
April 25, 2020

CARES Act UPDATE: SBA Issues Additional Paycheck Protection Program Guidance, Including for Private Equity Firms and Hedge Funds

Key Takeaways

- On April 24, 2020, the Small Business Administration (SBA) issued its fourth Interim Final Rule (the “Fourth IFR”)¹ for the Paycheck Protection Program (PPP),² which was established pursuant to the CARES Act,³ as well as supplemental guidance for calculating loan amounts.
- The Fourth IFR clarifies that (i) private equity firms and hedge funds are ineligible for the PPP and (ii) their portfolio companies may be eligible, subject to satisfying the affiliation rules, and such companies should “carefully review” the required certification that “current economic uncertainty makes [the] loan request necessary to support the ongoing operations of the Applicant.”
- The Fourth IFR also provides a “safe harbor” for any borrower that applied for a PPP loan prior to April 24, 2020 and repays the loan in full by May 7, 2020. Such borrowers will be deemed by the SBA to have made the aforementioned certification in good faith.
- On April 24, 2020, the SBA also published supplemental guidance to assist borrowers and lenders in calculating maximum loan amounts.⁴

¹ The full text of the Fourth IFR is available [here](#).

² For additional information regarding the PPP in particular, please click [here](#) and [here](#).

³ For additional information on the CARES Act generally, please click [here](#).

⁴ The full text of the SBA guidance on calculating maximum loan amounts is available [here](#).

SBA Guidance in the Fourth IFR for Private Equity Firms, Hedge Funds and Portfolio Companies

Eligibility of Private Equity Firms and Hedge Funds

The Fourth IFR clarifies that private equity firms and hedge funds are ineligible to receive PPP loans because they are primarily engaged in investment or speculation.⁵ The Fourth IFR explains that the SBA, in consultation with the U.S. Treasury, does not believe that Congress intended for these types of businesses to obtain PPP loans.⁶

Eligibility of Portfolio Companies

The Fourth IFR states that private equity portfolio companies must apply SBA affiliation requirements in considering their eligibility. The Fourth IFR also warns portfolio companies to “carefully review” the required certification that “current economic uncertainty makes this [PPP] loan request necessary to support the ongoing operations of the Applicant.”

No additional guidance is provided in the Fourth IFR on how this certification should be interpreted. However, a Frequently Asked Question (FAQ) released by the SBA the prior day (April 23, 2020) stated the following in the context of addressing “businesses owned by large companies with adequate sources of liquidity”: “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 “economic uncertainty”] certification in good faith, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification.” But in contrast to this FAQ, the Fourth IFR does not speak to the likelihood of whether portfolio companies would be able to make this certification.

Given the recent guidance in the Fourth IFR and FAQ, the Fourth IFR creates a “limited safe harbor” for any borrower that applied for a PPP loan prior to April 24, 2020 repays the loan in full by May 7, 2020. Such a borrower will be deemed by the SBA to have made the “economic uncertainty” certification in good faith. The SBA explained that it determined that this safe harbor was appropriate to “ensure that borrowers promptly repay PPP loan funds that the borrower obtained based on a misunderstanding or misapplication of the required certification standard.”

⁵ Previous SBA regulations include a list of businesses ineligible to receive SBA section 7(a) loans, including “[f]inancial businesses primarily engaged in the business of lending, such as banks, finance companies, and factors (pawn shops, although engaged in lending, may qualify in some circumstances).” (13 CFR 120.110(b)).

⁶ Refer to 13 CFR 120.110 for a complete list of ineligible businesses.

All borrowers, including portfolio companies, should consider the SBA's new guidance regarding the "economic uncertainty" certification and consider whether it is appropriate to take advantage of the safe harbor.

Other Topics Addressed in the Fourth IFR

Eligibility for Businesses Presently in Bankruptcy Proceedings

The Fourth IFR clarifies that an applicant is ineligible to receive a PPP loan if the applicant or its owner is or becomes a debtor in a bankruptcy proceeding, either when the application is submitted or at any time before loan disbursement. An applicant that becomes a debtor, or has an owner that becomes a debtor, in a bankruptcy proceeding prior to receiving the PPP loan proceeds, must notify the lender and request cancellation of the application. Failure to do so will be deemed an unauthorized use of PPP funds.

Eligibility for Certain Government-Owned Hospitals

The Fourth IFR creates an exception for certain government-owned hospitals to be eligible for a PPP loan.⁷ To qualify, the hospital must otherwise be eligible to receive a PPP loan as a business concern or nonprofit⁸ and must receive less than 50% of its funding from state or local government sources, exclusive of Medicaid.

Eligibility for Gaming Businesses

The Fourth IFR amends prior guidance for gaming businesses such that a business that is otherwise eligible for a PPP loan is not rendered ineligible due to its receipt of any legal gaming revenues and provides that 13 CFR 120.11(g) is inapplicable to PPP loans.⁹ As before, a business that receives illegal gaming revenue remains categorically ineligible.

⁷ This is an exception to 13 CFR 120.110(j), which deems government-owned entities (except for businesses owned or controlled by a Native American tribe) ineligible for SBA business loans.

⁸ As described in section 501(c)(3) of the Internal Revenue Code of 1986 and exempt from taxation under section 501(a) of such Code.

⁹ Prior SBA guidance required gaming businesses to (i) adhere to the existing standard set forth in 13 CFR 120.110(g), which bars businesses from obtaining SBA section 7(a) loans if they derive more than one-third of their gross annual revenue from legal gambling activities, or (ii) satisfy the two following conditions: (a) legal gaming revenue (net of payouts but not other expenses) did not exceed \$1 million in 2019; and (b) legal gaming revenue (net of payouts but not other expenses) comprised less than 50 percent of total revenue in 2019.

Affiliation Rules for Employee Stock Ownership Plans

A business's participation in an ESOP does not result in affiliation between the business and the ESOP.

SBA Guidance on Calculating Maximum Loan Amounts

The SBA's supplemental guidance for calculating maximum loan amounts offers borrowers a step-by-step guide to calculating monthly payroll costs, broken down by the type of borrower (e.g., partnerships, S corporations, C corporations). The guidance references a number of specific IRS tax forms and other documents that borrowers may use in their calculations, making clear that the SBA deems these particular documents satisfactory substantiation of a loan amount and that lenders that review loan applications and supporting documents in conformity with this and other SBA guidance and rules will not face challenge from the U.S. government.

* * *

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Roberto J. Gonzalez
+1-202-223-7316
rgonzalez@paulweiss.com

Gregory F. Laufer
+1-212-373-3441
glauffer@paulweiss.com

Brian C. Lavin
+1-212-373-3650
blavin@paulweiss.com

Jean M. McLoughlin
+1-212-373-3135
jmcloughlin@paulweiss.com

Carl L. Reisner
+1-212-373-3017
creisner@paulweiss.com

T. Robert Zochowski Jr.
+1-212-373-3762
rzochowski@paulweiss.com

Associates Jeffrey L. Stricker and David J. Rolla and law clerk Mariela Cisneros contributed to this Client Memorandum.