

April 03, 2020

SBA Issues Interim Final Rule on Paycheck Protection Program

As required under the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”), on April 2, 2020, the U.S. Small Business Administration (SBA) issued an Interim Final Rule, implementing key provisions of the new Paycheck Protection Program (the “Program”). The Program is intended to provide economic relief for small businesses that have been impacted by COVID-19, and is being rolled out with all due haste – the CARES Act was enacted on March 27, 2020, borrowers may now begin submitting loan applications to SBA-approved lenders, and the Interim Final Rule will go into effect as soon as it is published in the *Federal Register*. Although the rule is final and will be in effect in the coming days, the public will also have an opportunity to submit comments to the SBA for the 30-day period following publication of the Interim Final Rule in the *Federal Register*.

Our prior client alerts provide a summary of the Program, including key considerations for borrowers and lenders. In this client alert, we discuss the SBA’s new guidance under the Interim Final Rule, changes to prior guidance issued by the SBA and Treasury Department, and how borrowers and lenders can get started under the Program.

The Paycheck Protection Program

Section 1102 of the CARES Act temporarily authorizes the SBA to guarantee 100% of loans under the Program, which will be part of the SBA’s existing 7(a) loan program. Congress allocated \$349 billion for this purpose, and the SBA will guarantee loans under the Program until the earlier of those funds being exhausted and June 30, 2020.

1. *Eligible Borrowers*

Eligibility. In the Interim Final Rule, the SBA limited the scope of eligible borrowers under the Program. They include entities and individuals that were in business on February 15, 2020, and had either salaried employees or paid independent contractors that were reported on Form 1099-MISC, and are also:

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- i. A small business concern (as defined in the Small Business Act), subject to the SBA's affiliation rules unless specifically waived in the CARES Act;
- ii. A tax-exempt non-profit organization, tax-exempt veterans' organization (each as defined in the Internal Revenue Code), tribal business concern (as defined in the Small Business Act), or any other business; or
- iii. A sole proprietorship, independent contractor or eligible self-employed individual.

The Interim Final Rule also implies that businesses cannot base their eligibility for a Program loan on the SBA's revenue-based size standards, even if a business would otherwise qualify as a small business concern based on such revenue-based size standards. In other words, applicants must have 500 or fewer employees or, if an applicant operates in a certain industry that provides an employee-based size standard that is greater than 500 employees (based on its NAICS code), they must meet such applicable *employee-based* size standard for that industry. Essentially, the revenue limitations in the SBA's interactive size standards tool are inapplicable for purposes of this Program.

Even if a potential applicant meets each of the criteria above, it will not be eligible for the Program if:

- i. It engages in any illegal activity under federal, state or local law (e.g., the cannabis industry is not eligible);
- ii. It is a household employer;
- iii. A 20% (or more) equity owner is incarcerated, on probation, has current criminal charges against him/her, or was convicted of a felony in the past 5 years;
- iv. It or any business controlled or owned by it or one of its owners ever obtained a direct or guaranteed loan from the SBA or any other federal agency that is currently delinquent, or has defaulted within the past 7 years and caused a loss to the government.

Affiliation. The SBA stated that it will promptly provide additional guidance on the application of its affiliation rules to potential borrowers under the Program. This guidance is highly anticipated as there is ambiguity regarding how and where the waiver applies, with a potentially significant impact on the universe of eligible borrowers.

Independent Contractors. Applicants cannot include payments to independent contractors for purposes of calculating an applicant's maximum loan amount or for purposes of calculating the amount of the loan that can be forgiven under the Program. The language in the CARES Act could have been interpreted to include or exclude these payments, so this additional guidance clarifies that applicants cannot include these amounts. It has been from prior alerts, but this also confirms that independent contractors do not need to be included in the headcount for purposes of determining eligibility for a loan under the Program.

Payroll Costs. The term "payroll costs" includes amounts withheld for federal employment taxes and FICA (Federal Insurance Contributions Act) for all periods up to February 15, 2020. This means that if an applicant is using 2019 payroll costs for purposes of determining its maximum loan amount, it can include all federal withholding and FICA amounts in such calculation. However, if an applicant is using the past 12 months of payroll costs to determine its loan amount, then it can include such federal tax withholding and FICA amounts only up through February 15, 2020. In addition, an applicant cannot include any

federal tax withholding of FICA amounts for purposes of determining forgiveness, because the entire 8-week forgiveness period will fall into the period specifically excluded in the Interim Final Rule (i.e., February 15, 2020 through June 30, 2020). This difference could make it difficult to meet the requirement that 75% of the loan must be used for payroll costs (this new requirement is described in more detail below) because the loan amount will be based on a higher number than the loan forgiveness.

New Limits on Use of Proceeds and Related Penalties. Proceeds from a Program loan may only be used for the following purposes:

- i. Payroll costs
- ii. Costs related to the continuation of group health care benefits
- iii. Mortgage interest payments
- iv. Rent payments
- v. Utility payments
- vi. Interest payments on any other debt obligations incurred before February 15, 2020
- vii. Refinancing an SBA EIDL loan made between January 31, 2020 and April 3, 2020.

