
CARES ACT: SUPPORT FOR SMALL BUSINESSES

This Client Alert discusses certain key provisions of the Paycheck Protection Program (“PPP”) and Economic Injury Disaster Loans (“EIDL”) under the Coronavirus Aid, Relief, and Economic Security Act (“CARES”), which was signed into law today.

CERTAIN KEY PROVISIONS OF PPP

PPP will be implemented through Section 7(a) of the Small Business Act, as amended by CARES. Certain key provisions of PPP include:

- Up to \$349 billion of loans to support small businesses for the period from February 15, 2020 to June 30, 2020 (the “covered period”);
- Small businesses are defined as those with not more than the greater of 1) 500 employees or 2) if applicable, the existing Small Business Administration (“SBA”) size standard for the industry in which the borrower operates [with an exception for the accommodation and food sectors industry (NAICS Code 72) to the extent such business has no more than 500 employees per physical location];
- An “employee” includes individuals employed on a full-time, part-time, or other basis;
- Individuals who operate under a sole proprietorship or as an independent contractor and eligible self-employed individuals are eligible to receive a covered loan;
- Loans made during the covered period (“covered loans”) will be 100% guaranteed by the SBA;
- Only SBA-approved lenders may issue covered loans, which include lenders who are not currently SBA-approved but are subsequently approved by the Treasury Department in consultation with the SBA during the covered period;
- Proceeds of the covered loans may be used to pay payroll costs; costs related to the continuation of group health care benefits during periods of paid sick leave, medical or family leave, and insurance premiums; employee salaries, commissions, or similar compensation; interest on mortgage obligations; rent; utilities; and interest payments on other debt obligations incurred prior to the covered period;
- “Payroll costs” include salary, cash tips, leave benefits, insurance premiums, retirement benefits, and state or local tax assessed on the compensation of employees, but excludes compensation of an individual employee in excess of an annual salary of \$100,000, as pro-rated for the covered period, and any compensation of an employee whose principal place of residence is outside the United States;

- The maximum loan amount is determined by a formula based on the average total monthly payments for payroll costs incurred during the 1-year period before the date on which the loan is made multiplied by 2.5 plus any outstanding EIDL loan (discussed below) that is being refinanced by the covered loan, the total of which may not exceed \$10 million (with special rules for seasonal businesses and businesses not in business from February 15, 2019 through June 30, 2019);
- Lenders will be required to provide complete payment deferral for a period of between 6 months and 1 year;
- There is no recourse against any individual shareholder, member, or partner of the business, except to the extent that the loan proceeds are used for an unauthorized purpose;
- No collateral or personal guarantees will be required;
- The interest rate will not exceed 4%, and there will be no prepayment penalties;
- The maximum maturity will be 10 years from the date of loan forgiveness (discussed below);
- Small businesses must certify that the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient; the funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments; the eligible recipient does not have an application pending for a covered SBA 7(a) loan for the same purpose and duplicative of amounts applied for or received under a covered loan; and during the period beginning on February 15, 2020 and ending on December 31, 2020, the recipient has not received amounts under SBA 7(a) for the same purpose and duplicative of amounts applied for or received under a covered loan;
- The SBA will promulgate regulations necessary to carry out CARES within 15 days of the enactment of CARES; and
- The SBA will issue guidance no later than 30 days after CARES is implemented.

AFFILIATIONS RULE GENERALLY APPLICABLE TO PPP

Notably, the “affiliations rule” under the SBA will apply to PPP, but for a few exceptions. The affiliations rule typically aggregates the employees of companies that are under common control. For example, if ABC Company has 300 employees and is owned by a private equity fund that has 1,000 employees across all of its portfolio companies, ABC Company will not qualify as a small business, assuming the small business size standard for ABC Company’s industry is 500 employees. However, CARES waives the affiliations rule for: 1) any small business (500 employees or less) in the accommodation and food sectors industry; 2) any small business operating as a franchise that is assigned a franchise identifier code by the SBA; and 3) any business concern that receives financial assistance from a company licensed under Section 301 of the Small Business Investment Act of 1958.

LOAN FORGIVENESS UNDER PPP

CARES allows certain amounts of a PPP loan to be forgiven so long as it is an amount of principal that a lender reasonably expects a borrower to expend during an 8-week period (beginning on the date of the origination of the loan) on the sum of any:

- Payroll costs;
- Payments of interest only on any covered mortgage obligation;
- Payments on any covered rent obligation; and
- Covered utility payments.

