Keeping All American Workers Paid and Employed? How Small Businesses with Independent Contractors Feel Slighted by the Paycheck Protection Program and What Can be Done

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KEEPING ALL AMERICAN WORKERS PAID AND EMPLOYED? HOW SMALL BUSINESSES WITH INDEPENDENT CONTRACTORS FEEL SLIGHTED BY THE PAYCHECK PROTECTION PROGRAM AND WHAT CAN BE DONE

MARY CLAIRE DAVIS

ABSTRACT

Imagine\(^1\) it is late March 2020, and you own and manage a small transportation company that employs independent contractor drivers. In addition to managing the upheaval that has occurred to all small businesses across the country with the onset of the COVID-19 pandemic, you worry that your workers will not be able to keep food on the table. You hear about a new government program—the Paycheck Protection Program ("PPP") created by legislation known as the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act")—that is meant to "keep[] American workers paid and employed."\(^2\) You understand that the United States Small Business Administration ("SBA") has designated certain lenders to facilitate low-interest "PPP Loans," which provide funds to qualifying businesses based on their payroll costs from 2019. Better yet, your bank tells you that as long as the loan proceeds are spent on certain specified payroll and non-payroll business costs, your business will receive full forgiveness of the PPP Loan, which will make the money more like a grant.

You fill out the SBA’s PPP Loan application, and upon the guidance available to you at the time and the advice of your bank, you include independent contractor payroll calculations in your loan amount calculation. Based on your payroll costs from 2019 (including independent contractor payroll), you calculate your loan amount to be around $1 million. The loan is swiftly

\(^1\) The following vignette is a fictional amalgamation of facts and issues presented in PPP loan litigation across the country.

approved, and the loan funds are deposited into your business account within
days. You use the loan funds for approved payroll and non-payroll costs.

Fast forward one year, and you have applied for full forgiveness of the
PPP Loan. However, the SBA denies your application, explaining that small
businesses were forbidden from including independent contractor payroll in
their PPP Loan amount calculation. Then, your bank informs you that your loan
payments will become due shortly thereafter. Because your PPP Loan had a
maturity date of two years, your first monthly payment will be tens of thousands
of dollars. Had you known you would not be able to obtain forgiveness of your
loans, you would never have applied in the first place and would have considered
other means to weather the COVID-19 pandemic.

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I. INTRODUCTION

The CARES Act became law on March 27, 2020. Title I of the Act—“The Keeping American Workers Paid and Employed Act”3—created the PPP4 with the intent of “provid[ing] economic relief to small businesses nationwide” who were affected by the COVID-19 pandemic.5 While there were other programs set forth in the CARES Act to provide economic relief to small businesses, perhaps the most controversial and press-worthy was the PPP Loan program, which offered low-interest rate (1%) loans to qualifying small businesses to keep them afloat during the pandemic.6

The implementation of the PPP was rife with problems from the outset. “To say that the SBA was unprepared for th[e] challenge [of facilitating PPP Loans] would be a massive understatement.”7 SBA employees were facilitating $349 billion that Congress initially allocated for the PPP Loan program—more than 12 times the total loan amount issued by the SBA for small business loans in 2019—all while transitioning to remote working conditions.8 The result was “essentially an administrative nightmare.”9

This Article touches on one crucial and pervasive issue with the SBA’s mishandling of the PPP Loan application and forgiveness process: whether small business borrowers were entitled to include independent contractor payroll in their PPP Loan calculations, and correspondingly, whether they could receive forgiveness of those amounts. Part II of this Article will give an overview of the CARES Act and PPP, including how PPP Loans are calculated, serviced, and forgiven, and how borrowers who are denied forgiveness of their PPP Loans can lodge agency appeals; Part III will explain the SBA’s April 15, 2020 First Interim Final Rule, which disallowed small business borrowers from including independent contractor payroll in loan amount calculations, representing a significant departure from the language and purpose of the CARES Act. It will highlight the arguments that the SBA’s promulgation of the First Interim Final Rule—and its retroactive application of that Rule to loan applications filed before April 15, 2020—contravene the language, spirit, and purpose of the CARES Act and violate the Administrative Procedure Act; Part IV proposes avenues by

4 Id. sec. 3, § 1102 (codified at 15 U.S.C.A. § 636 (West 2023)).
8 Id. at 951–52.
9 Id. at 952.
which each of the three branches of government could address the independent contractor issue; and Part V concludes.

II. BACKGROUND: THE CARES ACT AND PAYCHECK PROTECTION PROGRAM

A. An “Administrative Nightmare”: Launching the PPP

Funding for government-backed PPP Loans to help small businesses retain members of their workforce came in three main waves. Congress initially allocated $349 billion in late March 2020.\(^\text{10}\) Congress then appropriated an additional $310 billion in April 2020.\(^\text{11}\) Later, in December 2020, Congress appropriated approximately $147 billion for a second round of loans, which had narrower requirements.\(^\text{12}\)

The CARES Act “temporarily permit[ted] SBA to guarantee 100 percent of [PPP] loans” and “provide[d] for forgiveness of up to the full principal amount of qualifying loans guaranteed under the [PPP].”\(^\text{13}\) Congress charged the SBA with “modify[ing] existing loan programs and establish[ing] a new loan program to assist small businesses nationwide.”\(^\text{14}\) The PPP Loans were assigned a fixed 1% interest rate for any unforgiven portion of the Loan and a maturity of two years.\(^\text{15}\) The United States Department of Treasury (the “Treasury”) issued guidance to lenders wishing to participate in the PPP, explaining, “[T]he SBA


