

## **SBA's Expanded "Safe Harbor" May Reduce, But Does Not Eliminate, Enforcement Risks for Businesses Seeking PPP Loans**

Borrowers that, together with their affiliates, received Paycheck Protection Program (PPP) loans in an aggregate amount less than \$2 million will be deemed to have made their certification that the loan was "necessary" in good faith, according to new guidance issued by the U.S. Small Business Administration (SBA). Borrowers who, together with their affiliates, received loans in excess of \$2 million will remain subject to review for compliance with the "necessary" standard and will be able to repay the loans without being subject to SBA enforcement actions or referrals to other agencies.

The SBA's revised [Frequently Asked Questions \(FAQs\)](#) released on May 13, 2020, focus on a requirement that loan applicants certify that the "[c]urrent economic uncertainty makes this loan request necessary to support the[ir] ongoing operations." The SBA previously applied a "safe harbor" that allows recipients of PPP loans to return the money by May 14, 2020, if they no longer believe they are eligible under this standard. On May 13, 2020, the SBA issued an FAQ indicating they will be extending that deadline to May 18, 2020.

This new "safe harbor" reduces the threat of enforcement actions against borrowers of PPP loans based on the "necessary" certification, depending on the size of the loan received by the borrower and their affiliates. But some enforcement risks remain. In addition, since this was announced through a FAQ instead of through an interim final rule or other official rulemaking, companies should treat the non-regulatory guidance with a note of caution. Also, the guidance does not shed additional light on the meaning of the "necessary" standard and how that standard will be applied by government auditors and investigators in their reviews.

This update focuses on the revised guidance concerning the "necessary" certification for PPP loans and its implications for companies that have applied for a loan on or before May 13, 2020, as well as companies that may wish to apply for a loan in the future.

### **PPP Loan Disbursements**

PPP loans were authorized under section 1102 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) to help small businesses affected by COVID-19. Eligible companies can use the loans to help pay payroll costs, employee benefits, rent, employee salaries, and other essential expenses during the crisis. The loans are 100% guaranteed by the SBA and will be forgiven to the extent that they are used for authorized purposes.

All of the nearly \$350 billion in loans that the U.S. Congress initially provided for the program was allocated within two weeks of the program's launch on April 3, 2020. According to SBA, more than 1.6 million loans were issued through April 16, 2020. Congress then provided additional funding to the program, with an additional 2.5 million loans totaling more than \$188 billion approved through May 8, 2020.

The SBA has implemented the program through a series of interim final rules and FAQs that have been repeatedly updated since early April 2020. As of May 13, 2020, the SBA has issued 47 FAQs addressing various aspects of the program.

## **The SBA's Evolving Guidance Regarding the "Necessary" Certification**

The certification that the loan is "necessary" is among several certifications that applicants must make in the PPP application. The certification has created confusion since the inception of the program, in part because the term "necessary" is undefined and because the certification also does not define the period of "ongoing operations" that need to be considered when making the certification. The SBA initially did not offer any guidance on the standard, leaving borrowers to determine for themselves what it meant.

On April 23, 2020, the SBA updated its FAQs to specify that, although the program suspends the rule that borrowers must be unable to obtain credit elsewhere, applicants must be able to certify in good faith that the loan is necessary. Notably, the legislation that created the program also eliminated an earlier regulation that would have required consideration of the borrower's ability to obtain funding from its owners. The April 23, 2020, guidance indicated that borrowers making this certification should "tak[e] into account their current business activity and their ability to access other sources of liquidity to support their ongoing operations in a manner that is not significantly detrimental to the business." At the same time, the SBA announced that it would audit recipients of loans of more than \$2 million and others, as appropriate. The U.S. Department of the Treasury secretary also made public comments indicating that companies that applied for loans but did not need them would face scrutiny.

### **SBA's Revised FAQs**

The SBA's revised FAQs apply a new rule that sharply distinguishes between borrowers who, together with their affiliates, received PPP loans below and above \$2 million. Borrowers of loans below \$2 million "will be deemed" to have made the "necessary" certification in good faith, but borrowers of larger loans will not be entitled to such protection.

The SBA has indicated that each loan above \$2 million will be "subject to review" for compliance with the program requirements. Previously, this threshold was considered to be on a borrower-by-borrower basis, without aggregating together affiliated entities. The new "safe harbor" applies to any "borrower that, together with its affiliates, received PPP loans" below \$2 million, indicating that the \$2 million threshold could apply to multiple loans among affiliated companies that, in the aggregate, total less than \$2 million. If the SBA determines based on its review that a borrower lacked an adequate basis for the certification concerning the necessity of the loan request, the SBA will "seek repayment of the outstanding PPP loan balance" and will inform the lender that the borrower is not eligible for loan forgiveness.

If the borrower repays the loan after receiving notification from the SBA, the SBA "will not pursue administrative enforcement or referrals to other agencies" based on its determination with respect to the certification that the loan is "necessary." The FAQs state further that the SBA's determination concerning the need certification will not affect the SBA's loan guarantee."