Other important items of notes with respect to this loan forgiveness include:

- The amount forgiven may not exceed the principal amount;
- The costs eligible for forgiveness, other than payroll costs, must have originated or incurred from a source (such as a contract or lease agreement) that was in effect before February 15, 2020;
- Any forgiven amounts will be treated as cancelled indebtedness by the lender and forgiven amounts will not be taxable to the borrower;
- The SBA will remit to the lender the forgiven amount, plus any interest accrued through the date of payment, no later than 90 days after the date that the amount is forgiven;
- Any remaining balance after a reduction based on the forgiveness amount will continue to be guaranteed by the SBA;
- The covered loan will have a maximum maturity of 10 years from the date the borrower applies for loan forgiveness;
- Any loan forgiveness will be reduced if employees were terminated or wages were reduced (as compared to the prior year or, in the case of a seasonal employer, the prior season);
- An eligible recipient with tipped employees may receive forgiveness for additional wages paid to those employees;
- Borrowers that re-hire (by June 30, 2020) workers previously laid off will not be penalized for having a reduced payroll at the beginning of the period;
- Any borrower seeking loan forgiveness must submit to the lender an application that contains the required information and certifications;
- The lender has a 60-day period to render a decision on the loan forgiveness application;
- The lender is held harmless, which means an enforcement action may not be taken against the lender relating to loan forgiveness for the categorical payments outlined, and the SBA cannot penalize the lender; and
- The SBA is required to issue guidance and regulations related to loan forgiveness no later than 30 days after the enactment of CARES.

CONTINUED AVAILABILITY OF EIDLs

EIDLs continue to be available to eligible recipients under Section 7(b)(2) of the SBA. Generally speaking, with respect to EIDLs:

- Recipients can apply directly with the SBA;
- Recipients must be located in a declared disaster area;
- Recipients must be economically impacted by the subject disaster;
- The maximum amount of an EIDL is \$2 million secured for financial obligations and expenses (or \$25,000 unsecured);
- The interest rate will be 3.75% for small businesses and 2.75% for non-profits; and
- CARES allows recipients of EIDLs for the period beginning January 31, 2020 to receive assistance through 7(a) loans, including PPP.

TEMPORARY WAIVERS OF PRE-EXISTING 7(B)(2) REQUIREMENTS

During the covered period for an EIDL, CARES waives the following:

- The personal guarantee requirement on advances and loans of not more than \$200,000;
- The requirement that an applicant needs to be in business for the 1-year period before the disaster (except that no waiver may be made for a business that was not in operation on January 31, 2020); and
- The requirement that an applicant be unable to obtain credit elsewhere.

EMERGENCY GRANTS

During the covered period, an eligible entity that applies for an EIDL can request, within three days after the SBA receives an application, that the SBA provide an advance of no more than \$10,000. These advances are required to be used for an allowable purpose, such as:

- Providing paid sick leave to employees unable to work due to the direct effect of COVID-19;
- Maintaining payroll to retain employees;
- Meeting increased costs to obtain materials unavailable from the applicant's original source due to interrupted supply chains;
- Making rent or mortgage payments; and
- Repaying obligations that cannot be met due to revenue losses.

Notably, an applicant will not be required to repay any amounts of an advance, even if subsequently denied an EIDL. If an applicant receives an advance, yet the applicant then transfers into

the 7(a) program (including PPP), the advance must be reduced from the loan forgiveness amount for a loan made for payroll costs. The SBA's authority to allow these grants terminates on December 31, 2020.

CARES has allocated \$10 billion for these emergency advances, so it is recommended that any clients who are severely strained apply immediately for an EIDL and seek such an advance. Businesses may make an application online directly on the [SBA website](#).

FINAL THOUGHTS

CARES uses, for the most part, the existing SBA structure to deploy the new \$349 billion economic relief program for small businesses, but there are some changes to extend eligibility requirements and waive certain other requirements.

There will likely be a strain on SBA resources and personnel due to the projected increase in demand for SBA loans. Thus, it is imperative that clients seeking SBA loans have documentation ready and apply as soon as possible.

For some clients who likely will not be able to use the SBA relief programs, such as portfolio companies of private equity funds, alternative resources spearheaded by the Treasury Department and the Federal Reserve may be available. Such programs, which are beyond the scope of this Client Alert, generally include:

- A mid-size business program (between 500 and 10,000 employees) for investment-grade companies who are solvent; and
- The soon-to-be announced "main street" lending program left to the Federal Reserve's discretion.

The mid-size business program will be administered through banks and includes a number of restrictions, such as stock buybacks, dividends, employee compensation, offshoring, and union friendliness. The "main street" lending program is in its infancy stages but it is anticipated that this program will not have many of the restrictions included in the mid-size business program.

WE ARE AVAILABLE TO HELP

If you have any questions about the information contained in this Client Alert, please contact the Thompson & Knight attorney with whom you regularly work or one of the attorneys listed below.

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