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PAYCHECK PROTECTION PROGRAM UPDATE: SBA ISSUES IMMEDIATELY EFFECTIVE RULES HOURS BEFORE BANKS MAY BEGIN ACCEPTING PPP LOAN APPLICATIONS

on 04/3/2020

On April 2, 2020 in the late afternoon, the Small Business Administration issued an interim final rule (Docket No. SBA-2020-0015, the "Rules") for the administration of the Paycheck Protection Program (PPP) created under Section 1102 of the CARES Act. The SBA states that the Rules are effective immediately, which takes the extraordinary step of dispensing with the 30-day delayed effective date provided in the Administrative Procedure Act. The SBA believes it has good cause to do so, given that small businesses need to be informed on how to apply for a PPP loan and the terms of the loan in order to submit their loan applications starting April 3, 2020. Comments will nevertheless be solicited the public on all aspects of the Rules and must be submitted on or before 30 days from the date the Rules are published in the Federal Register. The SBA will consider such comments and the need for making any revisions as a result.

While the Rules provide much-needed guidance to PPP borrowers and lenders, they also modify the PPP loan program as described in the CARES Act in several important ways and, in some cases, raise further questions and even appear inconsistent with the CARES Act. Fortunately, the SBA notes that further guidance will be forthcoming in several areas.

Borrowers should carefully consider their PPP loan applications (currently SBA Form 2483(04/20) as available April 3, 2020, the "Application") in light of these Rules, including the changes and clarifications they make to the PPP loan program as described in the CARES Act. The Application states that the applicant certifies to its eligibility to receive a PPP loan under the version of the Rules in effect at the time the Application has been submitted. Below is a summary of key changes, clarifications and new questions raised by the Rules.

1. At least 75% of PPP loan proceeds must be used for payroll costs

In a significant change from the CARES Act, the Rules provide that at least 75% of PPP loan proceeds must be used for payroll costs. While the CARES Act provided that PPP loan proceeds may be used for allowable uses described in section 7(a) of the Small Business Act, the SBA stated it believes that finite appropriations and the structure of the CARES Act warrant a requirement that borrowers use a substantial portion of the loan proceeds for payroll costs, consistent with Congress' overarching goal of keeping workers paid and employed.

The SBA also noted that if PPP funds are used for unauthorized purposes, which presumably includes where more than 25% of PPP proceeds are used for non-payroll costs, SBA will direct the borrower to repay those amounts. If a borrower knowingly uses funds for unauthorized purposes, the SBA states that the borrower will be subject to additional liability for criminal charges such as fraud. If a borrower's shareholders, members, or partners use PPP funds for unauthorized purposes, the SBA will have recourse against the shareholder, member or partner for the unauthorized use. Because borrowers must take care to monitor the use of PPP funds, some lenders are recommending that borrowers establish a separate operating account for PPP loan proceeds and/or payroll costs to help document the use of funds.

2. PPP loans will have a 2 year, not a 10 year, maturity

The maturity on a PPP loan is now set at 2 years, a significant departure from the CARES Act which allowed a maximum maturity of "up to" 10 years from when the borrower applied for the loan. The Rules note that the considerable economic disruption caused by COVID-19 is expected to abate well before the two year maturity date such that borrowers will be able to re-commence business operations and pay off any outstanding balances on their PPP loans. As a result, borrowers should consider when applying for the PPP loan that the maturity will be much shorter than originally expected for any portion that is not forgiven.

3. Loans will be at a 1% interest rate, not a 4% interest rate

The CARES Act stated that PPP loans would have an interest rate of not more than 4%, and the Rules have set the interest rate at 100 basis points or 1%. The SBA stated that this interest rate is appropriate because it provides low cost funds to borrowers while offering an attractive interest rate to lenders relative to the cost of funding for comparable maturities, especially considering the SBA guarantee and the processing fee that lenders will receive for PPP loans. The Rules also clarify that any accrued interest will be eligible for loan forgiveness, apparently referring to interest accrued during the covered period for loan forgiveness, which is the 8-week period beginning on the date of loan origination. The Rules state that the SBA will issue additional guidance on loan forgiveness.

4. Loan payments will be deferred for 6 months

While the CARES Act stated that loan payments would be deferred for at least 6 months up to 1 year, the Rules set the deferral period at 6 months. The SBA states that a 6 month deferral is appropriate in light of the low interest rate and the loan forgiveness provisions.

5. Qualified "payroll costs" and independent contractors

The Rules provide that subject to the exclusions in the CARES Act, qualified "payroll costs" consist of compensation to employees (whose principal place of residence is in the United States) in the form of salary, wages, commissions, or similar compensation; cash tips or the equivalent (based on employer records of past tips or, in the absence of such records, a reasonable, good-faith employer estimate of such tips); payment for vacation, parental, family, medical, or sick leave; allowance for separation or dismissal; payment for the provision of employee benefits consisting of group health care coverage, including insurance premiums, and retirement; payment of state and local taxes assessed on compensation of employees; and, for an independent contractor or sole proprietor, wage, commissions, income, or net earnings from self-employment or similar compensation.

