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SBA Programs Under the CARES Act: Are You Eligible for Federal Assistance?

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As has been well publicized, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) is a $2 trillion economic relief package enacted to help individuals and businesses in the United States weather the severe financial impact of the coronavirus pandemic. A key feature of the relief package is the creation of the Paycheck Protection Program (PPP), which will be administered by the Small Business Administration (SBA) under the umbrella of its 7(a) business loan regime. PPP loans will be made by participating commercial lenders between February 15, 2020, and June 30, 2020, subject to certain eligibility requirements, and will be 100% guaranteed by the SBA. Key features of PPP loans, and eligibility therefore, are summarized in this alert.

What is a PPP loan?

PPP loans will be made by participating commercial lenders between February 15, 2020, and June 30, 2020 (the covered period), to eligible borrowers (see below). These PPP loans are fully guaranteed by the SBA.

Who is eligible for a PPP loan?

In addition to small businesses, any business, nonprofit, veterans organization or Tribal organization is eligible if it employs not more than the greater of:

1. 500 employees; or
2. If applicable, the number of employees the SBA has established as the size standard for the business's primary North American Industry Classification System (NAICS) code.

Additionally, to be eligible an applicant must have been in operation on February 15, 2020, and certify that:

- The uncertainty of current economic conditions makes the loan request necessary to support the ongoing operations of the applicant;
- Funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments or utility payments;
- The applicant does not have an application pending for an SBA business 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 applicant has not received another SBA business loan for the same purpose and duplicative of PPP amounts applied for or received.

How do I count my total employees?

Applicants will count their own employees (including anyone employed on a full-time, part-time or other basis) *and* employees of their "affiliates" (as defined by the SBA rules and discussed below), and will exclude independent contractors.

As referenced above, applicants that are deemed to be "affiliated" with other entities (including their investors) must include affiliates' employees into their headcount for purposes of the PPP eligibility determination. Subject to certain limited exceptions (noted below), the SBA's method of determining "affiliation" will potentially make loan eligibility challenging for venture capital (VC) and private equity (PE) backed companies.

For companies for which the primary NAICS code begins with a 72 (accommodation, food services and drinking places) and for which there is more than one location, the company will be eligible if no one location has more

than 500 employees. Additionally, if the company's primary NAICS code begins with a 72 and the company has no more than 500 employees, the business has been assigned a franchise code by the SBA, or the company receives financial assistance from an SBIC licensed company, the company need not aggregate "affiliates" employees with its own.

For all other companies, the applicant's employee head count will be aggregated with that of any "affiliates" and of any affiliates of an affiliate.

What is an "affiliate" and how might the SBA's affiliation rules impact PPP eligibility?

The SBA considers entities "affiliates" of one another when one controls or has the power to control the other, or a third party controls or has the power to control both. Importantly, the SBA's conceptions of affiliation and control are more expansive than they are in the corporate context and in other legal regimes. For example, minority stockholders of a company are routinely deemed to "control" a company for SBA purposes (and, accordingly, each company "controlled" by the same minority stockholder would have to aggregate all employees across each other, even if otherwise unrelated).

While there are several ways companies can be affiliated,[1] the most common is through stock ownership:

1. A *majority* owner of the company's voting equity is an affiliate.
2. A *minority* owner is considered an affiliate if it can either:
    a. Prevent a quorum of the board of the company's directors or stockholders, or
    b. Veto day-to-day operational (as distinguished from extraordinary) decisions of the company, including encumbering or selling assets (short of all or substantially all assets), amending or terminating lease agreements, purchasing equipment, officer or employee compensation decisions, hiring and firing officers and executives, incurring debt, paying distributions or dividends, bringing or defending a lawsuit, approving or changing the budget, changes in strategic direction (aside from entering into a substantially different line of business), or establishing or amending an incentive or employee stock ownership plan.

Many PE and VC deals include some of these operational covenants and, as such, affiliation can be especially problematic for VC- and PE-backed companies. Where an investor is considered an affiliate of the PPP loan applicant, and the same investor also "controls" other entities (e.g., portfolio companies), those relationships would result in the aggregation of employee head counts across multiple, otherwise separate businesses, potentially putting the applicant itself over the PPP employee threshold.

What if an applicant company has access to credit elsewhere?

The PPP waives the ordinary requirement that a 7(a) business loan applicant be unable to obtain credit elsewhere.

Does any 20%+ owner or more of the company have to inject excess liquid capital prior to the PPP loan?

Recent SBA guidance indicates that the typical 7(a) requirement that any 20% or more owner of the applicant inject any liquid assets above a certain threshold in order to reduce the amount of the loan is part of the waived "credit elsewhere" requirement noted above, and therefore will likewise not apply to PPP loans. However, this guidance is not certain and the SBA may issue guidance clarifying the application of the liquid assets rule to the PPP. For businesses with 20% or more owners that hold liquid assets above the applicable threshold, additional analysis may be required.

If a business is eligible for a PPP loan, what loan amount can it apply for?

The PPP loans may not exceed 250% of the applicant business's average monthly "payroll costs" (see below) from (generally) the year prior to the loan, up to a total maximum of $10 million.

What costs are included in "payroll costs"?

Payroll costs include the total amount of any compensation to (1) employees in the form of a salaries, wages, commissions, cash tips, payments for leave, severance, group health care benefits, retirement benefits, or state or local taxes assessed on employee compensation, and (2) a sole proprietor or independent contractor in the form of wages, commissions, income or similar payments not to exceed $100,000 per sole proprietor or independent contractor in one year prorated for the covered period.

