suggest standards for eligibility that did not exist at the time borrowers applied for and obtained PPP loans, arguably conflict with the CARES Act's presumption that borrowers are adversely affected by COVID-19, and arguably conflict with the CARES Act's waiver of the "credit elsewhere" test and its rescission of the "personal resources test." Whether the questions being posed are appropriate or fair will likely be the subject of debate and litigation, but for-profit borrowers with PPP loans may need to address the assessments in Form 3509, especially if they (together with their affiliates) received PPP loans in amounts of \$2 million or more. Form 3510 calls for similar information about a nonprofit borrower's activity and liquidity, and will be addressed in a separate update.

The procedural status of these new questionnaires (including the October 31, 2020, expiration date that appears on the face of the forms), as well as the specific questions being asked, give rise to a host of potential questions and concerns about how responses will be used and to what effect. The update below highlights some of these questions and concerns and discusses potential actions borrowers can take if they receive one of these questionnaires.

Key Takeaways

- Concerned parties should consider providing comments to the OMB during the 30-day comment period, which expires on November 25, 2020. Comments should refer to the information collection by title and/or OMB Control Number (3245-0407) and should be sent to: Agency Clearance Officer, Curtis Rich, Small Business Administration, 409 3rd Street SW, 5th Floor, Washington, DC 20416; and SBA Desk Officer, Office of Information and Regulatory Affairs, Office of Management and Budget, New Executive Office Building, Washington, DC 20503.
- Borrowers who receive one of the new PPP necessity questionnaires will likely be asked to respond within 10 business days. Although the questionnaire indicates that the form expired on October 31, 2020, and that replies are not required for forms that do not include a current OMB control number, failing to respond may adversely affect the status of the PPP loan. Borrowers should consult with legal counsel regarding any updated guidance prior to responding.
- The necessity questionnaires require an authorized representative to certify the truthfulness of all the additional information and supporting documents provided. Borrowers should proceed cautiously and have a process for carefully verifying the accuracy of their responses, including supporting materials, to avoid exposing themselves to potential enforcement actions for false statements.

- Borrowers should keep in mind that appearances matter when it comes to how government regulators (not to mention the court of public perception) will scrutinize PPP loan applications, necessity certifications and requests for loan forgiveness. Accordingly, companies should be thoughtful about the tone of their response to the PPP necessity questionnaires and any public statements that relate to their PPP loan.
- In addition to answering the specific questions asked, some PPP borrowers may want to include additional or supplemental information in their response if there are facts and circumstances that support their original PPP loan application and necessity certification in a manner that is consistent with the letter and spirit of the program, but is not otherwise captured in the borrower's responses to the questions in the necessity questionnaire.
- Lenders should also exercise caution in gathering and submitting necessity questionnaires to the SBA to avoid potential liability for omitting or incorrectly processing information provided by the borrower.

The Necessity Certification and the New Necessity Questionnaires

Background

As a reminder, the so-called "necessity" certification appeared in the form of PPP loan application that the SBA required all borrowers to submit to their PPP lender. This called for PPP borrowers to certify **in good faith** that, "Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant." Borrowers began submitting these forms in early April 2020 when lenders first began accepting PPP loan applications. This was done against the backdrop of the CARES Act, which (1) expressly waived the SBA's "credit elsewhere" test with respect to borrower eligibility for a PPP loan, (2) included language saying that "an impacted borrower is presumed to have been adversely impacted by COVID-19" (for purposes of loan payment deferral), and (3) rescinded prior rulemaking that would have required a "personal resources test" for SBA loans, calling for analysis of the liquid resources of each owner of 20% or more of borrowing business.