The Rules also state that since independent contractors have the ability to apply for a PPP loan on their own, they do not count for purposes of a borrower's PPP loan calculation. This statement appears to exclude payments to independent contractors in a borrower's calculation of payroll costs. However, given that compensation for independent contractors is included elsewhere in the provisions of the CARES Act and the Rules regarding payroll costs, the SBA's guidance on independent contractors should be clarified.

6. A maximum of 25% of the loan forgiveness amount may be attributable to non-payroll costs

In line with the requirement that at least 75% of PPP loan proceeds must be used for payroll costs, the Rules also require that not more than 25% of the loan forgiveness amount may be attributable to non-payroll costs. While the CARES Act provided that borrowers are eligible for forgiveness in an amount equal to the sum of payroll costs and any payments of mortgage interest, rent, and utilities, the SBA stated in the Rules that the non-payroll portion of the forgivable loan amount should be limited to effectuate the core purpose of the statute and ensure finite program resources are devoted primarily to payroll. If less than 75% of PPP loan proceeds are used for payroll costs, the SBA has said elsewhere it will direct the borrower to repay amounts used for unauthorized purposes, indicating such a shortfall would not be forgiven but would not necessarily make the remainder of the PPP loan ineligible for forgiveness, at least where PPP funds were not intentionally misused.

7. Payments to independent contractors and PPP loan forgiveness

The Rules state that since independent contractors have the ability to apply for a PPP loan on their own, they do not count for purposes of a borrower's PPP loan forgiveness. This statement appears to exclude payments to independent contractors in calculating loan forgiveness. However, given that compensation for independent contractors is included elsewhere in the provisions of the CARES Act and the Rules regarding payroll costs, the SBA's guidance on independent contractors should be clarified.

8. The Rules indicate that a business borrower must be a "small business concern" which is inconsistent with the CARES Act

The Rules appear to state that a business is eligible if it has 500 or fewer employees, and it is a "small business concern" as defined in the Small Business Act. This would be a significant change to the PPP loan program as outlined in the CARES Act, which states that "in addition to small business concerns, any business concern . . . shall be eligible" if it has not more than 500 employees (or meets the SBA industry size standard in number of employees for small businesses). Because the CARES Act makes other qualified small businesses, "in addition to small business concerns," eligible for PPP loans, it seems unlikely that the SBA intended for the Rules to exclude all business borrowers other than "small business concerns." Moreover, the Application does not include any certification that the applicant is a small business concern. The SBA should provide clarification on this point.

In any event, otherwise qualified small business concerns are eligible for PPP loans. The Rules make it clear that small business concerns will be subject to SBA's affiliation rules under 13 CFR 12301(f) unless specifically waived in the CARES

Act. In general, a small business concern under the Small Business Act is a businesses that is independently owned and operated and not dominant in its field of operation. Further, the business must meet specific requirements for revenue and employee size established in the North American Industry Classification System (NAICS) codes in 13 CFR Sec. 121.201.

9. Borrowers must have been in operation on February 15, 2020

Borrowers must have been in operation on February 15, 2020, and borrowers that are businesses or nonprofits must have had either employees for whom salaries and payroll taxes were paid or paid independent contractors. Borrowers must also submit such documentation as is necessary to establish eligibility, such as payroll processor records, payroll tax filings, or Form 1099-MISC.

10. Borrowers that have obtained an Economic Injury Disaster Loan (EIDL) may still apply for a PPP loan, but if EIDL funds were used for payroll costs, the PPP loan must be used to re-finance the EIDL loan.

The Rules confirm that if a business previously obtained an EIDL loan between January 31, 2020 and April 3, 2020, it can still apply for a PPP loan. If the EIDL loan was not used for payroll costs, it does not affect eligibility for a PPP loan. However, the Rules state that if the EIDL loan was used for payroll costs, the PPP loan must be used to refinance the EIDL loan (although this may mean a portion of the EIDL loan, at least 75% of which was used for payroll costs). The Rules confirm that the refinanced amount of any EIDL loan will be included in determining whether at least 75% of the PPP loan proceeds were used for payroll costs.

11. Clarification of religious liberty protection

The Rules state that PPP loans will be made consistent with "constitutional, statutory, and regulatory protections for religious liberty, including the First Amendment to the Constitution, the Religious Freedom Restoration Act,…" and SBA regulation at 13 C.F.R. 113.3-1h, which states:

"Nothing in [SBA nondiscrimination regulations] shall apply to a religious corporation, association, educational institution or society with respect to the membership or the employment of individuals of a particular religion to perform work connected with the carrying on by such corporation, association, educational institution or society of its religious activities."

The SBA states that it intends to promptly issue additional guidance with regard to religious liberty protections under the PPP loan program.