\(^{12}\) Consolidated Appropriations Act, 2021, Pub. L. No. 116–260, Tit. III, sec. 323, 134 Stat. 1182, 2019 (2020). For example, under the second round of the PPP, borrowers had to show their business employed less than 300 employees, as opposed to 500 for the first round. \(\text{Id.}\) sec. 311, 134 Stat. at 2001 (codified at 15 U.S.C.A. § 636(a)(37)(A)(iv)(I)(aa)). Borrowers also had to show a 25% reduction in revenue from 2019 to 2020. \(\text{Id.}\)


\(^{14}\) Business Loan Program Temporary Changes; Paycheck Protection Program, \(\text{supra}\) note 5, at 20811.

guarantees 100% of the outstanding balance [of the PPP Loan], and that guarantee is backed by the full faith and credit of the United States . . . . The SBA waives all SBA guaranty fees, including the upfront and annual servicing fees."16 No collateral was required.17

The Treasury further explained that PPP lenders18 were required to confirm the following: receipt of borrower certifications that it was eligible for a PPP Loan; receipt of information demonstrating that a borrower had employees for whom it paid salaries and payroll taxes on or around February 15, 2020; and the amount of average monthly payroll costs.19 Lenders were instructed to refer to the SBA’s Interim Final Rules and Frequently Asked Questions (“FAQs”) for further guidance.20

The demand for PPP Loans was predictably high.21 The PPP was officially launched on Friday, April 3, 2020, and the New York Times reported that by Tuesday, April 7, 2020, 178,000 loans totaling $50 billion had already been approved through the PPP.22 By April 16, 2020, “the first appropriation of $349 billion was completely subscribed.”23 By August 8, 2020, when the deadline for first round applicants expired, the SBA had approved more than 5.2 million PPP loans totaling over $525 billion.24

Accordingly, in early April 2020, lenders “were left scrambling to determine their application processes without clear administrative guidance as customers demanded immediate loan access.”25 In fact, initial guidance for PPP Loan applications was released April 2, 2020, the night before the PPP itself was

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17 PPP Launches, supra note 15.
18 According to the Treasury, “[a]ll federally insured depository institutions, federally insured credit unions, and Farm Credit System institutions [were] eligible to participate” as PPP lenders. Existing SBA-certified lenders were given “delegated authority to speedily process PPP loans.” Lender Information, supra note 16.
19 Id.
20 Id.
21 Perkins, supra note 7, at 952.
25 Perkins, supra note 7, at 952.
launched. Many of the PPP’s problems “can be traced to its hurried creation in the frenzied days and nights of negotiation that led to the passage of the [CARES] Act, which was rushed together at breakneck speed to arrest the economy’s sudden free-fall.” According to a House Select Subcommittee Report issued in October 2020, “Treasury, SBA, and several large financial institutions failed to implement the PPP as Congress intended” in multiple ways.

To make matters more chaotic, guidance from the PPP itself was lacking. And because the SBA paid PPP lenders a percentage of the loan amounts as fees, it created a natural incentive for lenders to put as much money into the hands of borrowers as possible. In the end, the driving force behind the PPP was “pushing money into the hands of eligible small business owners as quickly as possible.”

B. Calculating a Maximum PPP Loan Amount Using “Payroll Costs”

To fully appreciate the impact of the PPP on small businesses with independent contractors, an overview of the loan calculation process and the SBA’s initial messaging about the same is necessary. On April 3, 2020, the SBA issued a press release explaining that PPP Loans were meant to cover up to eight weeks of payroll and other operating expenses for qualifying small businesses, as long as at least 75% of the loan proceeds were used for payroll costs in that eight-week period. The release defined “payroll costs” as “salary, commissions, tips; certain employee benefits including sick leave and health care premiums, and state and local taxes”; it did not differentiate between W-2

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26 Business Loan Program Temporary Changes; Paycheck Protection Program—Additional Eligibility Criteria and Requirements for Certain Pledges of Loans, supra note 13, at 21747 (noting that the SBA announced some rules for implementation of the CARES Act on April 2, 2020).


28 UNDERSERVED AND UNPROTECTED, supra note 24, at 1. For example, “Treasury privately encouraged banks to limit their PPP lending to existing customers, excluding many minority and women-owned businesses”; “SBA and Treasury failed to issue guidance prioritizing underserved markets, including minority and women-owned businesses”; and “Several lenders processed bigger PPP loans for wealthy customers at more than twice the speed of smaller loans for the neediest small businesses.” Id. at 1–2. While these individual issues are beyond the scope of this Article, they collectively show the initial chaos of the PPP rollout, which negatively affected the small businesses that needed PPP Loans the most.

29 The SBA paid fees to lenders for processing PPP Loans as follows: 5% for loans of not more than $350,000; 3% percent for loans of more than $350,000 and less than $2,000,000; and 1% percent for loans of at least $2,000,000. Perkins, supra note 7, at 951.

30 PPP Launches, supra note 15.
employee or independent contractor wages. The CARES Act itself made clear that—other than standard size requirements—lenders were required to entertain only two considerations in determining whether borrowers were eligible for a PPP Loan: whether the borrower (1) “was in operation on February 15, 2020”; and whether it (2) “had employees for whom the borrower paid salaries and payroll taxes; or paid independent contractors, as reported on a Form 1099-MISC.” In fact, the SBA’s PPP Loan application form required borrowers to certify that they “had employees for whom it paid salaries and payroll taxes or paid independent contractors, as reported on Form(s) 1099-MISC.”

The CARES Act instructed borrowers and lenders to calculate the “maximum loan amount”—and, in turn, the amount eligible for loan forgiveness—using a business’s “payroll costs.” Thus, the payroll cost amount was crucial because it dictated the maximum loan amount a borrower could receive. The CARES Act provided that the maximum loan amount for PPP Loans should be calculated as follows:

\[(i)(I) \text{ the sum of } \]
\[\quad \text{(aa) the product obtained by multiplying } \]
\[\quad \text{(AA) the average total monthly payments by } \]
\[\quad \text{the applicant for payroll costs incurred during } \]
\[\quad \text{the 1-year period before the date on which the } \]
\[\quad \text{loan is made . . .}; \]

\[\quad \text{by} \]

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32 Id.