No parameters were provided by the SBA on how borrowers were to interpret the "necessity" certification until April 23, 2020, when the SBA released a FAQ providing that, "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." In light of the express waiver of the "credit elsewhere" test and the rescission of the "personal resources test" in the CARES Act provisions that authorized PPP loans, as well as the presumed impact of COVID-19, this FAQ guidance was viewed as creating a significant change to the "necessity" certification since it called for consideration of other sources of liquidity. In addition, borrowers struggled to understand the meaning of the SBA's references to "current business activity" and "their ongoing operations." For example, was there a specific timeframe to be considered or a certain severity of business impact that would be insufficient to meet the "necessity" certification? This led many borrowers to prepare memoranda documenting the factors supporting their necessity certification, albeit with incomplete information regarding the applicable standards for making this certification. Our May 5, 2020, update providing practical tips for how to react to this guidance is [here](#).

In response to backlash regarding the FAQ guidance on "necessity," in early May 2020 the SBA announced a safe harbor for PPP borrowers who repaid their PPP loans by a specified date (initially May 7, 2020, but ultimately extended to May 18, 2020). Under this safe harbor, the SBA said they "will not pursue administrative enforcement or referrals to other agencies" based on the borrower's certification of necessity. Implicit in this guidance was a threat that borrowers who did not avail themselves of this safe harbor could be referred to the U.S. Department of Justice for investigation and potential federal False Claim Act charges (alleging a knowingly false or fraudulent claim for payment from the U.S. government). This led many PPP borrowers to reconsider their "necessity" certification based on the information and guidance available to them at that time, and some

elected to repay their loans rather than trying to run their business under the cloud of uncertainty created by the changing SBA guidance.

On May 13, 2020, the SBA announced a further "safe harbor," providing that borrowers who, together with their affiliates, received PPP loans in an aggregate amount less than \$2 million, will be deemed to have made their necessity certification in good faith. Our update on this development can be found [here](#). While this development provided some comfort for borrowers, neither this "safe harbor" nor the prior "safe harbor" truly shield companies from potential liability with respect to their PPP loan; instead, they only suggest that the SBA will not pursue or recommend enforcement action. Other regulators and third parties could still seek enforcement actions without receiving a recommendation or referral from the SBA.

With this backdrop, many borrowers are concerned about how the SBA will ultimately interpret "necessity" but have very little information on factors the SBA would consider when assessing "necessity."

Status of New PPP Necessity Questionnaires

The Notice refers to two forms of loan necessity questionnaire, Form 3509 (for for-profit borrowers) and Form 3510 (for nonprofit borrowers); however, as of November 3, 2020, neither the SBA nor the U.S. Department of Treasury have posted these forms to their PPP loan websites. A copy of Form 3509 (for for-profit borrowers) has appeared in news reports regarding this development, including on *Politico's* website [here](#). Importantly, Form 3509 provides that, "The completed form is due to the Lender servicing your PPP loan within ten business days of receipt from your Lender." It then provides that, "Failure to complete the form and provide the required supporting documents may result in SBA's determination that you were ineligible for either the PPP loan, the PPP loan amount, or any forgiveness amount claimed, and SBA may seek repayment of the loan or pursue other remedies."

The cover of Form 3509 also includes a Paperwork Reduction Act notice saying that "You are not required to respond to this collection of information unless it displays a currently valid OMB Control Number," and the form itself bears an expiration date of 10/31/20 for the OMB Control Number. The Notice requests comments on the necessity questionnaires and provides a November 25, 2020 deadline for comments, which can only be provided by mail (no electronic comments are being accepted).

Despite the questionable status of the PPP necessity questionnaires, PPP borrowers who receive Form 3509 from their PPP lender should strongly consider responding to the questionnaire to avoid the lack of a response (or an untimely response) being used by the SBA in making an adverse determination with respect to their PPP loan.

Information, Supporting Documentation, and Certifications Requested From For-Profit Borrowers

Since the SBA and U.S. Department of Treasury have not posted the new PPP necessity questionnaires, and since sites like *Politico* have only posted Form 3509, which is the form for for-profit businesses, the following summary is based on the version of Form 3509 reported by *Politico*.