Despite the Rule's clear statement regarding religious liberty, and the stated intent that PPP loans be available to religious institutions, the Application still requires applicants to "agree not to discriminate in any business practice, including employment practices and services to the public on the basis of categories cited in 13 C.F.R., Parts 112, 113, and 117 of SBA Regulations." 13 C.F.R. Part 113 prohibits discrimination on the basis of religion. The Application reminds borrowers that "knowingly making a false statement to obtain a guaranteed loan from SBA is punishable under the law, including under 18 USC 1001 and 3571 by imprisonment of not more than five years and/or a fine of up to $250,000; under 15 USC 645 by imprisonment of not more than two years and/or a fine of not more than $5,000; and, if submitted to a federally insured institution, under 18 USC 1014 by imprisonment of not more than thirty years and/or a fine of not more than $1,000,000." Religious organizations should consult with their legal counsel as to whether they are able to agree to the nondiscrimination terms in the Application.

12. Certain businesses not eligible for SBA 7(a) loans are also not eligible for PPP loans

The Rules state that except for nonprofits made eligible for PPP loans under the CARES Act, businesses that are identified in 13 CFR 120.110 and described further in SBA's Standard Operating Procedure (SOP) 50 10, Subpart B, Chapter 2 are not eligible for PPP loans. Those businesses generally include:

- Financial businesses primarily engaged in lending, such as banks, life insurance companies, finance companies, and factoring companies;
- Certain passive businesses, such as passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds;
- Businesses located in a foreign country or owned by undocumented (illegal) aliens;
- Businesses selling through a pyramid plan;
- Certain businesses engaged in legal gambling activities;
- Businesses engaged in any illegal activity (including certain marijuana-related businesses);
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Businesses which restrict patronage (e.g. a men's or women's only health club);

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Government-owned entities, excluding Native American Tribes;

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Businesses engaged in promoting religion -- although the Rules also state that all loans guaranteed by the SBA pursuant to the CARES Act will be made consistent with constitutional, statutory, and regulatory protections for religious liberty (see Item 11 above);

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Businesses providing prurient sexual material;

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Businesses primarily engaged in political or lobbying activities; and

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Speculation businesses (e.g. purchasing and holding an item until the market price increases).

13. Applications will be processed on a "first-come, first-served" basis

The Rules explicitly state loans will be processed on a "first-come, first-served" basis. The SBA notes that as of the publication of the Rules, the appropriations available for PPP loans are finite. Borrowers should consider making application for the PPP loan program as soon as possible.

14. Apply once, for the maximum amount

No eligible borrower may receive more than one PPP loan. The Rules therefore advise borrowers to consider applying for the maximum amount.

15. E-Signatures and e-consents are permitted

Consistent with other agencies' adoption of electronic signature emergency regulations and orders issued in March, the Rules permit the Application to be submitted with e-signatures or e-consents, regardless of the number of owners of the borrower.

16. Release of lender liability/importance of borrower certifications

In order to achieve an expeditious loan underwriting process, the Rules permit lenders to rely on certifications of the borrower in order to determine eligibility of the borrower and use of loan proceeds and to rely on specified documents provided by the borrower to determine qualifying loan amount and eligibility for loan forgiveness. Lenders must comply with the applicable lender obligations set forth in the Rules, but will be held harmless for borrowers' failures to comply with program criteria. The program requirements of the PPP identified in the Rules temporarily supersede any conflicting Loan Program Requirement (as defined in 13 CFR 120.10).

The Rules state that each lender's underwriting obligation under the PPP is limited to reviewing the "Paycheck Protection Application Form" and (i) confirming receipt of borrower certifications contained in Paycheck Protection Program Application form; (ii) confirming receipt of information demonstrating that a borrower had employees for whom the borrower paid salaries and payroll taxes on or around February 15, 2020; (iii) confirming the dollar amount of average monthly payroll costs for the preceding calendar year by reviewing the payroll documentation submitted with the borrower's application; and (iv) following applicable Bank Secrecy Act (BSA) requirements:

An authorized representative of the borrower is required to certify the matters stated in the Application in good faith. If a false statement is made on the Application, the borrower may be subject to criminal prosecution, which includes crimes with up to 5 years in prison and/or a fine up to $250,000. Consequently, it is important for borrowers to prepare the Application and make the required certifications in consultation with qualified financial and legal advisors.

17. Lenders are required to submit a processing form

The Rules also require a lender to submit a two-page application form on SBA Form 2484. This form generally seeks information regarding the lender, the applicant, loan structure, loan amount information, and relevant applicant certifications (e.g., as to eligibility, character determination, prior loss to government/delinquent federal debt and US employees).

18. Expect more regulations and guidance

The Rules promise further guidance on affiliation rules, loan forgiveness, and religious liberty protections. SBA may provide further guidance through SBA notices and a program guide which will be posted on SBA's website at www.sba.gov.

For more information, please contact David Kunstle at dkunstle@lrrc.com, Bobbie Collins at bcollins@lrrc.com or visit www.lrrc.com.

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