

COVID-19 Pandemic Small Business Lending Under the CARES Act's Paycheck Protection Program

Skadden

April 6, 2020



If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Seth E. Jacobson

Partner / Chicago
312.407.0889
seth.jacobson@skadden.com

Richard L. Oliver

Partner / Washington, D.C.
202.371.7248
richard.oliver@skadden.com

Michael Tomczyk

Associate / Chicago
312.407.0769
michael.tomczyk@skadden.com

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

One Manhattan West
New York, NY 10001
212.735.3000

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act), which became law on March 27, 2020, authorized \$349 billion for the Small Business Administration (SBA) to guarantee loans under Section 7(a) of the Small Business Act. Importantly, the CARES Act amended the Small Business Act by creating the Paycheck Protection Program and provides for forgiveness of up to 100% of the full principal amount of the qualifying loans guaranteed under the program. Businesses considering applying for a loan under the new program should understand the eligibility, terms and other considerations of the Paycheck Protection Program before applying.

Highlights of the Paycheck Protection Program

The Paycheck Protection Program (as implemented by the applicable regulations):

- expands eligibility for Section 7(a) loans;
- provides for 100% loan guarantees by the Administrator;
- provides for loans in an amount equal to the lesser of \$10 million or the sum of (a) 2.5 multiplied by the applicant's average total monthly payments for payroll costs incurred during the one-year period before the loan is made plus (b) the outstanding amount of Economic Injury Disaster Loan that was made during the period beginning on January 31, 2020, and ending on April 3, 2020;
- provides for loans with a 1% interest rate and a two-year maturity;
- waives the requirements of collateral, personal guarantees and a showing that credit is not otherwise available; and
- defers principal and interest payments for six months (although interest accrues during that period).

At least 75% of the proceeds of the loan must be used for payroll costs. The other 25% may be used for rent, utilities, mortgage interest and interest on debt incurred before February 15, 2020. As an incentive for businesses to retain precrisis employment levels, pursuant to Section 1106 of the CARES Act, loans may be forgiven up to the amount of payments made for payroll costs, rent, utilities, mortgage interest and interest on debt incurred before February 15, 2020. The amount of forgiveness may be reduced due to reduction in employees or reduction in salary.

COVID-19 Pandemic Small Business Lending Under the CARES Act's Paycheck Protection Program

Paycheck Protection Program Eligibility

Borrowers. Applicants may apply to lenders for Paycheck Protection Program loans between April 3, 2020, and June 30, 2020. Small business concerns, as defined by the SBA, other business concerns, and certain nonprofits, veterans and tribal organizations, are eligible to participate in the Paycheck Protection Program if, combined with their affiliates, they employ no more than 500 employees whose principal place of residence is the United States. Alternatively, they may qualify if they employ no more employees than the applicable size standard for the borrower's industry as established by the SBA, provided that the current affiliation rules are waived for certain types of business concerns (discussed below). Under the Paycheck Protection Program application published by the Department of the Treasury, the applicant must certify, among other things, as to its eligibility, that current economic uncertainty makes the loan request necessary to support the ongoing operations of the applicant, and funds will be used to retain workers and maintain payroll or mortgage payments, lease payments and utility payments. The applicant must represent that all of the loan proceeds will be used only for business-related purposes that are specified in the loan application. Borrowers must have been in operation before February 15, 2020, and had employees for whom it paid salaries and payroll taxes or independent contractors, as reported on a Form 1099-MISC.

Lenders. The SBA will delegate authority to approved lenders to issue Paycheck Protection Program loans through the newly created Preferred Lenders Program (PLP). Loans under the Paycheck Protection Program may be initiated, funded and serviced by SBA-approved lenders, which include federally regulated lenders and those regulated by federal financial institution lenders (e.g., Federal Deposit Insurance Corporation, The Federal Reserve Board) as well as SBA-supervised lenders. The Paycheck Protection Program permits additional lenders to participate so long as they possess the necessary qualifications as established by the SBA and the Secretary of the Treasury to process, close, disburse and service loans guaranteed by the SBA. Under the PLP, the loan process is streamlined by delegating the final credit decision and most servicing and liquidation authority and responsibility to PLP lenders. Lenders will review applications to determine whether they meet standard, conventional underwriting guidelines or if they require an SBA guaranty. PLP loan approvals are subject only to a brief eligibility review and the assignment of a loan number by the SBA; such lenders draft the SBA authorizations of loan guaranty approvals without the need for SBA's review and execute them on behalf of SBA. Lenders are entitled to rely on the representations of borrowers and documents supported by borrowers in support of their applications.