The body of Form 3509 is divided into a "business activity assessment" and a "liquidity assessment." The information requested is summarized as follows:

Business Activity Assessment

1. Borrower's gross revenue for Q2 2020 and Q2 2019.
2. Details regarding any state or local COVID-19 shut-down order applicable to the borrower since March 13, 2020.
3. Details regarding whether and how borrower was required to alter its operations under state or local COVID-19 orders since March 13, 2020, including the estimated cost of related cash outlays.
4. Whether the borrower has voluntarily ceased or reduced its operations due to COVID-19 since March 13, 2020.
5. Whether the borrower has voluntarily altered its operations due to COVID-19 since March 13, 2020.
6. Whether the borrower began any capital improvement project not due to COVID-19 between March 13, 2020, and the end of their PPP loan "covered period."
7. What is the borrower's primary six-digit NAICS code?
8. (Optional) Provide additional comments on any question in the business activity assessment.

Liquidity Assessment

1. Borrower's cash and cash equivalents as of the last day of the calendar quarter before the borrower's PPP loan application (i.e., March 31, 2020, or June 30, 2020, since loan applications were only accepted between April 3, 2020 and August 8, 2020).
2. Details regarding any dividends or other distributions paid by the borrower between March 13, 2020, and the end of the borrower's PPP loan "covered period."
3. Whether the borrower prepaid any outstanding debt before contractually due between March 13, 2020, and the end of the borrower's PPP loan "covered period."
4. Whether any of the borrower's employees were compensated in an amount exceeding \$250,000 on an annualized basis during the borrower's PPP loan "covered period." If so, disclose how many employees received compensation at this level and their aggregate compensation.

5. Whether any of the borrower's owners who work at the borrower were compensated in an amount exceeding \$250,000 on an annualized basis during the borrower's PPP loan "covered period." If so, disclose how many employees received compensation at this level and their aggregate compensation.
6. Whether the borrower had equity securities listed on a national securities exchange on the date of the borrower's PPP loan application. If so, provide the borrower's market capitalization on the date of their PPP loan application.
7. Whether any publicly traded company owned 20% or more of any class of the borrower's outstanding equity securities on the date of the borrower's PPP loan application. If so, the name of such stockholder and their market capitalization as of the PPP loan application date are to be provided.
8. For privately held companies, the book value (shareholders' equity value) of borrower as of the last day of the calendar quarter immediately before the date of the borrower's PPP loan application (March 31, 2020, or June 30, 2020).
9. Whether the borrower was a subsidiary of another company (at least 50% owned) on the date of the borrower's PPP application. If so, the name of the parent company, whether it is organized or incorporated outside of the U.S., and the market capitalization of the parent company's securities on the borrower's PPP loan application date (if listed on a national securities exchange or on a securities exchange in a non-U.S. jurisdiction).
10. Whether 20% or more of any class of borrower's outstanding equity securities were owned by a private equity firm, venture capital firm, or hedge fund (or a fund managed by such a firm).
11. Whether the borrower was an affiliate or a subsidiary of a foreign, state-owned enterprise or department, agency, or instrumentality of a foreign state on the date of the borrower's PPP loan application. If so, provide the name of the foreign, state-owned enterprise or the foreign state's department, agency, or instrumentality.
12. Whether the borrower received any funds from other CARES Act programs, excluding tax benefits. If so, provide the funding amount and identify the program name or funding source.
13. (Optional) Provide additional comments on any question in the liquidity assessment.

Borrowers are required to provide supporting documentation as to their answer for #1 under the business activity assessment, as well as for their answers to #1, 2, 3, 4, and 5 under the liquidity assessment. Presumably this will require disclosure of corresponding financial statements, payroll records, and bank records, but the specific supporting documentation that will be required is not specified in Form 3509.

Form 3509 provides a place for the borrower to indicate whether specific information and supporting documentation provided in response to the questionnaire is maintained by the borrower as confidential

information. However, Form 3509 provides no assurance that the SBA will treat this information as confidential or shelter it from a Freedom of Information Act (FOIA) request. Merely indicating that the information is considered confidential is unlikely to provide any protection for such confidential information. Instead, companies submitting information in response to Form 3509 should consider whether the information falls under one or more exemptions under FOIA and explain the basis for the exemption applying. For more information on treatment of mere "confidential" information under FOIA, see [here](#).

