Proskauer

CARES Act Expansion of SBA Loan Programs for Small Businesses – Summary and FAQ for Private Fund Sponsors

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On March 27, 2020, President Trump signed the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), a $2 trillion emergency relief and stimulus package aimed at easing the financial impact of the COVID-19 pandemic on individuals and businesses. Of particular interest to many private investment fund sponsors and their portfolio companies is Title I of the CARES Act which, in part, expands (both in terms of eligibility and size of loans available) two pre-existing loan programs administered by the Small Business Administration (the "SBA"): (i) the Paycheck Protection Program (the "PPP"), an expansion of the SBA's 7(a) loan program, to which the CARES Act allocates $349 billion of funding, and (ii) the Economic Injury Disaster Loan program (the "EIDL"), to which the CARES Act allocates $10 billion of funding. Although not all of the final implementing regulations for the CARES Act have been released as of the publication of this alert, on March 31, 2020, the U.S. Treasury Department and the SBA released an information sheet (the "Fact Sheet"), on April 2, 2020, the SBA released interim final rules (the "Interim Final Rules") that implement and provide guidelines for certain aspects of the PPP, and on April 3, 2020, the SBA released a revised sample application form for the PPP.

While the eligibility standards have been relaxed for these programs, a number of noteworthy limitations apply, in particular the continued applicability of the SBA's affiliation rules. In their current state, the affiliation rules applicable to the 7(a) loan program, and in existence prior to the CARES Act, are likely to make it challenging for many private fund-backed companies to take advantage of the PPP and/or the EIDL.

Key features of the PPP and the EIDL and some frequently asked questions related to the programs are set forth in this alert. For additional details on the CARES Act, more generally, please see our prior alerts with respect to Title I, see here, with respect to Title IV (generally geared toward larger businesses, however, we note that in particular, the Mid-Sized Business Program and Main Street Lending Program discussed therein may develop into potential lending sources for private fund-backed companies), see here, and with respect to certain tax aspects of the CARES Act, see here and here.

1. **What size businesses are eligible borrowers?**

PPP

The following businesses are generally eligible: (i) a business (including its affiliates) having 500 or fewer employees, (ii) a business (including its affiliates) that is able to satisfy the traditional SBA size test (based on the maximum employee head count or average annual receipts[1] for the prior three years, in each case, specific to the NAICS industry code[2] of such business) and (iii) a hospitality or food service business[3] with multiple locations, so long as each location has fewer than 500 employees. Note that the SBA maintains a list of certain types of borrowers that are ineligible for SBA business loans (PPP loans are SBA business loans).[4] Note also that, as a general matter, such businesses must be for-profit "business concerns" with a location in the U.S., and must primarily operate within the U.S. or make significant contributions to the U.S. economy through payment of taxes or use of American products, materials or labor.[5]

EIDL

Generally the same as the PPP, except that EIDL eligibility was not expanded for hospitality and food service businesses as described in (iii) above.

2. **How does an applicant determine who its affiliates are for purposes of size eligibility tests?**

PPP and EIDL

When determining whether the applicable size standards are met for SBA loan eligibility, SBA affiliation rules require a business to aggregate the number of its employees (and receipts, as applicable), with all employees (and receipts, as applicable) of its domestic and foreign affiliates. Affiliation is largely determined by "control". For an applicant business with a private fund investor, the affiliation and counting rules will require an analysis of the control relationship between (a) the investing private fund and the applicant business, and (b) the private fund and its other portfolio companies (and, depending on control relationships, potentially the private fund's adviser entity and the portfolio companies of other funds advised by the same adviser).

Entities are "affiliates" when one controls or has the power to control the other, or a third party or parties control or have the power to control both. "Control" is broadly defined to include majority ownership of voting equity, certain types of contractual rights, management control, identity of interest, economic dependence, and several other forms of "control" that can exist in both majority and minority ownership scenarios.

When determining affiliation, the SBA may consider all connections between the business and a potential affiliate. Even in cases in which no single factor is sufficient to constitute affiliation, the SBA can find affiliation on a case-by-case basis where there is ample evidence of affiliation based on the totality of the circumstances.

As a starting proposition, the SBA applies a non-rebuttable presumption that a person owning 50 percent or more of the voting securities[6] of a business is an affiliate of that business, requiring aggregation of employee headcount (and receipts, as applicable) between such business and the 50% owner.

Where a private fund owns less than a majority of the voting securities of a business, an analysis of the positive and negative control rights of the private fund over the business will be necessary. Historically, certain minority control rights have increased the likelihood the SBA would determine affiliation exists.[7] In contrast, certain other minority rights have not been as determinative, recognizing the importance of an investor's having some negative rights in order to protect its investment (e.g., in the case of extraordinary decisions), such as veto rights.[8]

In addition, if no individual or entity controls 50% or more of the voting equity of a business, the SBA will deem the board of directors or president or CEO (or other officers, managing members, or partners who control the management) to be in control of the business (which could be in addition to any owners of the business who are deemed to control the business through one or more of the minority control rights discussed above).