Are any payroll costs excluded?

Payroll costs may not include: (1) compensation to an individual employee in excess of an annual salary of $100,000, prorated for the covered period, and (2) certain other taxes, compensation of employees whose principal place of residence is outside the US, and qualified sick or family leave for which credit is allowed under the Families First Coronavirus Response Act.

So the maximum salary recoverable for each employee is what, exactly?

For any employee whose salary is $100,000 or more, only $8,333 per month can be included in the calculation of average monthly payroll costs, in addition to that employee's cost of health and retirement benefits and state and local taxes prorated for the covered period.

How can the PPP loan proceeds be used?

During the period from February 15, 2020, to June 30, 2020 (the covered period), the loans can be used for payroll costs, health care benefits, mortgage interest, rent, utilities and interest on any other debt obligation that was incurred before February 15, 2020.

Does the PPP loan need to be repaid, or is all or a portion forgivable?

Recipients can apply for and receive forgiveness of all or a portion of a PPP loan. Subject to some limitations (the main ones are noted below), generally forgiveness will be equivalent to the amounts the applicant can document that it paid in the eight weeks following origination of the loan for payroll, mortgage interest, rent and utilities (Expected Forgiveness Amount). Amounts used to pay interest on other obligations will not be forgiven. No amounts paid outside of the covered period of the loan are forgivable.

Wait, if my loan amount covers 2.5x my monthly payroll and other costs, but only eight weeks of those expenses are forgivable, will I owe the remainder back

to the lender?

Yes, the act allows for a maximum forgiveness of 8 weeks of approved costs. The remainder will be treated as a loan. Remember that the approved costs subject to forgiveness are broader than just payroll, and also include mortgage interest, rent and utilities.

What if the company has or will conduct layoffs or implement salary reductions?

The amount of the PPP loan actually forgiven by the SBA will be reduced by both of the following:

1. Multiplying the Expected Forgiveness Amount by the average number of full-time equivalent employees per month the recipient employed during the covered period divided by the average number of full-time equivalent employees per month that the company had either:
    a. From February 15, 2019, through June 30, 2019, or
    b. From January 1, 2020, through February 29, 2020.[2]
2. The amount of any reduction in the total salary or wages of any employee during the covered period that was in excess of 25% of the employee's salary or wages during the most recent full quarter prior to the covered period.[3]

What if I rehire and/or raise salaries back to their prior level?

The act provides that where layoffs or salary reductions occurred between February 15, 2020, and April 26, 2020, the PPP loan forgiveness reduction will not recognize those if the reductions in personnel or decrease in salaries are undone prior to June 30, 2020. We expect that the SBA will issue shortly clear guidance on how to calculate any reduction in loan forgiveness amounts.

What are some other important PPP loan terms?

No personal guarantee or collateral is required. The loans are fee-free, and payments of principal and interest are deferred for at least six months and up to a year. Any remaining balance on the loan after forgiveness will remain fully guaranteed by the SBA and subject to a maximum interest rate of 4% and maturity of 10 years.

How and when should a company apply?

We expect the SBA to issue guidance and an application process in the coming days or weeks, including clarifying certain aspects of the PPP loans eligibility and creating a work stream for application submittal. However, the act authorizes the SBA to guarantee up to $349 billion for this and its other lending programs, meaning that once that monetary threshold is reached, absent further Congressional action, no further loans could be guaranteed. Because the covered period for loan uses ends on June 30, 2020, and the maximum forgiveness period is eight weeks, any loan obtained after May 5 may not enjoy the full forgiveness period.

For this reason, companies should begin discussing potential applications with their lender and collecting documentation and information related to its employee headcount, average monthly payroll costs and other permitted loan costs for the past year, and SBA Form 1919, which the SBA may modify specifically for the PPP. If a company's existing lender does not plan to offer PPP loans, companies can contact other banks in their area that are SBA loan program participants. Existing participating lenders are listed on the SBA website for the district in which the company is located, and the SBA is authorized to add additional lenders for this program.

Can a company also apply for an Economic Injury

Disaster loan (EIDL) under the act?

Yes. The act likewise expands access to SBA's economic injury disaster loans (EIDL) program to businesses with fewer than 500 employees. The same affiliation issues described above apply. Eligible businesses that suffer substantial economic injury as a result of a disaster or emergency, which now includes COVID-19, can apply for a loan under this program between January 31, 2020, and December 31, 2020.

No personal guarantee is required for EIDLs under $200,000, and the loan can be made solely upon the applicant's credit score. Initial advances of up to $10,000 can be issued within three days and need not be repaid. The loan will bear a low rate of interest; however, unlike PPP 7(a) loans, the act does not provide for forgiveness for EIDLs. Businesses may receive both PPP loans and EIDLs, so long as both loans are not used for the same purpose or otherwise duplicative.

For more about the CARES Act, see our overview alert.

Please contact a member of Cooley's government contracts team shown below, who are available to help companies and investors with questions regarding the act, including the SBA's affiliation rules.

Coronavirus resource hub

Notes

1. For the complete list of bases for affiliation, see 13 CFR § 121.301(f).
2. The applicant may choose which denominator will result in a lower forgiveness reduction. Additionally, when calculating FTEs, "the average number of full-time equivalent employees shall be determined by calculating the average number of full-time equivalent employees for each pay period falling within a month."
3. Notably, this reduction only applies for employees who did not receive, during a single 2019 pay period, salary or wages at an annualized rate of pay over $100,000 (i.e., you may reduce the salary of any >$100,000 earning employee without impacting the forgiveness amount).

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