33 Generally, for first round PPP loans, businesses must not have employed more than 500 employees; for second round PPP loans, this number was reduced to 300. 15 U.S.C.A. §§ 636(a)(36)(D)(i)(I), 636(a)(37)(A)(iv)(I)(aa) (West 2023). There are some exceptions based on affiliation of businesses and industries assigned certain North American Industry Classification System (NAICS) codes. See, e.g., id. § 636(a)(36)(D)(iv); In re Gateway Radiology Consultants, P.A., 983 F.3d 1239, 1248 (11th Cir. 2020) (explaining the SBA “has specified in a regulation that to qualify as a small business concern an entity must be an operating business organized for profit, located in the United States, and that it must fit within detailed size requirements that vary by industry”) (citing 13 C.F.R. §§ 120.100(a)-(e), 121.201 (West 2023)).


38 The statute contains an exception for “an applicant that is a seasonal employer,” which is directed to “use the average total monthly payments for payroll for any 12-week period selected by the seasonal employer between February 15, 2019, and February 15, 2020.” 15 U.S.C.A. § 636(a)(36)(E)(i)(II) (West 2023). This Article does not address seasonal employees specifically, although the issue of which workers might be considered in the calculation of payroll costs is pertinent to seasonal business calculations as well.
The maximum loan amount cannot exceed $10,000,000. The formula also allows recipients of an SBA disaster loan to add the outstanding amount of such loan if it was “made during the period beginning on January 31, 2020, and ending on the date on which covered loans are made available to be refinanced under the covered loan.” This Article will not specifically address businesses in that situation.

In turn, Congress defined “payroll costs” to include “the sum of payments of any compensation to or income of a sole proprietor or independent contractor that is a wage, commission, income, net earnings from self-employment, or similar compensation,” as long as it is not more than $100,000 in one year.

C. The Promises of Forgiveness: Victims of a “Bait-and-Switch”

Perhaps the biggest draw and “key feature” of the PPP for small businesses was the widely believed notion that PPP Loans could be forgiven simply if the borrower used loan proceeds properly and maintained certain levels of employment. There was wide support for the belief in the early days of the loan application process that “[i]f a loan meets conditions to forgiveness, the government repays the lender (i.e., the loan becomes a grant).” For example,
the SBA’s initial press release explained, “The SBA will forgive the portion of loan proceeds used for payroll costs and other designated operating expenses for up to eight weeks, provided at least 75% of loan proceeds are used for payroll costs.”44 Lenders were also assuring borrowers of the same, whether due to the SBA’s messaging, or—as alleged in some pending putative class actions—for nefarious purposes, as the lender fee structure “gave [lenders] an incentive to increase the size of PPP loans.”45

This belief also comported with the language of the CARES Act, which provides,

An eligible recipient46 shall be eligible for forgiveness of indebtedness on a covered [PPP] loan in an amount equal to the sum of the following costs incurred and payments made during the covered period:47

1. Payroll costs.
2. Any payment of interest on any covered mortgage obligation (which shall not include any prepayment of or payment of principal on a covered mortgage obligation).
3. Any payment on any covered rent obligation.
4. Any covered utility payment.
5. Any covered operations expenditure.
6. Any covered property damage cost.
7. Any covered supplier cost.
8. Any covered worker protection expenditure.48

The CARES Act provides three main limitations on forgiveness: (1) the borrower’s forgiveness amount could not exceed the principal loan amount;49 (2) employee and compensation levels were maintained;50 and (3) the borrower’s payroll cost amount in the forgiveness formula was at least 75% of total amount,

47 Forgiveness is based on loan proceeds used during a “covered period” of time. The original covered period was eight weeks; however, on June 5, 2020, perhaps realizing that the pandemic would not end as quickly as anyone hoped, Congress amended § 636m to allow borrowers to utilize loan proceeds over a twenty-four (24) week period. Paycheck Protection Program Flexibility Act of 2020, supra note 44, at sec. 3.
49 Id. § 636m(d)(1).
50 Id. § 636m(d)(2). The statute does provide for a reduction in forgiveness amounts—not complete rejection of forgiveness—if the business’s full-time employee count has dropped. See id.
with non-payroll costs constituting not more than 25% (which was later changed to 60% and 40%, respectively). Borrowers were instructed to submit a forgiveness application created by the SBA to the lender that serviced the loan. As long as borrowers filed forgiveness applications within ten months of the end of their covered period, loan payments were automatically deferred until the SBA made a decision on the application, or until a timely filed appeal of that decision was resolved.

The SBA began to approve PPP Loan forgiveness applications in October 2020. Despite clear guidance and statutory language, lenders and the SBA began to reject forgiveness applications for reasons other than the three limitations mentioned above. Relevant here, the SBA and lenders rejected forgiveness applications because the loan amount was presumably calculated incorrectly, even though lenders had already disbursed that loan amount and borrowers had already spent the loan proceeds.

