

# Client Alert

## Updated Frequently Asked Questions Pertaining to the Paycheck Protection Program—Borrower Certification Risks

*Please note that this alert updates prior publications made by our firm pertaining to the subject matter discussed below.*

On April 26, 2020, the Small Business Administration (SBA), in consultation with the Department of the Treasury, published thirty-six supplemental “frequently asked questions” (FAQs) pertaining to loans under the Paycheck Protection Program (PPP). To review the full text of the FAQs for guidance that might be relevant to you, [click here](#).

All of the FAQs except for six questions were previously published in SBA guidance prior to April 23, 2020. These six new questions address the following wide range of issues for borrowers and applicants:

- Subject to other limitations, a borrower may include employee household stipends in payroll costs;
- To determine an individual employee’s principal place of business, borrowers and lenders may consider IRS regulations (26 CFR §1.121-1(b)(2));
- Subject to the other requirements of PPP loans, agricultural producers, farmers and ranchers are eligible for PPP loans;
- Subject to the other requirements of PPP loans, small agricultural cooperatives and other cooperatives may receive PPP loans;
- To determine eligibility under the 500-employee or other applicable threshold established by the CARES Act, a borrower must include all individuals employed on a full-time, part-time or other bases; and
- Provision of additional guidance for applicants regarding certifications for businesses with adequate sources of liquidity.

The remainder of this Client Alert relates to guidance in the fifth new FAQ listed above. This certification FAQ provides cautionary guidance regarding the certifications that must be submitted in connection with a borrower’s PPP loan application, and appears to address the recent public backlash regarding the amount of PPP funds that have been distributed to well-capitalized (sometimes publicly-traded) companies. This new guidance has been touted

May 15  
**2020**

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by the media as an attempt by the SBA to pressure such well-capitalized borrowers to immediately repay their PPP loans in order to retain as much funding as possible for smaller, more distressed businesses. The full text of the FAQ reads as follows:

**“Question: Do businesses owned by large companies with adequate sources of liquidity to support the business’s ongoing operations qualify for a PPP loan?”**

**Answer:** In addition to reviewing applicable affiliation rules to determine eligibility, all borrowers must assess their economic need for a PPP loan under the standard established by the CARES Act and the PPP regulations at the time of the loan application. Although the CARES Act suspends the ordinary requirement that borrowers must be unable to obtain credit elsewhere (as defined in section 3(h) of the Small Business Act), borrowers still must certify in good faith that their PPP loan request is necessary. Specifically, before submitting a PPP application, all borrowers should review carefully the required certification that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” 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. 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 certification. Lenders may rely on a borrower’s certification regarding the necessity of the loan request. Any borrower that applied for a PPP loan prior to the issuance of this guidance and repays the loan in full by May 18, 2020<sup>1</sup> will be deemed by SBA to have made the required certification in good faith.”

Prior to this FAQ, the PPP loan application requirement that the applicant certify that the PPP loan is necessary based solely on “current economic uncertainty” seemed to comply with the program’s eligibility requirements. It should be noted that while the question in this FAQ is framed in the context of a business owned by a large company with adequate sources of liquidity, the answer is directed at all borrowers and applicants. Accordingly, absent further guidance, based on this FAQ, the bar for determining whether a loan is “necessary” appears to have been raised. All borrowers and applicants should now analyze additional factors, which are discussed above and below, prior to making the required certification that a loan request is necessary. Unfortunately, whether intended or not, smaller and non-publicly traded borrowers and applicants would be well-advised to re-evaluate their certifications to confirm whether they remain valid in light of this new guidance and, if so, to properly document the basis for their conclusions.

- **Necessary Evaluation of Alternative Sources of Liquidity.** The CARES Act purported to eliminate the SBA’s requirement that would preclude an applicant from obtaining a PPP loan if it could obtain “credit elsewhere,” which is defined in the applicable regulations as, “the availability of credit from non-Federal sources on reasonable terms and conditions taking into consideration the prevailing rates and terms in the community in or near where the concern transacts business, or where the homeowner resides, for similar purposes and periods of time.” However, under this FAQ, the SBA requires borrowers and applicants to assess “their ability to access other sources of liquidity sufficient to support their ongoing operations in a

<sup>1</sup> The deadline was originally May 7, 2020 before being extended to May 18, 2020 by the SBA in an FAQ released on May 13, 2020.

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manner that is not significantly detrimental to the business.” Borrowers and applicants should note that what constitutes “significantly detrimental to the business” has not been clearly defined in this FAQ by the SBA, which may cause certification disputes in the future. In the absence of further guidance, when examining alternative sources of funding—which can include debt and/or equity—borrowers and applicants should examine the terms on which such funding can be obtained and evaluate whether obtaining such funding in lieu of the PPP loan would be significantly detrimental to its business. Based on the safe harbor provision discussed below, it is now critical that borrowers and applicants make this evaluation prior to May 18, 2020.

- **Necessary Evaluation of Current Economic Uncertainty, While Taking into Account Current Business Activity.** The required certification in the current form of the PPP loan application requires an applicant to certify that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” As a result of this FAQ, applicants must also “take into account their current business activity” in making its certification. In this context, a borrower or applicant should analyze the basis for its certification that current economic uncertainty resulting from the pandemic makes the loan request necessary to support its ongoing operations. While the SBA provided no specific guidance to a borrower or applicant to make this determination, its analysis should identify the relevant business factors that make its loan request necessary, while taking into account its current business activity. Based on the safe harbor provision discussed below, it is now critical that borrowers and applicants make this evaluation prior to May 18, 2020.
- **Certification Safe Harbor.** If a borrower that applied for a PPP loan prior to April 23, 2020 determines that the loan was not necessary based on this new guidance, such borrower may repay the loan in full by May 18, 2020 and still be deemed to have made the required certification in good faith.

Borrowers and applicants that determine that a PPP Loan is necessary should carefully document the basis for that conclusion, including their analysis of economic uncertainty, their liquidity needs and why obtaining one or more alternative sources of funding in lieu of a PPP loan would be detrimental to their business based on its current business activity.

Borrowers and applicants should be aware that the CARES Act authorizes criminal penalties for fraud or other misconduct related to the PPP and provides funding for audits and investigations. The federal government also has the power to level criminal and civil penalties against individuals and entities who provide false information or defraud the government.

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If you would like additional information, please contact:

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