Proskauer

"First Come, First Serve", Paycheck Protection Program Launched Today

April 3, 2020

On Thursday evening, April 2, 2020, the U.S. Small Business Administration (the "SBA") released its interim final rules (the "Rules") as well as the new borrower application form (the "Application") with respect to the Paycheck Protection Program (the "PPP") established under the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"). The CARES Act appropriates $349 billion in funding for this landmark loan program, which enables eligible businesses to apply for loans from approved lenders and guaranteed by the SBA. (For more information about the SBA loan programs under Title I of the CARES Act, including regarding the PPP, see: Small Business Administration Gets (Very) Big — SBA Loan Programs Under Title I of the CARES Act.)

The Rules and Application were issued just hours before the scheduled launch of the PPP, which, as previewed in the U.S. Treasury Department's borrower information sheet released on Tuesday, March 31, 2020, is set to begin April 3, 2020. The Rules and Application contain some significant clarifications as to how the SBA will implement the CARES Act and confirm that certain of the SBA's existing rules, which broadly impact borrower eligibility for PPP loans, will apply. Notable items are highlighted below:

- ***First Come, First Serve***. The Rules expressly state that the PPP is a "first-come, first-serve" program. Accordingly, applicants should be poised to move quickly once lender banks begin accepting applications. Note, however, that participating lenders are not required to process the applications they receive on a "first come, first serve" basis, and certain lenders have already indicated publicly that processing preference will be given to existing clients. Although the CARES Act provides it is the sense of the Senate that the SBA should issue guidance to lenders to ensure that processing and disbursement of PPP loans prioritizes businesses in rural and underserved markets (including to those owned by veterans, members of the military community, or socially and economically disadvantaged individuals), no such guidance has been issued thus far.
- ***Interest Rate***. The Rules set the interest rate on PPP loans at 1.0%.

- ***Maturity***. The Rules confirm that maturity will be 2 years from the date a borrower applies for loan forgiveness.
- ***Uses of PPP Loan Proceeds***. The Rules significantly constrain how borrowers can use PPP loan proceeds by requiring that at least 75% of such proceeds must be used for payroll costs (as defined in the CARES Act). The Rules clarify that the remaining 25% of the loan proceeds can be applied toward the specific categories of uses identified in the CARES Act and any other uses for which 7(a) loans are permitted under existing SBA rules.

Further, the Rules provide that a borrower who has received an economic injury disaster loan ("EIDL") between January 31 and April 3, 2020 and who used such EIDL funds for payroll costs is required to refinance any outstanding amounts under such EIDL with the proceeds of a PPP loan and such amounts count towards the $10 million maximum that a borrower is allowed to borrow under the PPP.

- ***Payment Deferment***. The Rules provide that deferment on loan payments will be for 6 months only (interest accrues over that time).
- ***Payroll Costs***. For purposes of calculating loan size, average monthly "payroll costs" are calculated on a trailing twelve month basis (not based on average monthly payroll costs from the 2019 calendar year).
- ***Loan Forgiveness***.
    - ***Maximum Amount***. In a positive development for potential borrowers, the Rules provide that PPP loans can be forgiven up to the full principal amount ***and*** any accrued interest.
    - ***25% Cap on Non-Payroll Costs***. The Rules confirm the limitation previewed earlier this week in the Treasury Department's information statement that not more than 25% of the forgiven amount may be for non-payroll costs.
    - ***More to Come***. The SBA has indicated that it intends to issue additional guidance on loan forgiveness, though when such additional guidance will arrive is not specified.
- ***Applicable Size Standards for PPP Eligibility***. The Application contains a certification that the applicant (1) is an independent contractor, eligible self-employed individual or sole proprietor or (2) employs no more than the greater of 500 employees or, if applicable, the size standard in number of employees established by the SBA for the applicant’s industry. This certification appears to imply that applicants whose industries are subject to an existing SBA size standard based on annual gross receipts (who otherwise qualify as a "small business

concern") will not be eligible for PPP loans if they have more than 500 employees, which is inconsistent with the CARES Act and the Rules.