For example, Veltor Underground, L.L.C. (“Veltor”), a utility construction contractor operating in Michigan and other states, was denied any and all forgiveness of a $125,000 PPP Loan because all of its payroll costs were

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51 Id. § 636m(d)(8).
55 See Laurence Kotlikoff, Bank Of America’s Malfeasant Treatment Of Small Businesses — Brian Moynihan, Pick Up The Damn Phone And Call Ember!, FORBES (Aug. 5, 2021, 2:36 PM), https://www.forbes.com/sites/kotlikoff/2021/08/05/bank-of-americas-malfeasant-treatment-of-small-businesses---brian-moynihan-pick-up-the-damn-phone-and-call-ember/?sh=4dbb92695779 (explaining that Ember, a small business owner, was approved for a PPP Loan through Bank of America for $76,773, and a year later, the bank sent her an email notifying her that only $4,377 would be forgiven because the bank had “made changes based on SBA rule changes that disqualified independent contractors”).
56 See, e.g., US Cargo Direct, Inc. v. PNC Bank, N.A., No. 22 C 3925, 2023 WL 374298, at *3 (N.D. Ill. Jan. 24, 2023) (small business borrower received a PPP Loan of $1,524,200, and after it applied for full loan forgiveness, the lender PNC Bank informed the borrower that only $53,017 of the loan was eligible for forgiveness due to improperly included independent contractor payroll, leaving the borrower with a loan balance of $1,470,983).
composed solely of independent contractor wages. Veltor claims that its lender and an SBA representative who aided Veltor in the PPP Loan process “represented to Veltor that independent contractor compensation was an eligible payroll cost,” leaving Veltor feeling “as though it was the victim of a bait-and-switch by the very hands that were to protect it.”

This process has frustrated small businesses that “would not have taken the full PPP loan had it understood payments made to independent contractor[s] . . . were ineligible for forgiveness.” Such businesses were left with no choice but to begin making payments on the PPP Loan or appeal the forgiveness decision through the SBA’s Office of Hearings and Appeals, a process which could take months or years.

D. The Forgiveness Appeals Process

Appealing the SBA’s forgiveness decision can be as challenging for small business borrowers as the forgiveness process itself. Borrowers denied full or partial forgiveness by the SBA may appeal to the SBA’s Office of Hearings and Appeals (“OHA”), and borrowers have 30 days to file appeals with the OHA from the SBA’s final loan decisions denying full or partial forgiveness.

Appealing borrowers may retain counsel, but are not required to do so, and even if they do, attorneys’ fees are not available to prevailing appellants. SBA rules require appeals to set forth “[a] full and specific statement as to why the final SBA loan review decision is alleged to be erroneous, together with all factual information and legal arguments supporting the allegations.” The rules explicitly preclude the opportunity for oral hearings.

Most concerning for small business appellants is that an SBA final loan decision will only be reversed if the borrower demonstrates a “clear error or fact or law” in the SBA’s forgiveness decision.

A borrower can also seek reconsideration of the OHA’s decision, but again, the OHA will only reverse an earlier decision if the borrower can “clearly show an error of fact or law material to the decision.” A borrower may appeal

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58 Id. ¶ 7.
60 13 C.F.R. § 134.1202(a) (West 2023).
61 Id. §§ 134.1204(a)(2)(i), 134.1213.
62 Id. § 134.1204(a)(2).
63 Id. § 134.1209(b).
64 Id. § 134.1211.
65 Id. § 134.1211(c).
the OHA’s final decision\textsuperscript{66} to a federal district court, but although loan payments are deferred while an OHA appeal is pending,\textsuperscript{67} the loan deferment period does not appear to extend for the duration of a federal appeal.\textsuperscript{68} Furthermore, the SBA’s regulations do not appear to allow the OHA to consider constitutional challenges or challenges to the SBA’s authority to promulgate rules like the Independent Contractor Rule.\textsuperscript{69} Considering this wildly deferential standard of review, restrictions on what the OHA may consider on appeal, and a practically impossible reconsideration standard, many small businesses that appeal to the OHA end up litigating further in federal court, but without the benefit of loan deferment.

III. HOW BUSINESSES WITH INDEPENDENT CONTRACTORS FEEL SLIGHTED BY THE PPP PROCESS.

A. The SBA’s First Interim Final Rule and Independent Contractor Rule

To carry out the mandate of the CARES Act and PPP, Congress required that, no later than 15 days after the enactment of the CARES Act, the SBA issue regulations to carry out the CARES Act, foregoing notice-and-comment requirements under 5 U.S.C.A. § 553(b).\textsuperscript{70} Accordingly, in April 2020, the SBA Administrator promulgated four interim rules.\textsuperscript{71} The first of those rules is discussed herein.

On April 15, 2020, the SBA promulgated the First Interim Final Rule (“FIFR”) to carry out the directives of the CARES Act.\textsuperscript{72} The FIFR outlined crucial information about the nuts and bolts of the PPP and delegated eligibility and calculation tasks to PPP lenders, some of which may not have served as SBA

\textsuperscript{66} A decision of the OHA becomes “final” 30 days after service of the decision upon the appellant. If a petition for reconsideration is filed, the decision becomes final 30 days after the reconsidered decision. \textit{Id.} §§ 134.1211(b), (c).

\textsuperscript{67} \textit{Id.} § 134.1202(b).

\textsuperscript{68} \textit{Id.} § 134.1211(g).

\textsuperscript{69} See \textit{id.} § 134.1201(b) (providing that borrowers may only appeal aspects of an SBA Final Loan Decision concluding that the borrower was ineligible for the PPP Loan or ineligible for the loan amount).


\textsuperscript{72} Business Loan Program Temporary Changes; Paycheck Protection Program, \textit{supra} note 5.
lenders in the past. The FIFR explained, “SBA will allow 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.”\footnote{Id. at 20812.} It also explained that lenders “will be held harmless for borrowers’ failure to comply with program criteria,”\footnote{Id.} even though many borrowers had no choice but to rely on the lender’s expertise.