Finally, depending on the fact pattern, there may be more than one person or entity, whether or not related in a broader commercial sense, who could be deemed affiliates of a particular business under the affiliation rules. For example, if multiple private funds sponsored by different firms have invested in a company, depending on the control relationships between any such private fund and the applicant business, and between such private fund and its other portfolio companies, it is possible the company would be required to aggregate the employee headcount (or receipts, as applicable) of one or more such sponsors (and one or more of the other portfolio companies of the investing fund of any such sponsor) with its own employee headcount (or receipts, as applicable).

3. **Are there any exceptions to the affiliation rules?**

PPP and EIDL

The CARES Act waives the affiliation rules in only three very limited scenarios: (i) businesses in the accommodation and food services sector (NAICS code 72), (ii) franchises with a franchise identifier code assigned by the SBA, and (iii) businesses receiving financial assistance from an approved Small Business Investment Company (e.g., an SBIC fund). The Fact Sheet and the Interim Final Rules further indicate that the PPP waiver is limited to this narrow list.

It is uncertain whether the SBA through rule-making in respect of the CARES Act will simplify or provide for additional exceptions to the existing affiliation rules beyond the information in the Fact Sheet and the Interim Final Rules regarding the PPP. However, the Interim Final Rules indicate that the SBA expects to issue additional guidance with regard to the applicability of its affiliation rules in the near future. Until then, as discussed above, it could be challenging for many companies backed by private funds to obtain PPP and EIDL loans.

4. **What can the loans be used for?**

PPP

PPP loans can generally be used for payroll costs; costs related to the continuation of group health care benefits (including insurance premiums); payments for vacation, parental, family, medical or sick leave; payment of employee salaries, commissions, or similar compensations; payments of interest on any mortgage (but not prepayment of or payment of principal); rent (including under a lease agreement); utilities; or interest on any other debt obligations incurred before February 15, 2020; however, pursuant to the Interim Final Rules, at least 75% of PPP loan proceeds must be used for payroll costs (please see Question 5 below for more details as to what constitutes payroll costs). Additionally, the Interim Final Rules clarify that the remaining 25% of PPP loan proceeds can also be used for any other uses that have historically been permitted under the SBA's traditional 7(a) loan program[9]; however, amounts used for such purposes would not be eligible for loan forgiveness.

EIDL

EIDL loans can be used to fund working capital necessary to carry on the business and for expenditures necessary to alleviate the specific economic injury (e.g., service existing debt, employee payroll, making rent or mortgage payments, accounts payable, and other operating expenses). EIDL loans cannot be used to refinance debt existing prior to the disaster, repair physical damage, or pay dividends (other than reasonable remuneration to owners for services).

5. **What are the maximum amounts of the loans?**

PPP

A PPP loan may not exceed 2.5 times the business's average monthly payroll costs[10] from (generally) the year prior to the loan (plus any outstanding amount under a pre-existing EIDL loan made on or after January 31, 2020 and before the CARES Act SBA loans are available), up to a total maximum of $10 million. The sample application further indicates that, rather than the trailing twelve month average as of the time of the application, (non-seasonal) applicant businesses will use the average monthly payroll for 2019.

EIDL

An EIDL loan is generally limited to $2 million. The loan also may not exceed the economic injury as determined by the SBA (further reduced by any business interruption insurance or other recoveries). The borrower may also request an advance of up to $10,000, which the SBA endeavors to make available within three days of receiving the applicant's application. The SBA also offers an Express Bridge Loan Program of up to $25,000 for borrowers that experience a disaster and have an existing relationship with an SBA Express Lender.

6. **What are other key terms of the loans?**

Key Term	PPP	EIDL
Maximum size	$10 million, generally.	$2 million, generally.
Interest rate	No more than 4% (CARES Act). The Fact Sheet specified that the interest rate would be a 0.50% fixed rate; however the Interim Final Rules provide that the interest rate will be a 1% fixed rate.	3.75%.
Maxium maturity	Up to 10 years (CARES Act). The Fact Sheet and Interim Final Rules clarified that maximum maturity will be 2 years.	30 years.
Availability	Through June 30, 2020.	Through December 31, 2020.
Requirement to certify "No credit Available Elsewhere"	Waived.	Waived.

Key Term	PPP	EIDL
Deferral	No payment of principal or interest for at least 6 months (up to 1 year). The Interim Final Rules clarified that deferral period will be 6 months.	Not available.
Collateral	Not required.	Collateral may be required for EIDL loans in excess of $25,000.
Guarantees	Not required.	Not required for borrowed amounts of less than $200,000. Personal guarantees may still be required for loans in excess of such amount.
Loan forgiveness	Yes, subject to limitations. [11][12]	None.

7. **How do I apply for the loans?**

PPP

PPP loans are made by SBA registered lenders, not directly by the SBA itself. The SBA, however, has released a sample application form for PPP loans and expects that banks may be able to begin accepting applications as soon as April 3, 2020. Note that the PPP sample application form requires certain certifications[13] from the applicant, disclosure of any 20% owner[14] of the applicant, and whether the applicant or any of its owners is an owner of, or has common management with, any other business, including a list of such businesses and a description of the relationship.