Finally, Form 3509 requires the authorized representative of the borrower to certify that its responses and corresponding documentation are true and correct in all material respects, including an acknowledgement regarding potential civil and criminal penalties that could apply for knowingly making false statements to obtain a guaranteed loan or forgiveness of an SBA-guaranteed loan.

Potential Implications of PPP Necessity Questionnaires

The specific implications of a borrower's answers to the new PPP necessity questionnaires are not yet known and may be subject to change. However, the questions being asked and the questions that are not being asked may be a considerable source of anxiety for borrowers. For example, Form 3509 could be read to imply the following:

- If a borrower's Q2 2020 gross revenue was consistent with or greater than their Q2 2019 gross revenue, then the borrower may not have been eligible for a PPP loan.
- If a borrower had a balance of cash or cash equivalents above an unspecified threshold as of the end of the calendar quarter preceding the date of their PPP loan application, then the borrower may not have been eligible for a PPP loan or may have improperly certified as to necessity.
- If a borrower cannot point to COVID-19 shut-down orders that directly affected their business, they may not have been eligible for a PPP loan or may have improperly certified as to necessity.
- If a borrower began a capital improvement project between March 13, 2020, and the end of their "covered period," they may not have been eligible for a PPP loan or may have improperly certified as to necessity.
- If the borrower paid dividends or made distributions (excluding limited tax distributions), then they may have improperly certified as to necessity, even if such payments were made with funds unrelated to the borrower's PPP loan.
- If the borrower prepaid other debt, then they may have improperly certified as to necessity, even if such repayment was made with funds unrelated to the borrower's PPP loan.
- If the borrower paid employees or owners more than \$250,000 in cash on an annualized basis during their "covered period," then they may have improperly certified as to necessity, even if such payments were made with funds unrelated to the borrower's PPP loan.
- If a borrower (1) had their securities traded on a national securities exchange and a market capitalization above an unspecified level, (2) had an owner of more than 20% of any class of their stock who had securities traded on a national securities exchange with a market capitalization above an unspecified level, (3) had an owner of more than 20% of any class of their stock that could be characterized as a private equity fund, venture capital fund, or hedge fund (or a fund managed by such a firm), or (4) had an owner of more than 20% of any class of their stock that could be characterized as a foreign, state-owned enterprise or department, agency, or instrumentality of a foreign state, then they may not have been eligible for a PPP loan or may have improperly certified as to necessity.
- If a borrower received other government funding under the CARES Act, or funding in an amount in excess of an unspecified level, then they may not have been eligible for a PPP loan or may have improperly certified as to necessity.

The potential implications above are only that—*potential* implications. Notably, the standards implied by Form 3509 are no clearer than the SBA's prior guidance on necessity and suggest standards for eligibility that simply

did not exist at the time borrowers applied for and obtained PPP loans. In addition, aspects of the business impact assessment arguably conflict with the CARES Act's presumption that borrowers are adversely affected by COVID-19 and aspects of the liquidity assessment arguably conflict with the CARES Act's waiver of the "credit elsewhere" test and rescission of the "personal resources test."

Not only is loan forgiveness potentially at risk, but the borrower's eligibility for the PPP loan (including the 1% interest rate and other favorable loan terms) and the threat of False Claims Act and/or other liability are also implicated by these questionnaires.

Care and Caution Are Warranted Due to the SBA's New Questions and Continued Uncertainty

Form 3509 requires borrowers to provide a significant amount of information that was not previously required for PPP loans and to certify the accuracy of all information and supplementary documents submitted. Companies should approach this process carefully in order to avoid even the appearance of providing false or incomplete information to the SBA in response to the questionnaire. Although the original PPP loan applications were necessarily based upon information available to the borrower at the time of the application, some of the questions now being asked suggest that the SBA is interested in how companies were actually affected by COVID-19 and whether they ultimately "needed" the loan funds for which they applied and are now seeking forgiveness. This may put some companies in the awkward position of being scrutinized more closely for having fared better during the pandemic than was anticipated. It should not come as a surprise to the SBA, however, that some companies found their products and services to be in higher demand as a result of COVID-19. Companies that made a good faith necessity certification based upon their analysis of relevant factors at the time of the PPP loan application should be well-positioned to defend their applications if necessary, although there continues to be a lack of guidance and clarity surrounding future SBA audits, loan forgiveness standards, and even potential enforcement actions. In any event, perceptions may matter and companies whose liquidity needs have been significantly less than anticipated, or that have thrived over the last six months, may face more questions and potential criticism for having participated in the PPP loan program.