Notably, in the FIFR, the SBA stated that independent contractors “do not count for purposes of a borrower’s PPP loan calculation” (hereinafter, the “Independent Contractor Rule”).\footnote{Id. at 20813.} This guidance came in the form of a question-and-answer section of the FIFR entitled “What do borrowers need to know and do?”\footnote{Id. at 20812.} The full passage reads as follows:

h. Do independent contractors count as employees for purposes of PPP loan calculations?  
No, independent contractors have the ability to apply for a PPP loan on their own so they do not count for purposes of a borrower’s PPP loan calculation.\footnote{Id. at 20813.}

Similarly, the FIFR stated that independent contractors do not count for purposes of loan forgiveness as well:

p. Do independent contractors count as employees for purposes of PPP loan forgiveness?  
No, independent contractors have the ability to apply for a PPP loan on their own so they do not count for purposes of a borrower’s PPP loan forgiveness.\footnote{Id. at 20814.}

Crucially, the provisions of the FIFR were “effective April 15, 2020,”\footnote{Id. at 20811.} and the FIFR explicitly had “no preemptive or retroactive effect.”\footnote{Id. at 20817.}

Small businesses like Veltor argue that, based on the clear effective date of the FIFR and the CARES Act wording and purpose, the Independent Contractor Rule is arbitrary, capricious, and contravenes the CARES Act and therefore should be inapplicable to all PPP Loans; and the SBA’s application of the Independent Contractor Rule to loan applications filed before April 15, 2020, violates well-established federal law. The next section lays out these budding arguments and their legal underpinnings.
B. The Argument that the Independent Contractor Rule Is Arbitrary, Capricious, and Manifestly Contrary to the CARES Act.

Pursuant to the Administrative Procedure Act, federal courts should “hold unlawful and set aside agency action” that is “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law,” or that is “in excess of statutory jurisdiction, authority, or limitations.” The argument being made by Veltor and other small business borrowers with independent contractors is that the SBA’s interpretation of the CARES Act and promulgation of the Independent Contractor Rule itself is contrary to the plain language of the CARES Act and the SBA’s own guidance.

Courts have applied the familiar Chevron doctrine in challenges to ascertain whether the SBA exceeded its authority under the CARES Act and/or interpreted the Act in a permissible manner. For example, the Eleventh Circuit applied the Chevron doctrine to a bankruptcy debtor’s challenge to SBA’s Fourth Interim Final Rule, which provided that such debtors are ineligible for the PPP. The debtor contended that this provision violated the Administrative Procedure Act. The court explained, “We typically apply the two-step Chevron framework to determine whether an agency exceeded its statutory authority.” Similarly, the Eastern District of Louisiana applied a Chevron analysis to a claim challenging the SBA’s rule that, if an owner of 20% or more of the equity of a business is subject to an indictment for a felony, the business is not eligible to receive a PPP loan. Challenges to the Independent Contractor Rule, which was an agency creation, will likewise invoke Chevron.

Chevron Step One. At step one of the Chevron test, courts ask “whether Congress has directly spoken to the precise question at issue.” If the intent of Congress is clear, “that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.” The judiciary, after all, “is the final authority on issues of statutory construction

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82 Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837 (1984). In January 2024, the United States Supreme Court heard oral argument in Loper Bright Enterps. v. Raimondo, which presents the question of whether Chevron should be overruled. 143 S. Ct. 2429 (2023) (order granting certiorari). Whether and how such a decision would affect the PPP litigation discussed herein is beyond the scope of this article, although PPP borrowers should be aware that the Court’s decision may limit or proscribe the SBA’s authority regarding the Independent Contractor Rule.
84 Gateway Radiology, 983 F.3d at 1249.
85 Id. at 1255.
87 Chevron, 467 U.S. at 842.
88 Id. at 842–43.
and must reject administrative constructions which are contrary to clear congressional intent.\(^{89}\)

At step one, the issue is whether the CARES Act’s definition of “payroll costs” includes independent contractor payroll; that is, whether “Congress has supplied a clear and unambiguous answer to the interpretive question at hand.”\(^{90}\)

Veltor contends that Congress’s intent to include independent contractor payroll in the definition of “payroll costs” is quite clear. To begin, the CARES Act defines “payroll costs” to be “the sum of payments of any compensation to or income of a sole proprietor or independent contractor that is a wage, commission, income, net earnings from self-employment, or similar compensation.”\(^{91}\) This language plainly encompasses compensation made to independent contractors. Moreover, the CARES Act sets forth types of compensation excluded from the definition of payroll costs\(^ {92}\) but does not provide that independent contractor compensation is to be excluded.\(^ {93}\) Veltor invokes the doctrine of *expressio unis est exclusio alterius*, which instructs that “where a law expressly describes a particular situation to which it shall apply, what was omitted or excluded was intended to be omitted or excluded.”\(^ {94}\) By these arguments, Veltor argues that it is clear Congress did not intend to exclude independent contractor payroll from the definition of payroll costs.

It is also helpful to look to the context and purpose behind the CARES Act and its standards for eligibility for the program. The CARES Act dictates that qualifying small businesses employing independent contractors were both eligible for PPP Loans and were entitled to include independent contractor payroll in PPP Loan calculations. To begin, the Act provides that “any business concern . . . shall be eligible to receive a [PPP] loan,” as long as the business does not employ more than a certain number of employees (for first draw loans, 500 employees).\(^ {95}\) By this language, the CARES Act mandates a “broad grant of

\(^{89}\) Id. at 843 n.9.


\(^{92}\) Compensation excluded from the definition of payroll costs includes (a) the compensation of an individual employee in excess of $100,000 on an annualized (prorated) basis; (b) taxes imposed or withheld under certain (inapplicable) chapters of the tax code during the applicable period; (c) any compensation of an employee whose principal place of residence is outside of the United States; (d) certain qualified sick leave wages; and (e) certain qualified family leave wages. 15 U.S.C.A. § 636(a)(36)(A)(viii)(II) (West 2023).

\(^{93}\) Id.

\(^{94}\) Id.

There is simply no language in the CARES Act purporting to exclude businesses employing independent contractors from the scope of the PPP, just as there is no language excluding independent contractor payroll from the loan amount calculation.

