



Office of the General Counsel

3211 FOURTH STREET NE • WASHINGTON DC 20017-1194 • 202-541-3300 • FAX 202-541-3337

May 4, 2020

LEGAL CONSIDERATIONS INFORMING “GOOD FAITH CERTIFICATION” THAT PAYCHECK PROTECTION PROGRAM LOAN IS “NECESSARY”

I. PROBLEM

Borrowers under the Paycheck Protection Program (PPP) are required to “make a good faith certification” that the loan is “necessary” to support their ongoing operations. Soon after PPP implementation began, controversies arose because some businesses for whom the PPP loans did not appear “necessary”—such as Ruth’s Chris Steak House, Shake Shack Restaurants, and the Los Angeles Lakers—nonetheless received the loans, and many apparently more needy businesses did not. In response, the Small Business Administration (SBA) began to issue additional regulatory guidance to curb such apparent abuses. That additional guidance is ambiguous; appears to create new requirements that were not apparent at the time of prior applications; and increases the level of risk in receiving the PPP loan.

One element of the guidance is that a PPP borrower will be deemed to have acted in “good faith” if any funds received are returned by May 7, 2020. May 7 is now upon us, generating the question whether to return funds received (or drop any pending application) in time for the “safe harbor” deadline, or to retain funds received (or proceed with any pending applications) in light of the additional uncertainties and risks. The purpose of this memorandum is to set out the applicable legal framework to the extent it can be discerned, and to describe a method for the application of those legal principles to the facts of each situation.

II. APPLICABLE LEGAL STANDARD

A. Statutory and Regulatory Materials

The CARES Act was signed into law on March 27, 2020. A major component of this law is the Paycheck Protection Program, whose purpose, as its title suggests, is to protect employees against layoffs and pay cuts. *See also* CARES Act, Div. A, Title I (PPP included within law entitled “Keeping American Workers Paid and Employed Act”). The PPP advances this goal by providing \$659 billion in loans to struggling small businesses—those with fewer than 500 employees—to help them pay their workers, their mortgage interest or rent, and their utility bills. The terms of the loans are especially favorable, covering up to two-and-a-half months of covered expenses, due in two-years at 1% interest, with payments deferred for the first six months. Covered costs incurred and payments made during the 8-week period beginning on the date of the origination of a covered loan can be forgiven entirely if the borrower avoids laying off employees or cutting their pay. CARES Act, Section 1106. In order to show sufficient need to warrant receipt of these scarce benefits, PPP loan applicants are required to “make a **good faith certification . . . 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 (emphasis added).

On April 23, the SBA supplemented its regulatory guidance to add a Frequently Asked Question (FAQ) and corresponding answer relating to the good faith certification of necessity:

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 7, 2020 will be deemed by SBA to have made the required certification in good faith.

Moreover, during a television interview on April 28, Treasury Secretary Steven Mnuchin stated that the government will audit any company that receives more than \$2 million from the PPP.¹ The next day, the SBA issued an amended FAQ indicating that it has decided, in consultation with the Department of the Treasury, that it "will review all loans in excess of \$2 million, *in addition to other loans as appropriate*, following the lender's submission of the borrower's loan forgiveness application."² Thus, even loans under \$2 million are subject to audit. And on May 1, Secretary Mnuchin tweeted that private K-12 schools with "significant endowments" that have received PPP loans should return them, and President Trump has since echoed this view through a spokesman.³

¹ <https://www.cnbc.com/2020/04/28/small-business-loans-above-2-million-will-get-full-audit-to-make-sure-theyre-valid-mnuchin-says.html>.

² See FAQ No. 39 (emphasis added), https://www.sba.gov/sites/default/files/2020-04/Paycheck-Protection-Program-Frequently-Asked-Questions_04%2029%2020_2.pdf.

³ <https://thehill.com/homenews/administration/495827-wh-official-says-trump-believes-k-12-private-schools-should-give-back>.

B. Legal Analysis and Discussion

The legislative and regulatory materials described above are entirely new and, in important respects, vague. There is no governing precedent or authoritative explanation of their meaning. We are, however, obliged to do our best to understand their meaning under the circumstances. The following discussion of the key terms is to provide some assistance in this regard.

1. “Good Faith Certification” – The modifier “good faith” provides some breathing room for the applicant in certifying the necessity of the loan. If, for example, the government later determines that the loan was not “necessary,” the government is unlikely to find that the law has been violated if the certification was made honestly and conscientiously.⁴ Such an honest and conscientious effort would include a careful examination of the applicable statutory and regulatory language (which the present memorandum is designed to assist), and a careful examination of the particular facts of each applicant’s situation.

2. “Uncertainty of Current Economic Conditions” – This is the statutory language used to describe the factual basis of the certification. Note that the certification is based on the “uncertainty” of current circumstances. It does not require certainty, but instead an informed assessment of the borrower’s financial need based on what is known and reasonably anticipated at the time of the application.⁵ Of course, if there is certainty, then the standard would appear to be more than satisfied. For example, if the problems that the statute is designed to minimize or prevent—*i.e.*, pay cuts or layoffs, or missed rent, mortgage, or utility payments—are *already* occurring or, based on current information, are *certain to occur in the future*, then the loan would appear “necessary” to reduce or eliminate those effects. But the point here is that the language does not appear to require such extreme showings—they are very likely sufficient, but probably also unnecessary. Instead, the statute would seem to be satisfied if conscientious examination of current economic circumstances supports the likelihood—again, not the certainty—that the employer will have to lay off employees or cut their pay, or miss rent, mortgage, or utility payments.