General Terms and Conditions of Paycheck Protection Program Loans

All loan terms will be the same for everyone. Borrowers are limited to only one Paycheck Protection Program loan. The maturity for the Paycheck Protection Program loans will be two years, and the interest rate will be 1% fixed rate. Loan payments are deferred for six months, but interest will accrue during this time.

The maximum loan amount is the lesser of \$10 million or 2.5 multiplied by the applicant's average total monthly payments for payroll costs incurred during the one-year period before the loan is made plus the outstanding amount of Economic Injury Disaster Loan that was made during the period beginning on January 31, 2020, and ending on April 3, 2020. The lender will calculate the eligible loan amount by using submitted tax documents. Payroll costs include payments for compensation of employees, such as wages, leave of absence payments, severance benefits, health care benefits, retirement benefits, and income taxes by states or localities. The payroll costs used to determine the loan amount are limited to \$100,000 per year per individual, pro-rated as necessary. Payroll costs do not include costs for individuals whose principal place of residence is not within the U.S.

Proceeds of the loans under the Paycheck Protection Program may only be applied for limited uses. The proceeds of a loan under the Paycheck Protection Program may cover mortgage interests, payroll costs, health benefits, compensation, rent, utilities and interests on debt incurred prior to February 15, 2020. Such expenditures and employment levels must be documented and submitted to the lender for the eight weeks following the loan commencement. Not more than 25% of the loan proceeds may be used for nonpayroll costs.

Additional Considerations

Affiliation and Eligibility. For determining whether the size test for Section 7(a) loans is met, borrowers must include the employees of its affiliates. Business concerns and entities are affiliates of each other when one controls or has the power to control the other, or a third party controls or has the power to control both. The rules published by the Treasury on April 3, 2020, set forth four bases of affiliation:

- stock ownership (*i.e.*, more than 50% voting equity);
- stock options, convertible securities and agreements to merge;
- common management; and
- identity of interests (*i.e.*, close family relationships).

COVID-19 Pandemic Small Business Lending Under the CARES Act's Paycheck Protection Program

The CARES Act waives the ordinary requirements for Section 7(a) loans with respect to affiliation for business concerns that (i) do not have more than 500 employees and are assigned a NAICS code beginning with 72, (ii) operate as a franchise that is assigned a franchise identifier code by the SBA or (iii) receive financial assistance from a small business investment company licensed under the Section 301 of the Small Business Investment Act of 1958. The number of employees includes those employed full-time, part-time and on other bases. Additionally, business concerns that have no more than 500 employees per physical location and are assigned a NAICS code beginning with 72 are eligible for loans under the Paycheck Protection Program. Entities that engage in certain lines of business are ineligible to receive Section 7(a) loans; this includes but is not limited to financial businesses primarily engaged in the business of lending, life insurance companies, and certain passive businesses owned by developers and landlords. A full list of ineligible

entities can be found at 13 C.F.R. §120.110, but note that, pursuant to the CARES Act, certain nonprofit organizations may be eligible for Section 7(a) loans notwithstanding the provisions of 13 C.F.R. §120.110.

Loan Forgiveness. Section 1106 of the CARES Act provides for loan forgiveness of Paycheck Protection Program loans. These loans are eligible for forgiveness in an aggregate amount equal to the amount spent by the borrower during the eight-week period following the date of loan origination on payroll costs, mortgage interest payments, rent payments and utility payments. No more than 25% of the amount forgiven can be for nonpayroll costs. The amount eligible for forgiveness is decreased if a borrower reduces an employee's salary by more than 25% or reduces its number of employees as compared to certain precrisis time periods set forth in the CARES Act, unless the borrower cures the reductions by June 30, 2020.