

Paycheck Protection Program Curve Ball for Some Loan Recipients

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When large, publicly traded companies received multi-million dollar loans from the Paycheck Protection Program, the public began to take notice. Shortly after Shake Shack's receipt of \$10,000,000 from the Paycheck Protection Program (the maximum loan amount), Shake Shack announced it was giving the loan back. Why? The issue was whether Shake Shack, and similarly situated large public companies, could validly certify "that the uncertainty of current economic conditions makes necessary the loan request to support ongoing operations of the eligible recipient." All applicants for a loan through the Paycheck Protection Program made that certification. The question now is whether they should have.

On April 23, 2020, the Small Business Administration supplemented its [guidance](#) on the Paycheck Protection Loans, which included guidance on what we are calling the "Necessity Certification." This *Legal Update* addresses that guidance.

Necessity Certification

When first enacted, the CARES Act included four certifications that each applicant needed to make when applying for a loan through the Paycheck Protection Program. The first certification related to necessity: that the uncertainty of current economic conditions makes necessary the loan request to support ongoing operations of the eligible recipient.

Read in isolation, one could interpret the Necessity Certification in a variety of ways. On one hand, the U.S. economy is facing an unprecedented pandemic. Even for a stable company, maintaining ongoing operations has transitioned into a day-to-day concern. Uncertainty abounds. On the other hand, many companies have access to capital in various forms for dealing with market disruptions. COVID-19 is unique due to its impact across the country, but most businesses still have access to those forms of debt they would typically rely upon when times get tough.

Complicating the interpretation of the Necessity Certification are the rules that typically govern SBA loans, and the waiver of those rules for purposes of the Paycheck Protection Program. Generally, SBA loans function as debt of last resort. When a small business has nowhere else to turn, they can turn to the SBA. Under that framework, the necessity of an SBA loan is more clear. However, under the Paycheck Protection Program, those restrictions that made SBA loans a loan of last resort were

generally removed. Presumably, the federal government wanted to deploy dollars to a much broader category of business than the typical SBA program. The only restriction associated with necessity appears in the Necessity Certification. Applicants were left without clear guidance in determining whether they could make the Necessity Certification in good faith.

Guidance on the Necessity Certification

The April 23, 2020 SBA guidance addresses a component of the Necessity Certification. In question and answer format it provides the following:

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.

The SBA guidance raises the concept that access to other capital undermines an applicant's ability to make the Necessity Certification. The example listed targets public companies “with substantial market value and access to capital markets.” The same analysis conceivably could apply to privately-held companies that have sources of liquidity. For some recipients of a loan through the Paycheck Protection Program, they may need to revisit their analysis in making the Necessity Certification.

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