Practical Suggestions for Borrowers

To reduce the likelihood of the SBA or a PPP lender taking adverse action with respect to a PPP loan, such as denial of forgiveness, it is important that the borrower provide timely and accurate answers to the necessity questionnaire if requested.

Since the standard of "necessity" was not defined when many borrowers applied for their PPP loan, and since the standard described in the April 23, 2020, FAQ was vague and inconsistent with the provisions of the CARES Act, the new PPP necessity questionnaires and implications from those questionnaires will almost certainly require litigation or further regulatory action to give lenders and borrowers clarity. In the meantime, we would suggest that borrowers not rely on this ambiguity being favorably resolved in the future, but instead do what they can to protect their interests. For this reason, borrowers should consider supplementing their answers to Form 3509 to ensure that the PPP lender and the SBA have a complete picture of the circumstances justifying the borrower's need for the PPP loan. Such additional information could be provided in response to question 8 of the business activity assessment and question 13 of the liquidity assessment; however, Form 3509 only allows 1,000 characters in each of these fields.

Some suggestions to provide the PPP lender and the SBA the full picture include the following:

- **Revenue, Cash, and Forecasts.** Form 3509 requests information regarding the borrower's revenue and cash position; however, the specific time periods for which this information is requested provide only a limited snapshot regarding the status of the borrower's business as of the specified dates, at least as to revenue amounts, are as of a date that is well after many borrowers made their "necessity" certification. This provides the SBA the benefit of knowing the actual revenue performance in April, May, and June 2020, which is something many borrowers did not know when they applied for their PPP loan. If additional information is needed to demonstrate the trends and circumstances that the borrower was responding to when applying for a PPP loan, consider providing that information. For example, cash balances as of March 31, 2020, and revenue data as of June 30, 2020, would not necessarily correspond to the decline in revenue or losses that the business was projecting when it applied for a PPP loan, the borrower's forecasts for how long the business could remain viable, or the impact on the business's employees if the PPP loan was not obtained. To the extent obtaining a PPP loan allowed a borrower to avoid or delay employee pay cuts, furloughs, and layoffs, it may be helpful to highlight that fact since this was the stated purpose of the PPP loans. For many businesses, the narrow snapshot requested by the SBA does not accurately capture the "economic uncertainty" that made the loan necessary or capture the realities of trying to operate a business through a global pandemic, and it may provide the SBA the benefit of hindsight, which is a luxury borrowers did not have when they applied for their PPP loans.
- **Impact of COVID-19.** Form 3509 calls for information regarding state or local COVID-19 shut-down orders and voluntary shut-downs. For some businesses, reductions in business or shut-downs were not ordered or voluntary, but instead were based on trade or industry organizations or in response to decreased consumer demand. If applicable, this should be disclosed. For other businesses, reductions in business or shut-downs were the result of employee absences directly caused by COVID-19 (e.g., to care for a child or other family member due to COVID-19 or to recover from COVID-19), and this could also be noted (but without disclosing any personal identifiable information).
- **Dividends, Distributions, and Pre-Paid Debt.** Payment of dividends or distributions may have been mandated under pre-existing contractual obligations, and debt could have been pre-paid to obtain more favorable terms or as part of a change of control to avoid defaulting on that debt. If there are legal or business reasons for taking such actions, consider explaining these actions.
- **Capital Expenditures.** Capital expenditures may have been required to maintain business operations, comply with contractual obligations, or to allow the business to resume after COVID-19. Consider explaining why the capital expenditures were made.
- **Compensation in Excess of \$250,000.** Payment of cash compensation (including tips, leave of absence pay, or severance) to any employees or owners in excess of \$250,000 on an annualized basis may have been required to retain key talent or to prevent a broader business shutdown. Circumstances requiring such payments, including prior contractual obligations and a need to avoid defaulting on those obligations, could be noted to explain why these payments were made. Borrowers should also consider explaining any cost-savings actions taken after March 13, 2020, including freezing wage levels, deferring or avoiding bonus payments, voluntary salary reductions by management and hiring freezes. For companies where base pay is generally at or above \$250,000 (e.g., technology companies), consider explaining the local market for talent and resulting compensation levels backed by survey data.
- **Publicly Traded Stock.** The fact that a business has a class of its stock that is publicly traded does not mean that the business realistically had access to liquidity. If the business had stock publicly traded but could not reasonably raise money through the capital markets, that should be explained.
- **Certain Owners.** If a business had 20% or more of a class of their stock owned by a private equity fund, venture capital fund, hedge fund, or a foreign, state-owned enterprise or department, agency, or instrumentality of a foreign state, that does not necessarily mean that the business had access to liquidity at all, or on reasonable terms. Such stockholders may not have had access to liquidity themselves. In addition, such stockholders may have limitations on their ability to invest further in portfolio companies and many stopped (or significantly limited) making investments between April 2020 and August 2020 (the

