

# CORONAVIRUS INFORMATION & UPDATES

April 5, 2020

## Small Business Administration and Treasury Provide Additional Information on Paycheck Protection Program

\*\*\*This legal development is still in progress. We will update this Alert as additional information is provided.\*\*\*

As previously described in a prior [Alert issued March 27th](#), the bipartisan Coronavirus Aid, Relief, and Economic Security Act (CARES Act), commonly referred to as Phase 3 of the federal government's response to the coronavirus outbreak, was approved by the House and signed into law by the President. Among other measures, the CARES Act establishes a \$350 billion forgivable loan program through the SBA referred to as the Paycheck Protection Program (PPP). While certain participating lenders began accepting PPP applications on Friday, additional guidance from Treasury and the SBA have been issued into the weekend. A copy of the PPP application can be found [here](#) and the Interim Final Rule and additional guidance from Treasury and the SBA can be found as follows: [Interim Final Rule](#), [Interim Final Rule on Affiliation](#), and [Applicable Affiliation Rules](#). Below is a summary of significant provisions around the PPP and key developments:

### Key Loan Terms

- Maximum Loan Amount: 2.5 times the average total monthly payroll costs (excluding compensation to the extent in excess of \$100,000/year and subject to an aggregate \$10 million cap).
- Use of Proceeds: payroll costs, interest on mortgage obligations, rent, utilities, and interest on other outstanding debt incurred prior to February 15, 2020.
  - *Interim rules from the SBA provides that at least 75% of loan proceeds must be used toward payroll costs.*
- Interest: 1.00% fixed rate.
- Maturity: 2 years.
- Collateral: no collateral or personal guarantees required.
- Non-Recourse: loans are nonrecourse.
- Payment Deferral: all loan payments eligible for deferral for 6-12 months

### Eligibility

- Until June 30, 2020, any business is eligible to receive a loan if the business, together with its affiliates (described below), employs not more than the greater of (1) 500 employees, or (2) the size standard in number of employees established by the SBA for the industry in which it operates. Restaurants and lodging businesses with multiple locations may be eligible if each location employs less than 500 employees.
  - *Updated guidance from the SBIC clarifies that, for purposes of determining whether a business has 500 employees, applicants should use the average number of employees during the 12-month period prior to the date of loan application (as opposed to the number of employees as of the loan application application).*

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### Affiliation

- General Principles: The SBA generally includes the employees of a business concern's U.S. and non-U.S. affiliates when determining whether the business concern qualifies to participate in SBA programs, but only U.S. employees count for PPP. The SBA considers factors such as ownership, management, previous relationships with or ties to another concern, and contractual relationships, in determining whether affiliation exists. Control may be affirmative or negative. Negative control includes, but is not limited to, instances where a minority investor has the ability to prevent a quorum or otherwise block action by the board of directors or shareholders. Affiliation may be found where an investor exercises control indirectly through a third party. In determining whether affiliation exists, the SBA will consider the totality of the circumstances, and may find affiliation even though no single factor is sufficient to constitute affiliation.
- Affiliation Through Majority Investments: Ownership of 50% or more of the voting stock of a business concern will result in affiliation under SBA rules and require aggregation of headcount with the majority owner and its other affiliates.
- Common Management of Private Equity Funds: Private equity funds that are under common control are affiliates under SBA rules. In addition, a portfolio company of a private equity fund that is under common control with another private equity fund will be deemed affiliated with both private equity funds and their respective controlled portfolio companies.
- Affiliation Through Minority Investments: The SBA's test for affiliation through minority investment is highly fact specific. In general, affiliation will exist where an investor has negative control/veto rights that affect day-to-day operations. The terms of any minority investment that is potentially eligible for a SBA loan should be closely reviewed.
  - *Based on previous SBA guidance, there was a lack of clarity as to whether veto/consent rights that would be sufficient to give one minority investor control over a company were also a concern if such rights were held by a group of investors (who were not acting in concert). New guidance from the SBA clarifies that applicant should look to 13 CFR 121.301 to determine affiliation, which mitigates this concern.*
- Exceptions to Affiliation: For purposes of PPP, the SBA's affiliation and headcount aggregation rules are waived for the following business concerns:
  - Any business concern with not more than 500 employees that is assigned a NAICS code beginning with 72.
  - Any business concern operating as a franchise that is assigned a franchise identifier code by the SBA.
  - Any business concern that receives "financial assistance" from a company licensed under section 301 of the Small Business Investment Act of 1958.
    - *Based on additional guidance, the SBA will interpret "financial assistance" to include equity investments and loans from SBIC funds and will not interpret the Act to require a minimum investment amount or loan amount from a SBIC fund.*
  - *While there had been some speculation that the SBA rules would offer broad exemption to the affiliation requirements beyond those contained in the CARES Act, neither the Interim Final Rule nor additional SBA*

