CORPORATE ALERT | APRIL 8, 2020

The Coronavirus Aid, Relief, and Economic Security (CARES) Act – Financial Relief for Businesses

By Sarah Hewitt

On March 27, 2020, the President signed the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") into law - the third piece of federal legislation addressing the COVID-19 pandemic. The CARES Act follows passage of the Coronavirus Preparedness and Response Supplemental Appropriations Act and the Families First Coronavirus Response Act ("FFCRA"). While the first law focused on COVID-19 preparations and the FFCRA focused on paid leave, the CARES Act provides financial relief for small and medium-sized businesses during the coronavirus crisis.

Small and medium-sized businesses affected by the COVID-19 outbreak may find some relief in Title 1 of the CARES Act, which provides $377 billion in funding for loans and other assistance. Title 1 of the CARES Act contains three main provisions which: (1) allocate up to $349 billion through June 30, 2020 in 100 percent federally guaranteed potentially forgivable Small Business Administration ("SBA") loans to help small businesses keep workers employed amid the pandemic and economic downturn through the addition of the newly-created Paycheck Protection Program; (2) provide $10 billion in direct grants for businesses that do not qualify for the currently-existing Economic Injury Disaster Loan Program ("EIDLP"); and (3) allocate $17 billion to the SBA to provide six months of principal and interest payments for all currently outstanding SBA-backed business loans. This Alert addresses the key details of these three forms of financial relief for businesses.

THE PAYCHECK PROTECTION PROGRAM

The CARES Act stimulus package contains changes to the SBA's 7(a) loan program which has been amended to create the Paycheck Protection Program ("PPP") to incentivize small businesses to continue to employ workers and to pay employee benefits. The Treasury Department made certain revisions to and provided additional guidance for the PPP on March 31, 2020 and the SBA issued additional guidance on April 2, 2020. Subsequent policy clarifications should be expected from these agencies.

Loan Terms

Under the CARES Act, small businesses may take out SBA loans of up to the lesser of $10 million and 2.5 *times* the average total monthly payroll costs incurred during the year prior to the loan date, as discussed in more detail below. The interest rate on loans under the PPP may not exceed 4 percent and is currently at a fixed rate of 1.0 percent. Interest payments are deferred for six months but interest will continue to accrue over this period. The maximum term of the loan is currently two years and can be prepaid without penalty or fees. There is no revenue requirement for eligibility unlike traditional SBA loans.

There is no requirement to evaluate the borrower's ability to repay the covered loan or that the borrower sought and was not able to find credit elsewhere, unlike the standard 7(a) loan program requirements. There are no collateral or personal guarantees required for borrowing. Loan administrators will have no recourse against any individual, shareholder, member or partner of an eligible loan recipient for non-payment, unless the individual uses the loan proceeds for unauthorized purposes in which case the U.S. government may pursue criminal charges.

All loan terms will be the same for every business. Only one PPP loan can be requested by a business. The period covered by the PPP is from February 15, 2020 to June 30, 2020.

Who is Eligible?

To be eligible for a loan under the Paycheck Protection Program, a business or non-profit must (1) have been operational on February 15, 2020; (2) have paid salaries and payroll taxes to employees or paid independent contractors; (3) be substantially impacted by public health restrictions related to COVID-19; and (4) make a good faith certification that it (a) has been affected by COVID-19, (b) will use funds to retain workers, maintain payroll, and address other debt obligations, and (c) is not receiving funds from another SBA program for the same uses. A fact sheet regarding the PPP can be found here: https://home.treasury.gov/system/files/136/PPP--Fact-Sheet.pdf.

Small businesses eligible for the PPP include:

- small businesses with fewer than 500 employees, regardless of status and hours worked;
- small businesses that otherwise meets the SBA's size standards found at https://www.sba.gov/document/support--table-size-standards;
- 501(c)(3) nonprofit organizations with 500 or fewer employees;
- sole proprietors, independent contractors, and individuals who are self-employed and regularly carry on any trade or business; and
- certain special categories, like tribal business concerns, veterans organizations, and small businesses in the accommodation and food services industries (see NAICS code 72) or that are franchises in the SBA's Franchise Directory that employ 500 or fewer employees or meet the applicable SBA size standards described above.

Borrowers must include their affiliates when applying size tests to determine eligibility for a PPP loan. The detailed affiliate rules found in 13 C.F.R. 121.103, which are very broad, currently do not apply to PPP borrowers. The regulation at 13 C.F.R. 12.103(a)(8) provides that applicants in the SBA's business loan programs (which include the PPP) are subject to the affiliation rule contained in 13 C.F.R. 121.301, so these latter rules will apply to PPP borrowers. This means that concerns and entities are affiliates of each other when one controls or has the power to control the other, or a third party or parties controls or has the power to control both. It does not matter whether control is exercised, so long as the power to control exists. Affiliation can be based on such factors as ownership, management, previous relationships with or ties to another concern, and contractual relationships as well as totality of circumstances.