period in which PPP loans were made) in light of the same "economic uncertainty" that justified the borrower's application for the PPP loan. To the extent applicable, these circumstances could be explained.

- **Other CARES Act Relief.** With limited exceptions, government support under the CARES Act was not provided on an exclusive basis, and PPP borrowers may have qualified for other forms of relief. To the extent applicable, the basis for qualifying for other forms of CARES Act relief could be disclosed.

Borrowers that closely considered the topic of "necessity" in April and May when the SBA previously flagged this as a potential area for further review should revisit the analysis they conducted at that time. For those with detailed memoranda on this topic, supplementing the Form 3509 responses with additional information may be an easy exercise.

For those borrowers who (together with their affiliates) received PPP loans in the amount of \$2 million or more and did not previously go through this exercise, it would be prudent to begin that work even if not yet in receipt of Form 3509 to be prepared to timely respond to their PPP lender.

Lender Responsibilities

Form 3509 calls for PPP lenders to upload borrower responses and supporting documents to the SBA PPP Forgiveness Platform within five business days after the borrower provides the information to the PPP lender, but also calls for the lender to separately input the borrower's responses to each question into the web form available on the platform.

As PPP lenders have previously experienced in the original PPP loan application process and in the loan forgiveness application process, loading documentation and information to the SBA's platform can pose significant logistical and technological challenges. In addition, the additional step requiring lenders to input responses into a web form creates the potential for human error. Since the SBA has threatened that untimely or incomplete responses could result in the SBA's determination that the borrower was ineligible for the PPP loan, the loan amount, or forgiveness, and trigger the SBA seeking repayment of the loan or pursuing other remedies, this creates the risk that mistakes made by the lender could have severe implications for PPP borrowers. Accordingly, lenders' interests in this process should align with borrowers' interests.

To the extent lenders are concerned about the process and documentation requirements outlined in Form 3509, they should consider providing comments to the SBA and the OMB during the comment period.

Resources

- [Federal Register Notice](#) - effective October 26, 2020.
- [Form 3509](#) - form for for-profit borrowers (as posted by *Politico*).
- [U.S. Treasury CARES Act Resources](#).
- [SBA Paycheck Protection Program website](#).
- [PPP Loan FAQ](#) - Published on an incremental basis beginning on April 8, 2020.

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Authors



Joe Bailey

Partner

JoeBailey@perkinscoie.com [503.727.2173](tel:503.727.2173)



Kevin R. Feldis

Partner

KFeldis@perkinscoie.com [650.838.4837](tel:650.838.4837)



Teri A. Lindquist

Partner

TLindquist@perkinscoie.com [312.324.8547](tel:312.324.8547)



Alexander O. Canizares

Partner

ACanizares@perkinscoie.com [202.654.1769](tel:202.654.1769)

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