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*guidance has provided relief generally to the private equity or venture capital industries (subject to the clarification above on companies with multiple investors).*

## Forgiveness

- The maximum loan forgiveness is an amount up to 100% of the payroll costs, mortgage interest payments, rent, and utilities incurred or paid by a borrower during the 8-week period beginning on the date of loan origination (subject to reduction for employee terminations and salary reductions of 25% or more for employees who earned \$100,000 or less in 2019).
  - *Consistent with the requirement on use of proceeds described above, updated guidance from the SBA provides that at least 75% of the loan proceeds must be used for payroll costs in order to obtain full forgiveness.*
- A borrower's maximum forgiveness amount will be reduced if it reduces the number of full-time equivalent employees and/or reduces wage or salary compensation of its full-time equivalent employees.
  - The maximum forgiveness amount will be reduced in the same proportion that the borrower's full-time equivalent employees are decreased during the 8-week period following the origination of the loan measured against the borrower's monthly average full-time equivalent employees from either (i) February 15, 2019, June 30, 2019 or (ii) January 1, 2020-February 29, 2020, at the borrower's election.
- Amount of loan forgiveness will be excluded from taxable income.

## Application Details

- Required Certifications: The application requires that applicants certify the following:
  - Eligibility to receive the SBA loans pursuant to the CARES Act.
  - Employment of no more than 500 employees or is a sole proprietorship, independent contractor or self-employed individual.
  - SBA loan proceeds will only be used for business-related purposes specified in the loan application and PPP rules (i.e. payroll costs, rent, mortgage interest, utilities).
  - Any previous Section 7(b)(2) SBA loan was for a purpose other than paying payroll costs and other allowable uses under PPP rules.
  - Current economic uncertainty makes this loan request necessary to support the ongoing operations of the applicant.
    - *Although the CARES Act removed the requirement (for traditional SBA loans) that the applicant sought other sources of financing before accessing SBA programs, applicants must still make this certification. While there is room for interpretation – and some applicants will be able to easily make this certification – applicants should carefully consider whether they can do so.*
- Required Disclosure: The application also requires disclosure of all owners of 20% or more of the equity of the applicant.

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- Additionally, a list of all other businesses which the applicant or any owner of the applicant owns or has common management with must be listed in an addendum.
- Freedom of Information Act: The application itself has disclosure that most parts of the application will be subject to FOIA requests.
- Lender Diligence: The Interim Final Rule makes clear that lenders are not required to independently verify applications. The SBA has also agreed to hold harmless any lender that relies on the applicant's submitted documents.
  - *Applicants should understand that they should not rely on a pre-approval audit lenders to ensure eligibility and that it is likely that both the government and private parties will be auditing the program after the fact.*

## Additional Considerations

As expected, demand for these loans has been unprecedented and Treasury and the SBA have indicated that they expect demand to exceed loan availability. Already, news and opinion articles are addressing (and Members of Congress are saying) that there will be significant oversight over funds distributed through PPP. Private individuals have also made clear that they intend to exercise their rights under the Freedom of Information Act to identify the recipients of PPP loans with a view to identifying those who, in their view, were not the intended beneficiaries of the program. Applicants should be aware of possible negative public relations consequences of participating in the program (even if clearly eligible), and that clients who take aggressive positions with respect to eligibility may run a heightened risk of scrutiny. For more about possible exposure under the False Claims Act, see [here](#).