Moreover, the plain language of the CARES Act dictates that if a borrower paid independent contractors (and otherwise meets the business size standards), it is eligible for a PPP Loan. The Act provides that, under the PPP, when “evaluating the eligibility of a borrower” for a PPP Loan, the assigned lender “shall consider whether the borrower . . . had employees for whom the borrower paid salaries and payroll taxes; or [] paid independent contractors, as reported on a Form 1099-MISC.” It would make little sense for the CARES Act to deem businesses that pay independent contractors to be eligible for a PPP Loan, but then to deem that business to be ineligible for the loan amount that is based on independent contractor payroll.

As an example of the absurdity stemming from this interpretation, and as set forth by Veltor in its summary judgment motion in the Eastern District of Michigan, Veltor’s payroll costs were composed entirely of independent contractor payroll; therefore, it was clearly eligible for a PPP Loan because it “paid independent contractors.” But according to the SBA’s Independent Contractor Rule, it is entitled to no loan amount whatsoever. Such a result is “glaringly absurd” and must be avoided.

Finally, “[c]ourts must interpret a given statute in accord with Congress’s purposes and intent in enacting it.” Congress created the SBA to “aid, counsel, assist, and protect insofar as it is possible the interests of small-business concerns.” The purpose and spirit of the CARES Act was to keep “American workers” paid and employed. The Act says nothing about keeping only W-2 employees paid and employed, and Congress had been clear that small

2023) (emphasis added). There are other size standards by which the SBA define eligible “small” businesses that are not relevant to the arguments in this Article.

97 During the covered period, “any business concern . . . shall be eligible to receive a covered loan if the business concern . . . employs not more than the greater of . . . 500 employees; or . . . if applicable, the size standard in number of employees established by the [SBA] for the industry in which the business concern . . . operates.” 15 U.S.C.A § 636(a)(36)(D)(i)(I) (West 2023).
98 Id. § 636(a)(36)(F)(ii)(II)(bb) (emphasis added).
businesses eligible for PPP Loans necessarily include those paying independent contractors.

Chevron Step Two. Even if courts consider the definition of payroll costs to be ambiguous, at Chevron step two, the FIFR is arbitrary, capricious, and an impermissible interpretation of the CARES Act for at least two reasons: (1) the FIFR is internally inconsistent; and (2) the SBA provided insufficient and irrelevant reasoning for the creation of the Independent Contractor Rule.

1. The First Interim Final Rule is Internally Inconsistent

Veltor also argues the FIFR itself is internally contradictory. “Illogic and internal inconsistency are characteristic of arbitrary and unreasonable agency action.”\(^{104}\) As explained above, under the heading “What do borrowers need to know and do?” and subheading “Am I eligible?” the FIFR explains that an entity is eligible for a PPP Loan if it “paid independent contractors.”\(^{105}\) Under the heading “What certifications need to be made?” the IFR explains that the borrower must certify that it “had employees for whom it paid salaries and payroll taxes or paid independent contractors.”\(^{106}\) Yet under the Independent Contractor Rule, as applied in cases like the Veltor matter, an eligible business which paid only independent contractors would have no “payroll costs” and could not obtain a loan.

In another part of the FIFR, the agency indicates that borrowers should use compensation paid to independent contractors in the calculation of payroll costs. Specifically, the FIFR sets forth how borrowers should calculate the maximum loan amount:

e. How do I calculate the maximum amount I can borrow?
The following methodology, which is one of the methodologies contained in the Act, will be most useful for many applicants.
i. Step 1: Aggregate payroll costs (defined in detail below in f.) from the last twelve months for employees whose principal place of residence is the United States.

\(i.\) \textit{Step} 2: Subtract any compensation paid to an employee in excess of an annual salary of $100,000 and/or any amounts paid to an independent contractor or sole proprietor in excess of $100,000 per year.

\(iii.\) Step 3: Calculate average monthly payroll costs (divide the amount from Step 2 by 12).


\(^{105}\) Business Loan Program Temporary Changes; Paycheck Protection Program, \textit{supra} note 5, at 20812.

\(^{106}\) \textit{Id.} at 20814 (emphasis added).
iv. Step 4: Multiply the average monthly payroll costs from Step 3 by 2.5.

v. Step 5: Add the outstanding amount of an Economic Injury Disaster Loan (EIDL) made between January 31, 2020 and April 3, 2020, less the amount of any “advance” under an EIDL COVID-19 loan (because it does not have to be repaid).

In turn, subsection “f” defines payroll costs to include “compensation to employees (whose principal place of residence is the United States) in the form of salary, wages, commissions, or similar compensation; . . . and for an independent contractor . . . wages, commissions, income, or net earnings from self-employment, or similar compensation.” Read together, this section of the FIFR clearly contemplates independent contractor wages being used in the loan amount calculation. This is, of course, in stark contrast to the Independent Contractor Rule.

2. The SBA provided insufficient and irrelevant reasoning for the creation of the Independent Contractor Rule

Another way courts may conclude that the FIFR fails at step two of Chevron is—as argued by Veltor—that the SBA did not sufficiently explain its rationale for the Independent Contractor Rule, and the brief reasoning it did provide in the FIFR is not applicable to all loans. The SBA stated only that “independent contractors have the ability to apply for a PPP loan on their own” as a rationale for the Independent Contractor Rule. But courts will likely adjudge this reasoning to be insufficient.

For an agency action to be upheld by the federal courts, the agency must have “examine[d] the relevant data and articulate[d] a satisfactory explanation for its action.” As part of this “satisfactory explanation,” the agency must articulate a “rational connection between the facts found and the choice made.”