3. “Necessary ... to Support the Ongoing Operations” – Needing the loan to “support the ongoing operations” of the applicant appears to be distinct from—and substantially easier to satisfy than—needing the loan “to prevent the bankruptcy” of the

⁴ Black’s Law Dictionary defines “good faith” as “an intangible and abstract quality with no technical meaning or statutory definition, and it encompasses, among other things, an honest belief, the absence of malice and the absence of design to defraud or to seek an unconscionable advantage.”

⁵ Question 31 of the SBA’s FAQ says that “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.*” (Emphasis added.) The regulations state that “*On the Paycheck Protection Program application,*” an authorized representative of the applicant must make the requisite good faith certifications. 85 Fed. Reg. 20811, 20814 (Apr. 15, 2020) (emphasis added).

applicant. Congress could have used the latter language but did not. In light of this, an applicant probably does not need to show that its situation is so desperate that it may have to fold entirely without the loan.⁶ Instead, a fair reading appears to be that the applicant must be under enough financial stress that, without the loan, it would probably have to do the things that the PPP was designed to prevent (such as pay cuts or layoffs, or missing rent, mortgage, or utility payments) to stay financially healthy.

This reading is further supported by two segments of the FAQ. First, it urges applicants to consider “their *current* business activity” (emphasis added) in relation to their access to additional liquidity. This focus on what is “current” could fairly be read as asking applicants to assess whether the loan is necessary to preserve the *status quo* regarding expenses such as payroll, not whether the loan is necessary to maintain some lower but still viable level of business activity. Second, the FAQ appears to require applicants to exhaust only those sources of liquidity that can be accessed “in a manner that is not significantly detrimental to the business,” and reiterates that the CARES Act waives the ordinary SBA requirement that the applicant have no other source of credit available at all. Here again, this suggests that the program is not merely for applicants who can’t survive *at all* without the loan, but also for those who *could* survive without it, but whose broader financial health would then require layoffs, pay cuts, or other financial moves that Congress created the PPP to minimize.⁷

III. METHOD FOR APPLICATION TO PARTICULAR FACTS

In light of the foregoing, what follows is a method for assessing whether it is legally sound⁸ to certify that a PPP loan is “necessary”:

1. What is the total cost of the “ongoing operations” that might be supported by the loan (*i.e.*, payroll, mortgage interest or rent, and utilities)?⁹

⁶ As above, regarding applicants who have certainty of layoffs at the time of the loan application loan, it would appear that applicants who face such an immediate mortal threat to their business more than meet the standard of “necessity ... to support ongoing operations,” but such a strong showing is probably unnecessary to meet the standard.

⁷ Notably, SBA’s example of an entity that probably could not certify necessity in good faith—“a public company with substantial market value and access to capital markets”—does not describe any religious nonprofit entity. Nonprofits are not publicly held, the concept of “market value” does not fit them readily, and they cannot issue stock. This is not to say that religious nonprofits would always satisfy the good faith certification requirement, but simply that they are not in the class that is apparently categorically excluded by the example.

⁸ There are separate questions, not addressed by this memorandum, whether receipt of PPP funds is prudent in terms of public relations or political risk.

⁹ There are special legal risks to religious organizations in using PPP funds to cover the cost of facilities, especially mortgage interest. Even if an applicant does not use PPP funds to pay mortgage interest, that expense is often a major part of the cost of “ongoing operations,” and so contributes substantially to the overall picture of financial need. Accordingly, that cost may fairly be included for purposes of demonstrating need to the government, even if PPP funds are only used to cover the other components of “ongoing operations” (namely, payroll or utilities).

2. What is the “current business activity” of the applicant, including not only the current expenses of “ongoing operations” described in item 1 above, but the remaining current expenses of the business, as well as current levels of income corresponding to those expenses.
3. What particular elements of “uncertainty of current economic conditions” are likely to reduce anticipated sources income or increase anticipated expenses described in item 2, and to what extent? The more documentation of this “uncertainty”—both its existence and its extent—can be gathered by the time of application, the stronger the claim that the certification was made in “good faith,” and the greater the comfort that good answers will be readily available in the event of an audit.
4. Because of the reduced income and/or increased expenses projected in item 3, what is the anticipated total shortfall of funds available to cover the “ongoing operations” described in item 1?
5. What “sources of liquidity” other than the PPP loan may be accessed to cover the deficit described above in item 4 “in a manner that is not significantly detrimental to the business”?¹⁰
6. After drawing on any available, non-detrimental sources of liquidity described in item 5, does the applicant still reasonably anticipate having to reduce the “ongoing operations” described in item 1 (i.e., lay off employees or cut their pay) if the PPP loan is not obtained?

¹⁰ If an organization relies on investments to generate annual income as part of its “current business activity,” we expect that a strong argument could be made that cashing out those investments as a source of liquidity, especially when those investments are down, would be “significantly detrimental to the business.” On the other hand, borrowing against those investments may represent a lower cost source of liquidity, which may or may not be “significantly detrimental to the business.”