- ***Affiliation***. The Rules confirm that the SBA's affiliation rules (in 13 C.F.R. § 120.301(f)) indeed apply to businesses other than those expressly excepted under the CARES Act (businesses (1) in the accommodations and food services industries; (2) that are franchises in the SBA's franchise directory; or (3) that receive financial assistance from SBA-licensed small business investment companies (SBICs)). The Application requires disclosure of whether the applicant or any of its owners[1] is an owner of, or has common management with, any other business, including a list of such businesses and a description of the relationship.
- ***Ineligible Industries***. The Rules likewise confirm that the existing SBA regulations (in 13 C.F.R. § 120.110) regarding eligibility apply to the PPP. Therefore, businesses in certain industries remain ineligible for loans under 7(a) of the Small Business Act.
- ***Foreign Ownership Not Restricted***. The Application no longer restricts foreign ownership of the applicant business. The applicant business need only be an operating business located in the U.S. under the existing SBA rules.
- ***20% or More Owners***. The Application no longer requires submission of application forms and corresponding certifications by each "20% or more owner of an applicant business," though applicants must disclose the identity of each 20% or more equity owner. Forms need only to be signed by any authorized representative of the applicant.
- ***Independent Contractors***. The Rules make it clear that a business cannot include independent contractors as "employees" for purposes of loan calculations and determining loan forgiveness. The Rules emphasize that independent contractors can themselves apply for a PPP loan.
- ***Lender Obligations***. The Rules permit lenders to rely on borrower certifications in determining loan eligibility and provide that the SBA will hold lenders harmless for a borrower’s failures to comply with the PPP's criteria. The lender's underwriting obligations under the PPP are generally limited to reviewing a borrower's application and supporting documentation, and confirming (i) that the borrower has made the requisite certifications (including a new certification in the Application that the applicant is eligible to receive a loan under SBA rules then in effect), (ii) that the borrower has supplied information supporting that it had employees for whom salaries and payroll takes were paid as of February 15, 2020, and (iii) the dollar amount of average monthly payroll costs for 2019. With respect to loan forgiveness, a lender is likewise not required to conduct any verification of documentation submitted by a borrower supporting its request for loan forgiveness. Therefore, the Rules place the burden on a borrower to confirm its own eligibility

and the accuracy of the information it supplies to the lender.

- ***Lender Fees***. Processing fees paid to lenders will be based on the balance of the loan outstanding at the time of final disbursement. A lender will receive a fee equal to a percentage of such final disbursement as follows: (i) 5.00% for loans $350,000 and under; (ii) 3.00% for loans of more than $350,000 and less than $2 million; and (iii) 1.00% for loans of at least $2 million. Lenders may not collect any fees from the applicant.
- ***Agent Fees***. The Rules provide that the fees of agents who assist a borrower to prepare a PPP loan application will be paid by the lender out of the fees the lender receives from the SBA (*i.e.*, the agent may not collect fees from the borrower or be paid out of PPP loan proceeds). The total amount an agent can collect from a lender for providing such assistance is capped at: (i) 1.0% for loans of not more than $350,000 (≤$3,500); (ii) 0.50% for loans of more than $350,000 and less than $2 million ($1,750 - ~$9,999); and (iii) 0.25% for loans of at least $2 million ($5,000 +).

The Rules are effective immediately. However, the SBA is soliciting comments from interested members of the public, which comments must be submitted within 30 days. The SBA will consider such comments, and may make changes to the Rules if warranted; otherwise, if the SBA decides not to alter the interim rule it will publish a final rule in the Federal Register.

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Proskauer's cross-disciplinary, cross-jurisdictional Coronavirus Response Team is focused on supporting and addressing client concerns. We will continue to evaluate the CARES Act, related rules and regulations and any subsequent legislation to provide our clients guidance in real time. Please visit our Coronavirus Resource Center for guidance on risk management measures, practical steps businesses can take and resources to help manage ongoing operations.

[1] Where not otherwise specified, each of the following parties are considered "owners" and "principals" of the applicant business: (i) for a sole proprietorship, the sole proprietor; (ii) for a partnership, all general partners, and all limited partners owning 20% or more of the equity of the firm; (iii) for a corporation, all owners of 20% or more of the corporation; (iv) for limited liability companies, all members owning 20% or more of the company; and (v) any trustor (if the applicant is owned by a trust).

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