The fact that independent contractors could apply for loans on their own does not provide ample support for the Independent Contractor Rule. For one thing, there is nothing precluding small businesses from choosing to use the independent contractor payroll or allowing the contractors to apply on their own. In addition,

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107 Id. at 20812 (emphasis added).
108 Id. at 20813.
110 Business Loan Program Temporary Changes; Paycheck Protection Program, supra note 5, at 20813.
independent contractors could not apply for their own loans until April 10, 2020. By that time, hundreds of thousands of businesses had already applied and were awarded PPP Loans, so this rationale does not apply to their situation at all.

C. The Argument that the Interim Final Rule Should Not Be Applied Retroactively to Loan Applications Submitted Before April 15, 2020

By April 7, 2020, 178,000 PPP Loans totaling $50 billion had already been approved, and one news outlet reported that by April 15, 2020, 1.3 million loans had been approved, with a total value of more than $296 billion. The IFIR (and thereby, the Independent Contractor Rule) was by its terms effective beginning April 15, 2020—not a day sooner. Therefore, there were 1.3 million loans that had been approved before the IFIR was not in effect. Moreover, the SBA—seemingly aware of the rushed nature of the PPP rollout and the constantly changing guidance—issued an FAQ explaining, “Borrowers and lenders may rely on the laws, rules, and guidance available at the time of the relevant application.”

The SBA’s rejection of loan forgiveness for independent contractor payroll also violates black letter law that statutes and regulations cannot be applied retroactively unless there is a “manifest intention” that they are meant to be retroactive. This rule “avoid[s] unnecessary post hoc changes to legal rules on which parties relied in shaping their primary conduct.” Indeed, as Veltor argued in its summary judgment motion, the Supreme Court has made clear that “congressional enactments and administrative rules will not be construed to have retroactive effect unless their language requires this result.”

114 Flitter, McCabe & Cowley, supra note 22.
116 Business Loan Program Temporary Changes; Paycheck Protection Program, supra note 5, at 20811.
118 Union Pac. R.R. Co. v. Laramie Stock Yards Co., 231 U.S. 190, 199 (1913) (internal quotation marks omitted); see also Greene v. United States, 376 U.S. 149, 160 (1964) (explaining regulations “viewed as if they were statutes” should not be given retroactive effect absent a “manifest intention” to do so).
Elementary considerations of fairness dictate that individuals should have an opportunity to know what the law is and to conform their conduct accordingly; settled expectations should not be lightly disrupted. For that reason, the “principle that the legal effect of conduct should ordinarily be assessed under the law that existed when the conduct took place has timeless and universal appeal.”

Accordingly, without express authorization, federal regulations do not and cannot apply retroactively. There is no such authorization here; to the contrary, the FIFR explicitly states that it has no “retroactive effect.” Therefore, there is strong support for the argument that application of the Independent Contractor Rule to loan applications submitted before April 15, 2020, is arbitrary, capricious, and contrary to law.

IV. WHAT CAN BE DONE

Each branch of the American government can play a role in addressing and remedying the chaos the Independent Contractor Rule has caused for many small businesses using independent contractors as the backbone of their workforce.

A. The Legislative Branch: Clarifying or New Legislation

First, Congress can correct the SBA’s misguided interpretation of the CARES Act by issuing clarifying or new legislation explaining that payroll costs of independent contractors who did not apply for PPP Loans on their own could be properly included in the maximum PPP Loan amounts. Such legislation would correspond with the purpose of the CARES Act and would retain consistency with other CARES Act provisions.

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122 Business Loan Program Temporary Changes; Paycheck Protection Program, *supra* note 5, at 20817. According to Veltor’s summary judgment briefing, the OHA has already issued at least one decision in favor of a small business borrower on the ground that “the SBA’s retroactive application of the Independent Contractor Rule to a loan application filed on April 5, 2020 (the same date as Veltor’s application) was ‘clear error.’” Mot. Summ. J. at 10, Veltor Underground, L.L.C. v. U.S. Small Bus. Admin., No. 2:23-cv-11183-TGB-EAS (E.D. Mich. Jan. 12, 2024). The OHA—in a non-precedential but nonetheless relevant ruling—explained that given the effective date of the FIFR, it was clearly erroneous for the SBA to apply the FIFR to the borrower’s loan application. *Id.*
Many times, Congress has issued legislation changing or clarifying the scope of the CARES Act and the PPP. As one example, before Congress established the PPP, the SBA had promulgated regulations setting forth exclusions from eligibility for small business loans, including businesses primarily engaged in lending and pyramid sale distribution plans. These regulations were not specifically adopted in the CARES Act for first round loans. However, when Congress passed the Consolidated Appropriations Act in December 2020, creating round two of the PPP, it explicitly incorporated by reference those eligibility standards. As explained in Part III.C., supra, Congress could also express a manifest intention for the legislation to apply retroactively to unforgiven independent contractor payroll wages.

Congress could also pass legislation providing for recourse against lenders who have made false assurances and misguided claims to borrowers in the loan application process. As explained in Part II.A., supra, the SBA offered lenders processing fees based on the size of loans, ranging from 5% for loans of $350,000 or less to 1% for loans of $2 million, which “gave [lenders] an incentive to increase the size of PPP loans.” As it stands, there is very little accountability on the part of lenders and very little recourse for borrowers. The FIFR declared that lenders “will be held harmless for borrowers’ failure to comply with program criteria.” This ignores the reality that, in the midst of the tumultuous onset of the pandemic, borrowers were left with no choice but to rely on the expertise of lenders participating in the PPP.

B. The Judicial Branch: APA Lawsuits and Class Actions

Attempts to remedy the unfairness and confusion of the Independent Contractor Rule have taken hold in the courts as well. As explained, there is a cropping of federal lawsuits seeking to invalidate the Independent Contractor Rule or, at the very least, its application to borrowers who applied for PPP Loans before April 15, 2020. Plaintiffs in those cases have also sought nationwide injunctions seeking to bar application of the Independent Contractor Rule altogether.