In order to help potential borrowers identify other businesses with which they may be deemed to be affiliated, the application form requires applicants to list other businesses with which they have common management so they can assess whether they have affiliates that should be included in the number of their employees reported on the application.

A small business that is controlled by a private equity sponsor is likely to be considered an affiliate of the other businesses controlled by that same equity sponsor, perhaps causing these small businesses to be ineligible for the PPP. However, the CARES Act waives the SBA's affiliation standards for small businesses in the accommodation and food services industries, those that are franchises in the SBA's Franchise Directory, or those that receive financial assistance from small business investment companies licensed by the SBA.

The Treasury Department has said that it may release additional guidance on affiliation standards, as appropriate.

How Much Can You Borrow?

Under the CARES Act, small businesses may take out SBA loans of up to the lesser of $10 million and 2.5

times the average total monthly payroll costs incurred during the year prior to the loan date (there is a different calculation for seasonal employers) *plus* any outstanding loan amounts made under the EIDLP between January 31, 2020 and the date on which the loan may be refinanced as part of this new program. In the alternative, a loan may be up to 2.5 *times* the average total monthly payroll costs incurred for January and February 2020 for small businesses not operational in 2019 *plus* any outstanding loan amounts made under the EIDLP between January 31, 2020 and the date on which the loan may be refinanced as part of this new program.

Payroll costs consist of the sum of all "included" payroll costs minus the sum of all "excluded" payroll costs. Included payroll costs for small business employers include all payments of any employee compensation that is (i) salary, wage, commission or similar compensation; (ii) payment of cash tip or equivalent; (iii) payment for vacation, parental, family, medical, or sick leave; (iv) allowance for dismissal or separation; (v) payment required for the provision of group health care benefits, including insurance premiums; (vi) payment of any retirement benefit; and (vii) payment of state or local tax assessed on the compensation of the employee. Payroll costs for sole proprietors, independent contractors, and self-employed individuals consist of the sum of payments of any compensation to or income of a sole proprietor or independent contractor that is wages, commissions, income, net earnings from self-employment, or similar compensation, in an amount not more than $100,000 in any one year, as pro-rated for the covered period.

Excluded payroll costs include (i) compensation of an individual employee in excess of an annual salary of $100,000 pro-rated for the period February 15 to June 30, 2020; (ii) payroll taxes, railroad retirement taxes, and income taxes; (iii) any compensation of an employee whose principal place of residence is outside of the United States; and (iv) qualified sick leave wages for which a credit is allowed under section 7001 of the FFCRA or qualified family leave wages for which a credit is allowed under section 7003 of the FFCRA.

What Can You Use the Loan For?

The loans provided under the PPP may be used for employee compensation including salary, wages and commissions or tips, through June 30, 2020, up to $100,000 on an annualized basis per employee. Employers also may use the loans for: group health care benefit costs including insurance premiums; payments for vacation, parental, family, medical, or sick leave (other than payments for paid leave provided per FFCRA); severance payments; payments required for retirement benefits; and state and local employment taxes. A sole proprietor or independent contractor may use the loans provided under the PPP for wages, commissions, income, or net earnings from self-employment, up to $100,000 on an annualized basis per employee. Notably, the PPP loans can only be used to pay employees based in the United States.

In addition to salary assistance, the loans may be used for rent payments under lease agreements in force before February 15, 2020; interest on mortgage obligations incurred before February 15, 2020; utility payments for services which began before February 15, 2020; and interest on loans incurred prior to February 15, 2020.

How Can You Apply and What Are Lenders Looking For?

Small businesses and sole proprietorships may apply for a PPP loan beginning April 3, 2020 and independent contractors and self-employed individuals may apply beginning April 10, 2020. A sample form of the PPP loan application is now available on the SBA website. See the loan application at https://www.sba.gov/document/sba-form--paycheck-protection-program-ppp-sample-application-form-0.

Businesses should first gather the information for the PPP application. Completing the form in advance will help to ensure the needed information is readily available. Applications and payroll documentation should be submitted to an approved lender by June 30, 2020. However, businesses are encouraged to apply as early as possible since there is a funding cap and lenders will need time to process the application.

Businesses may apply through any existing SBA lender or through any participating federally insured depository institution, federally insured credit union, and Farm Credit System institution. Visit www.sba.gov for a list of SBA lenders. Other regulated lenders may be available once approved and enrolled in the program.