Although the CARES Act allows for a broader range of uses for Program loan proceeds, the SBA narrowed this list (in keeping with Congress's goals to keep workers employed and paid), and added that *at least 75% of loan proceeds must be used for payroll costs*. If a borrower does not use at least 75% of the loan proceeds for payroll costs, it will be subject to the penalties set forth below.

Given this provision, there is some concern that liability for misuse (see below) could arise in the event that an employer take too high a loan amount and is unable, for whatever reason, to use 75% of the loan for payroll costs. In some case, employers may need to consider rehiring people so that they are sure they meet the 75% requirement.

Interest Rate. Contrary to what the SBA and Treasury published earlier this week, the interest rate was increased from a fixed rate of 0.5% to a fixed rate of 1.0%.

Borrower Certifications. An authorized representative of each applicant must certify, among other things, that the Program funds will be used for one of the stated uses above, including no more than 25% going to anything besides payroll costs. The applicant will also need to provide documentation verifying its full-time employees, the dollar amount of payroll costs, covered mortgage interest payments, covered rent payments and covered utilities for an 8-week period.

Penalties; Misuse. The SBA added that knowingly making a false statement to obtain a guaranteed loan is punishable by imprisonment and fines. In addition, if a borrower misuses loan proceeds (i.e., does not use at least 75% for payroll costs), the SBA will order such borrower to repay those amounts back, and the borrower may also be charged with fraud if the misuse was knowing. Moreover, if an applicant's shareholders, members or partners use Program funds for unauthorized purposes, the SBA will also have recourse against the individual shareholder, member or partner for the unauthorized use.

2. Lenders

Importantly for lenders, the SBA explicitly states that Program lenders (i) may rely on borrower certifications and documentation to determine eligibility and loan amount, (ii) must comply with the applicable lender obligations set forth in the Interim Final Rule, and (iii) *will be held harmless for borrowers' failure to comply with Program criteria*.

As set forth in the CARES Act, all SBA-authorized lenders may be a lender under the Program. In the Interim Final Rule, the SBA and Treasury Department decided to authorize additional Program lenders, including any of the following entities, so long as they are not designated in Troubled Condition or subject to a formal enforcement action related to unsafe or unsound lending practices by their primary federal regulator:

- i. Federally insured depository institutions and credit unions;
- ii. Farm Credit System institutions that apply the Bank Secrecy Act (BSA) requirements;
- iii. Certain other financing providers that originate, maintain, and service business loans, have a formal compliance program, that apply BSA requirements as a federally regulated financial institution, has been operating since at least February 15, 2019, and has originated, maintained and serviced more than \$50 million in business loans or certain other financial receivables during a consecutive 12-month period in the past 36 months, or a service provider to any insured depository institution that has a contract to support its lending activity and is in good standing with the relevant federal banking agency.

The entities set forth in clauses (i) and (ii) *will automatically qualify as Program lenders* under the SBA's delegated authority, as soon as they submit SBA Form 3506 (the CARES Act Section 1102 Lender Agreement, not yet available).

Before lending to eligible borrowers under the Program, SBA lenders will need to confirm receipt of borrower certifications, confirm receipt of information about borrower's salaried employees, confirm dollar amount of average monthly payroll costs based on payroll documentation, and follow applicable BSA requirements.

Note that Program loans can be sold into the secondary market after the loan is fully disbursed (at a premium or discounted). The SBA intends to issue additional guidance on any advance purchase for loans sold in the secondary market.

3. *Loan Terms*

Program lenders can lend up to the lesser of \$10 million and the amount determined using the payroll-based formula set forth in the CARES Act. The SBA clarified that independent contractors *do not* count towards the payroll-based calculation because they can apply for their own Program loans. In the Interim Final Rule, the SBA recommended that borrowers apply for the maximum loan amount, since each borrower is only eligible for one loan.

Although the original information provided by the Treasury Department suggested that the interest rate for Program loans would be 0.5%, it correct this number in the Interim Final Rule: *the Program interest rate will actually be 1.0%*. And, despite the fact that the CARES Act allows for a maximum maturity of 10 years, all Program loans will have a maturity of 2 years.

Loan Forgiveness

Section 1106 of the CARES Act provides for forgiveness up to the full principal amount of qualifying loans guaranteed under the Program. The SBA provided slightly more information about this aspect of the Program, including that a lender may request that the SBA purchase the expected forgiveness amount of a Program loan or pool of Program loans at the end of week 7 of the covered period. The “expected forgiveness amount” is the amount of loan principal the lender reasonably the borrower to expend on payroll costs, covered mortgage interest, covered rent, and covered utility payments. As with the loan proceeds, at least 75% of the loan forgiveness must be allocated to payroll costs.

Helpful Resources for Borrowers and Lenders

Want more information on the new Paycheck Protection Program? The Treasury Department’s “Assistance for Small Businesses” web page includes a number of helpful resources and forms related to the Program, including this high level overview.

Interested in applying for a loan under the Program? Potential borrowers should review the following:

Fact Sheet for Borrowers

Borrower Application Form

Interested in becoming a Program lender?

Fact Sheet for Lenders

Lender Application Form (to be submitted to the SBA for each Program loan, and retained in the Lender’s loan file)

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