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123 See 13 C.F.R. § 120.110 (West 2023).
126 Stutts, supra note 45.
128 Business Loan Program Temporary Changes; Paycheck Protection Program, supra note 5, at 20812.
In addition, small businesses have begun to file putative class actions against lenders for allegedly pushing PPP Loans to businesses that used independent contractors on the basis that the debt would be forgiven by the SBA.\(^{130}\) Others have lodged claims against lenders for breach of contract, unjust enrichment, breach of fiduciary duty, negligent misrepresentation, and promissory estoppel.\(^ {131}\) Some of these lawsuits claim that the small business “never would have applied for the amounts they applied for without [the lender’s] promises and assurances that the resulting loans would be forgiven.”\(^ {132}\)

As these cases progress, courts will have a chance to address the hastily implemented PPP and the SBA’s internal inconsistencies.

C. The Executive Branch: SBA Policy Change

Finally, the SBA itself can correct the problem by promulgating new rules and/or FAQs and issuing updated guidance changing the Independent Contractor Rule to comport with federal law. Throughout the PPP implementation process, the SBA has made changes to the PPP process and issued guidance documents that are meant to “provide important background on applicable policies, help clarify standards and expectations for various agency

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\(^{130}\) Stutts, supra note 45; see also McCune Law Group, *Class Action Complaint Filed Against Bank of America for Misleading Statements About PPP Program*, CISION PR NEWSWIRE (Feb. 23, 2023, 11:47 PM), https://www.prnewswire.com/news-releases/class-action-complaint-filed-against-bank-of-america-for-misleading-statements-about-ppp-program-301754725.html (discussing class action complaint alleging misrepresentation on the part of PPP lender, explaining, “According to the complaint, Bank of America advertised these livelihood-saving loans as forgivable so long as the funds were used according to stated terms. Although the small businesses complied with those terms, when they later applied for forgiveness, they learned the loans were ineligible for forgiveness because Bank of America had failed to instruct them correctly regarding their application and eligibility for forgiveness.”).

\(^{131}\) U.S. Cargo Direct, Inc. v. PNC Bank, N.A., No. 22-C-3925, 2023 WL 374298, at *1 (N.D. Ill. Jan. 24, 2023) (explaining that US Cargo sued its lender for breach of contract, unjust enrichment, breach of fiduciary duty, negligent misrepresentation, and promissory estoppel after US Cargo applied for and received a PPP Loan for $1,524,200 and used the loan proceeds to pay its workforce, comprised almost entirely of independent contractor truck drivers, believing the loan would be completely forgiven, but in the end, only about $53,000 was forgiven); see also Happy Puppy LA, Inc. v. Bank of Am., No. 2:23-CV-01354-JLS-PD, 2023 WL 6192702, at *1 (C.D. Cal. June 30, 2023), motion to certify appeal denied sub nom. Happy Puppy LA, Inc., et al. v. Bank of Am., N.A., No. 2:23-CV-01354-JLS-PD, 2023 WL 6787778 (C.D. Cal. Sept. 27, 2023) (discussing borrower’s complaint, which alleges that Bank of America ‘‘marketed the [PPP] program to small business owners in a deceptive and misleading way’’ to increase how many PPP loans it originated as well as the loan amounts, which would in turn allow the Bank to profit from higher loan processing fees”).

\(^{132}\) Happy Puppy LA, Inc., 2023 WL 6192702, at *1; see also U.S. Cargo Direct, Inc., 2023 WL 374298, at *3.
audiences, and offer suggested best practices related to SBA’s mission."\(^{133}\) It issues Standard Operating Procedures, Policy Notices, Procedural Notices, and other guidance.\(^{134}\) As an example, on January 27, 2022, the SBA issued a Procedural Notice that allowed borrowers to request an SBA loan review of a partial forgiveness decision from a PPP lender.\(^{135}\) Policy Notices specifically alert businesses to changes in agency policy; for example, the SBA issued a Policy Notice announcing changes to the franchise review process for certain small business loans on February 14, 2017.\(^{136}\)

In addition, the SBA “may review any PPP loan, as the [SBA] Administrator deems appropriate,” including review to determine whether a “borrower is eligible for the PPP loan based on the provisions of the CARES Act . . . [and] the rules and guidance available at the time of the borrower’s PPP loan application.”\(^{137}\) Considering the chaos it has created, and to save small businesses the time and expense of protracted litigation, the SBA must either review PPP Loan applications of businesses using independent contractor payroll and grant forgiveness for independent contractor wages, engage in the rule-making process and rescind the Independent Contractor Rule for all completed and pending forgiveness applications, or at the very least, retroactively limit its application to those applications submitted on April 15, 2020, or after.

V. CONCLUSION

Congress created the SBA to “aid, counsel, assist, and protect insofar as it is possible the interests of small-business concerns.”\(^{138}\) Similarly, the intent of the CARES Act was “that SBA provide relief to America’s small businesses expeditiously.”\(^{139}\) While funds were distributed quickly, the process has provided

\(^{133}\) SBA Guidance, U.S. SMALL BUS. ADMIN., https://www.sba.gov/about-sba/open-government/sba-guidance (last visited Jan. 8, 2024). This is especially crucial now that at least one OHA judge has determined it was clear error for the SBA to apply the FIFR to loan applications submitted before April 15, 2020. See supra note 122.

\(^{134}\) Id.


\(^{139}\) Business Loan Program Temporary Changes; Paycheck Protection Program, supra note 5, at 20812.
certain small businesses anything but relief, and businesses with independent contractors feel anything but aided, counseled, assisted, or protected. The SBA, Congress, and the courts are well poised to clean up the mess created by a hasty and arbitrary launch of the Paycheck Protection Program and restore faith to America’s workforce.