Some financial institutions are giving priority for PPP loans to existing business customers (ideally with online banking credentials). Companies should consider applying for a PPP loan through their current financial institution if it is an SBA approved lender. Most financial institutions will make PPP applications available on their website for businesses to apply online and upload the needed documentation.

In evaluating eligibility, lenders are directed to consider whether borrowers meet the criteria for PPP loans as described above and as contained in SBA guidelines issued pursuant to the CARES Act.

Lenders will ask for a good faith certification, among other things, that (i) current economic uncertainty makes the loan request necessary to support ongoing operations; (ii) the funds will be used to retain workers and maintain payroll or make mortgage, lease, and utility payments; (iii) the borrower does not have an application pending for a loan duplicative of the purpose and amounts applied for under the PPP; (iv) during the period beginning on February 15, 2020 and ending on December 31, 2020, the borrower has not and will not receive another loan under the PPP, although there is an opportunity to fold emergency loans made pursuant to the EIDLP between January 31, 2020 and April 3, 2020 into the new PPP loan; and (v) the borrower will provide to the lender documentation that verifies the number of full-time equivalent employees on payroll and the dollar amounts of payroll costs and covered mortgage interest, rent and utility payments for the eight weeks after getting the loan. False certification of a PPP loan application could subject the officer who signs the application to criminal penalties which may not be covered under a directors and officers liability insurance policy.

Here is a partial checklist of important information to consider gathering for the PPP application:

- Schedule of payroll costs for calendar year 2019 used in computing average monthly payroll, excluding costs over $100,000, on an annualized basis for each employee;
- 2019 payroll reports and 941 filings;
- 1099s for 2019 for independent contractors who would otherwise be an employee of the business;
- Documentation showing the total of all health insurance premiums paid in 2019 and YTD 2020 by the company under a group health plan;
- Documentation for the sum of all retirement plan funding that was paid by the company in 2019, not including funding that came from employees out of their paycheck deferrals;
- For independent contractors, sole proprietors, or self-employed individuals, lenders will also look for certain documents such as payroll tax filings, Forms 1099-MISC, and income and expenses from the sole proprietorship.

Loan Forgiveness

Potential borrowers should be aware of the loan forgiveness provisions of the PPP that incentivize employers to keep staffing and wages at or near the status quo. Borrowers are eligible for loan forgiveness as long as the loan proceeds are used to cover: payroll costs; interest payment on any mortgage incurred before February 15, 2020; rent on any lease in force before February 15, 2020; and utilities for which service began before February 15, 2020. These costs must be incurred in the eight week period after the loan is made and while employment and compensation levels are maintained. Loan amounts used for any other purpose will not be forgiven. Payroll costs are capped at $100,000 on an annualized basis for each employee. It is expected that not more than 25 percent of the forgiven amount may be used for non-payroll costs.

Loan forgiveness is available as early as eight weeks after the date the loan is made. However, the forgiveness amount may be reduced if there are fewer employees at the end of the covered period, February 15, 2020 – June 30, 2020, than there were at the conclusion of the last quarter ending prior to February 15, 2020. In the alternative, forgiveness amounts will be reduced if any employee's salary is reduced by more than 25 percent when compared with the employee's salary at the end of the last quarter prior to February 15, 2020. Businesses have until June 30, 2020 to restore their full-time employment and salary levels for any changes made between February 15, 2020 and April 26, 2020.

To request loan forgiveness, borrowers should submit a request to their lender with documents that verify the number of full-time equivalent employees and pay rates. Documentation may include payroll tax filings, state income tax filings, and payments on eligible mortgage, lease, and utility obligations. Certification is required that the documents are true and that the forgiveness amount was used to retain employees and make eligible mortgage interest, rent, and utility payments. Borrowers that rehire workers previously laid off cannot be penalized for having reduced payroll at the beginning of the period. The lender has 60 days to make a decision on the forgiveness.

The loan forgiveness feature of the PPP is a significant benefit for small businesses during these times of economic uncertainty. Small businesses interested in these loans and also considering furloughs, layoffs, or salary reductions should ensure that their staffing decisions will not adversely impact any forgiveness possible through the PPP loan program.

Relationship with EIDLP

If a borrower already received an EIDL, the borrower can also apply for a loan under the PPP if the EIDL was used for a purpose other than those permitted for PPP loans.

EXPANSION OF THE ECONOMIC INJURY DISASTER LOAN PROGRAM

The CARES Act stimulus program contains changes to the Economic Injury Disaster Loan Program ("EIDLP") which has now been expanded to allow the SBA to make loans of up to $2 million available for small businesses and non-profits to cover the period of January 31, 2020 to December 31, 2020.