The SBA initially gave applicants until May 7, 2020, to repay their loans and be deemed to have made the "necessary" certification in good faith. The SBA later extended that deadline to May 14, 2020, and indicated it would announce revised guidance to help borrowers evaluate "whether they may have misunderstood or misapplied" the "necessary" certification. In extending the deadline, SBA noted that the extension would give borrowers "time to review the forthcoming SBA guidance and decide whether to avail themselves of the safe harbor."

Perhaps recognizing that the revised guidance issued on May 13, 2020, gives businesses almost no time to consider the new guidance in deciding whether to repay their loans under the then-existing May 14 deadline, the SBA announced in the FAQs that it intends to again extend the safe harbor period, this time to May 18, 2020. Such extension is to be formally provided through a new interim final rule.

## Considerations for Borrowers

Many companies have already been analyzing and documenting their "necessity" for PPP loan funds based upon the uncertainty that has existed thus far. Some have already repaid their loans based on the guidance issued by the SBA since April 23, 2020.

The SBA's latest guidance essentially divides borrowers into categories: those that are subject to a "safe harbor" based on the size of their loans and those that are not.

- The new expanded safe harbor for borrowers that, together with their affiliates, have loans under \$2 million may make the decision to keep PPP funds much less risky for companies in that category. Borrowers of loans below \$2 million should treat the FAQs with a note of caution, however.
- The "safe harbor" is not a blanket exemption from applicable laws, such as criminal statutes that penalize false statements or the False Claims Act. Although the FAQs specify that a borrower whose loan was less than \$2 million "will be deemed" to have made its certification in good faith, the FAQs do not clearly address whether action will be taken against borrowers of smaller loans that are perceived as making false or misleading statements in loan documents.
- The U.S. Department of Justice (DOJ) is not bound by SBA's guidance and has pledged to vigorously enforce criminal laws related to COVID-19-related fraud. On May 5, 2020, DOJ [announced](#) the first criminal charges related to fraud in the PPP program. Two Rhode Island businessmen were charged with fraudulently seeking PPP loans by falsely claiming to have dozens of employees at multiple business entities.
- The "safe harbor" does not provide immunity from all enforcement actions or private party litigation that may be looming in the future. The new FAQ does not purport to limit companies' exposure to third-party allegations or to government investigations that do not depend on the SBA for their initiation. For example, *qui tam* lawsuits brought by private parties (relators) under the False Claims Act are unaffected by the guidance. Such lawsuits are a possible consequence of increased spending under the CARES Act.
- It is unclear whether companies that have not already applied for loans prior to May 13, 2020, will be subject to the new "safe harbor." The SBA's previous "safe harbor" in its April 24, 2020, interim final rule applied to borrowers that had "applied for a PPP loan prior to the issuance of this regulation." The new guidance does not specify whether a similar limitation applies to the new \$2 million "safe harbor."
- The FAQs also do not explain what it means for a certification to be "deemed" to be made in good faith or, importantly, whether and under what circumstances the SBA may decide that a company's "necessary" certification is not, in fact, made in good faith. Also, the FAQs are not binding regulations with the force of law.
- Borrowers who, together with their affiliates, have applied for or received loans above \$2 million have little time, even with the latest extension of the safe harbor to May 18, 2020, to decide whether to repay their loans or keep them. For those above the \$2 million threshold, there may be somewhat less comfort taken in SBA's commitment not to refer the matter for enforcement if borrowers return the money despite having failed the still unclear "necessity" standard. If borrowers decide to keep their loans, they should be prepared for SBA audits and reviews on **all** eligibility issues. They should spend the time now to carefully document their eligibility determinations, including with respect to their certification as to why the loan is "necessary."

- Borrowers that are uncertain about how the SBA's guidance on "necessity" will apply to them face the risk of having to repay their PPP loan if it is later determined that they did not satisfy the "necessity" standard. Simultaneously, those borrowers are under a deadline to spend their PPP loan proceeds on eligible expenses within an eight-week period after their loan was disbursed so as to qualify for even partial loan forgiveness. This is complicated by the fact that the SBA has not yet issued guidance regarding loan forgiveness, leaving vague many of the rules regarding forgiveness. This combination of factors places many borrowers in the position of either making difficult business decisions about cost-cutting measures (such as layoffs and furloughs for employees), or keeping and spending the PPP loan proceeds. Taking such cost-cutting measures may have a clear impact on the business' cash flows, but keeping and spending the PPP loan proceeds to retain and rehire employees provides a far less certain outcome and could leave the business in a position where it is unable to repay the loan. For some businesses, this uncertainty makes keeping the loan proceeds untenable.
- In all cases, and particularly those involving loans over \$2 million, it remains important to carefully consider and support the necessity certification to justify future loan forgiveness and avoid future criticisms and legal actions that could still result.
- The SBA's April 23, 2020, FAQs regarding the "necessary" certification remain unchanged. Thus, a company's ability to access alternative sources of liquidity sufficient to support their ongoing operations in a manner that is not "significantly detrimental" to the business remains a factor. The guidance does not clarify this issue.

Additional analysis on the \$2 million SBA safe harbor for PPP loans can be found in this [Bloomberg Law](#) article examining the guidance and describing how companies will continue to benefit from conducting a PPP "necessity" analysis.

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