

Practice Update

PPP Ineligible Business Types: Constantly Changing Guidelines Leave Many Small Businesses Confused

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Small businesses have experienced a great deal of confusion as they try to determine their eligibility for a Paycheck Protection Program (PPP) loan under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). The U.S. Small Business Administration (SBA) and the U.S. Department of the Treasury (Treasury) are providing ad hoc guidance through issuing a number of Interim Final Rules (individually an IFR, and collectively, IFRs) and publishing Frequently Asked Questions (FAQs). Yet, the IFRs and FAQs have led to more questions than answers. Struggling businesses are now spending their limited time, resources, and money, figuring out if they are allowed to apply for or keep a PPP loan that could determine the fate of their employees' livelihoods.

On March 31, 2020, the Treasury published the “Top-Line Overview of PPP” announcing in large bold font that “All Small Businesses [Are] Eligible.” This is consistent with Congress’ language within the CARES Act, which states that any business that has fewer than 500 employees or meets other applicable SBA size standards is eligible.[1] This announcement provided hope for all small businesses struggling to survive the economic hardships following the COVID-19 pandemic.

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Despite Congress' stated goal to provide relief to the widest possible set of businesses through the PPP program, the SBA announced in its first IFR on April 2, 2020, that any business previously considered ineligible under the SBA's current lending program would also be considered ineligible for a PPP loan under 13 CFR § 120.110(b) (Ineligibility Rules), unless the CARES Act specifically states otherwise.

Regardless of demonstrating a necessity for PPP funds, compliance with the applicable size standard, and legitimate use of PPP funds, the first IFR restricts numerous business concerns from obtaining PPP loans, including financial businesses, speculative businesses, faith-based businesses, government-owned entities, businesses deriving more than one-third of gross annual revenue from legal gambling activities, businesses that provide live performances of a prurient sexual nature, and more.

Further complicating this issue, the SBA later determined that some of the previously ineligible businesses under the Ineligibility Rules are now eligible for PPP loans. For instance, the second IFR deemed faith-based businesses eligible, the third IFR relaxed the restrictions on the ineligibility of gambling businesses, and the fourth IFR allowed certain government-owned entities, such as hospitals, to obtain PPP loans.

As the SBA unwinds its own Ineligibility Rules, they simultaneously reinforce the ineligibility of certain business types. For instance, the SBA's second IFR, proclaimed hedge funds as ineligible under the Ineligibility Rules as a speculative business. Meanwhile, the Treasury publicly admonished larger eligible companies that received PPP loans, which resulted in eligible businesses returning PPP funds.

The SBA's and Treasury's contradictions with the CARES Act and piecemeal application of its own rules have left many business owners trying to determine whether they are eligible for relief. Even small business that are not expressly prohibited

under the Ineligibility Rules, but are related to ineligible businesses, such as management companies, are at a loss regarding their eligibility.

To make matters worse, the IFRs allow PPP lenders to rely on borrower certifications regarding eligibility, and the SBA will hold lenders harmless for originating loans to ineligible borrowers. This shifts the risk of originating a non-compliant PPP loan to the borrower, which can lead to fines and possible imprisonment.

Left with the choice of either risking criminal prosecution, penalties, or allowing their small business to fail, some ineligible applicants have decided to take legal action against the SBA. On May 11, the U.S. District Court for the Eastern District of Michigan concluded that the SBA exceeded its statutory authority when it applied the Ineligibility Rules to PPP loans. Here, the SBA deemed forty-two gentlemen's clubs ineligible as businesses that provide live performances of a prurient sexual nature. However, Judge Matthew Leitman interpreted the CARES Act to apply to any business that otherwise meets the requirements for a PPP loan. Consequently, Judge Leitman granted a temporary restraining order preventing the SBA from denying the plaintiff's applications for PPP loans. Though this ruling only applies to the named plaintiffs in this case, it illustrates the ambiguity surrounding PPP ineligibility and the judicial system's willingness to uphold Congress' intent of the CARES Act: "Keeping American Workers Paid and Employed." Later, the Sixth Circuit denied the SBA's motion to halt Judge Leitman's order until the SBA's appeal. Other previously ineligible businesses, such as finance companies, have also filed suit against the SBA with similar arguments.

Although the Eastern District Court's decision has provided hope to previously ineligible small businesses, the SBA and Treasury have declined to comment on the ruling, allowing the confusion surrounding ineligibility to fester with no apparent

end in sight. Additionally, Congress has amended the CARES Act three times, and is currently debating making further changes when they pass the next coronavirus relief bill. This undoubtedly has created more obstacles for small businesses when determining their eligibility for relief under the CARES Act.

Below are certain steps that small businesses should consider when applying for a PPP loan:

- Carefully review IFRs, FAQs, 13 CFR § 120.110(b), the SBA's Standard Operating Procedures, and the Office of Hearings and Appeals database, as there may be exceptions or precedent that support eligibility.
- Document all facts demonstrating that the applicant will lose their business if they are unable to obtain a PPP immediately.
- Confirm that the applicant's business meets the SBA's applicable size standards.
- Memorialize management and board deliberations, decision making, and analysis supporting eligibility.
- Document the impact of COVID-19 on business operations, including the applicant's plan to use the PPP funds to avoid workforce reductions.

Below are additional steps that a small business that received a PPP loan should consider if it is concerned with its ineligibility in order to prepare for PPP loan audit and scrutiny by the SBA:

- Consult with advisors to review the PPP loan application for accuracy, full disclosures, and transparency as this may help demonstrate that at the time the PPP loan application was made, all facts available to the applicant at the time were considered, disclosed, and that there was no intent to mislead the government.
- Consult with legal counsel to determine if there is precedent supporting eligibility in the applicable

jurisdiction.

[1] 15 U.S.C. § 636(a)(36)(D)(i)(I)-(II)

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