Loan Terms

The EIDLP offers loans ("EIDLs") at 3.7 percent fixed interest rate on loans to for-profit companies or 2.75 percent fixed interest rate to non-profit companies. EIDLs have up to 30-year terms and amortization, determined on a case-by-case basis, based on the borrower's ability to repay the loan. The CARES Act waives the requirement that the borrower provide a personal guarantee for loans up to $200,000. There are no up-front fees or early payment penalties charged by the SBA.

Who is Eligible?

In addition to entities traditionally eligible for EIDLs, including small business and non-profits in declared disaster areas, the following may also receive EIDLs under the CARES Act:

- businesses with 500 or fewer employees;
- sole proprietorships, with or without employees, and independent contractors;
- cooperatives with 500 or fewer employees; and
- Employee Stock Ownership Plans (ESOPs) with 500 or fewer employees.

The SBA is also empowered to approve applicants for small-dollar loans solely based on a borrower's credit score or alternative appropriate methods to determine an applicant's ability to repay.

The CARES Act waives the requirement that the eligible business be in operation for one year before the disaster and the borrower be unable to obtain credit elsewhere.

How Much Can You Borrow?

Loan amounts are based on a company's actual economic injury and financial need, up to $2 million per loan.

Borrowers seeking an immediate influx of funds may receive a $10,000 emergency advance within three days after applying for an EIDL. If the EIDL application is denied, the borrower is not required to repay the $10,000 advance. Emergency advance funds can be used for payroll costs, increased material costs, rent or mortgage payments, or repaying obligations that cannot be met due to revenue losses.

What Can You Use the Loan For?

The EIDL may be used to meet financial obligations and operating expenses that the company would otherwise have been able to meet had the COVID-19 pandemic not occurred.

How Can You Apply?

Those that qualify can apply online using the application available on the SBA's website. Companies must be prepared to provide a personal financial statement, a schedule of liabilities, a signed and dated IRS Form 4506-T giving permission for the IRS to provide the SBA with their tax return information, and certification as to the truthfulness of the information provided in the application.

The SBA noted that review of applications for COVID-19 related EIDLs is likely to take about five days. If approved, disbursement of funds is to occur three weeks after approval. As the number of applicants increases, the timeline before funding is released is likely to extend beyond three to four weeks.

The SBA is working directly with state governors to provide EIDLs to small businesses and non-profits that have been severely impacted by COVID-19.

Loan Forgiveness

There is no loan forgiveness feature for EIDLs except the $10,000 emergency advance option.

Relationship with PPP

If a borrower already received an EIDL, the borrower can also apply for a loan under the PPP if the EIDL was used for a purpose other than those permitted for PPP loans.

EIDL loans may be refinanced with proceeds of PPP loans, which may increase the maximum available PPP loan by the amount of the refinanced EIDL.

Small Business Resiliency

Businesses already approved for EIDLs can borrow an additional 20 percent to pay for business continuity and resilience improvements to ensure that these companies are better equipped to handle any new economic disturbances.

SBA DEBT RELIEF

To relieve the burden of current SBA loans on small businesses, the CARES Act provides existing SBA borrowers with six months of relief from SBA loan payments for principal, interest, and fees. It also permits banks to extend the duration of existing loan terms and provides an extension on certain reporting requirements.

CONSENT REQUIREMENTS

Borrowers should consider whether they require consent from any lenders, landlords, or investors under existing debt facilities, leases, and investment documents in connection with borrowing an EIDL or under the PPP. Because these new loans do not require borrowers or their affiliates to provide personal guarantees, these loans are unsecured and, therefore, effectively junior to existing secured debt instruments.

CONCLUSION

The CARES Act and the FFCRA provide significant financial support to small and medium-sized businesses. The SBA is expected to provide further guidance, as needed, through formal notices and a program guide which will be posted on the SBA's website at www.sba.gov. Businesses are encouraged to apply as early as possible for PPP loans and EIDLs since there are funding caps and lenders will need time to process the applications.

This Alert is based on information available at the time of publishing. It is subject to change. Business leaders should consult with counsel and refer to government websites and publications for the most up-to-date information.

For more detailed analysis on a wide range of legal issues, please see Schnader's COVID-19 Resource

Center at www.schnader.com/blog/covid-19-coronavirus-resource-center. ◆

This summary of legal issues is published for informational purposes only. It does not dispense legal advice or create an attorney-client relationship with those who read it. Readers should obtain professional legal advice before taking any legal action.

For more information about Schnader's Corporate Practice Group or to speak with a member of the firm, please contact:

Sarah Hewitt
Chair, Corporate Practice Group
212-973-8123
shewitt@schnader.com

www.schnader.com

** See: www.schnader.com/jakarta*