If you have a relationship with an existing bank, we recommend you contact that lender as they may have an SBA division (which may ease the application process generally, including in respect of working through any potential inter-creditor issues).

EIDL

Borrowers can already apply for EIDL loans on the SBA's website.

8. **Can a company apply for both PPP and EIDL loans?**

Yes. Businesses may obtain both PPP and EIDL loans, so long as both loans are not used for the same purpose, or otherwise duplicative. In addition, a borrower with an EIDL loan unrelated to COVID-19 may apply for a PPP loan, with an option to refinance the previously existing EIDL loan into the PPP loan.

9. **Are these rules final?**

The SBA must issue regulations to fully implement Title I (including the PPP) without regard to notice and comment requirements within 15 days from enactment of the CARES Act under emergency rulemaking authority.

In order to fully assess how a party may be impacted by and become eligible for assistance under this landmark legislation it will be imperative to review and understand the SBA's rules, regulations, applications, processes and guidance implementing the CARES Act. It remains to be seen what effect additional SBA rules, regulations and guidance (as the SBA continues to implement these programs) will have on the ability of small businesses (in particular those with private fund investors) to utilize the PPP and the EIDL.

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Proskauer's cross-disciplinary, cross-jurisdictional Coronavirus Response Team is focused on supporting and addressing client concerns. We will continue to evaluate the CARES Act, related regulations and any subsequent legislation to provide our clients guidance in real time. Please visit our Coronavirus Resource Center for guidance on risk management measures, practical steps businesses can take and resources to help manage ongoing operations.

[1] Receipts means all revenue in whatever form received or accrued from whatever source, including from the sales of products or services, interest, dividends, rents, royalties, fees, or commissions, reduced by returns and allowances. Generally, receipts are considered "total income" (or in the case of a sole proprietorship "gross income") plus "cost of goods sold" as these terms are defined and reported on Internal Revenue Service (IRS) tax return forms. See 13 C.F.R. §121.104.

[2] The SBA's industry size standards (as to both employee headcount and average annual receipts) can be found in 13 C.F.R. §121.201. Note that the highest size standard for number of employees for any industry is 1,500 employees.

[3] NAICS Sector 72 "Accommodation and Food Services" businesses.

[4] See 13 C.F.R §120.110.

[5] See 13 C.F.R §120.105. Note that PPP loans are also potentially available to public and private non-profit organizations, veteran organizations, tribal business concerns, sole proprietorships, self-employed individuals and independent contractors (not covered by the scope of this alert).

[6] Stock options and other convertible securities are generally considered to be fully exercised.

[7] For example, the ability to block day-to-day operational decisions of the company; the ability to block the establishment of a quorum at a meeting of stockholders or the board of directors; the ability to block or have control over the payment of distributions or dividends, approval of or making changes to the company’s budget or capital expenditures outside of the budget, determination of employee compensation, the hiring and firing of officers, changes in the company's strategic direction, initiating or defending a lawsuit, entering into contracts or joint ventures, amending or terminating leases, or the incurrence or guaranteeing of debts or obligations.

[8] For example, rights to approve or veto: selling or placing an encumbrance on all or substantially of the assets of the business; an action that could change the character or alter the amount capital contributions to the business; changing the company's line of business; engaging in a merger transaction; issuing additional stock/equity; amending the organizational documents of a company; filing for bankruptcy; amending the governing documents to materially alter the rights of the existing owners; dissolving the company; and increasing, decreasing, or reclassifying the authorized capital of the company.

[9] Generally, these permitted usages include: paying operational expenses, accounts payable and/or to purchase inventory; financing construction; purchasing equipment, machinery, furniture, fixtures, supplies or materials; purchasing real estate, including land and buildings; to construct a new building or renovate an existing building; establishing a new business or assist in the acquisition, operation or expansion of an existing business; and to refinance existing business debt, under certain conditions. See 13 C.F.R. §120.120.

[10] "Payroll Costs" exclude (i) compensation above $100,000 per annum for any person (*pro-rated* for the period from February 15, 2020 to June 30, 2020); (ii) federal wage withholding taxes and certain federal employment taxes for the period from February 15, 2020 to June 30, 2020; (iii) compensation for employees with a principal place of residence outside the U.S.; and (iv) qualified sick or family leave wages for which a credit is allowed under the Families First Coronavirus Response Act. Note that certain adjustments are made to "Payroll Cost" calculations for seasonal workers.

[11] A loan will be eligible for forgiveness in an amount not to exceed the sum of permitted payroll costs, interest payments on mortgages existing before February 15, 2020, rent with respect to leases in place before February 15, 2020, and payments for utilities for which service began before February 15, 2020, in each case incurred or paid within 8 weeks from loan origination. The loan forgiveness amount is capped at the principal (and any interest accrued) and will be reduced for reductions of employees or their compensation which are not restored by June 30, 2020. Amounts forgiven are not taxable income to the borrower.

[12] The Fact Sheet and the Interim Final Rules provide that not more than 25% of the forgiven amount may be for non-payroll costs. This statement merits additional consideration when applying for PPP loans to cover non-payroll costs during the covered 8-week period as a portion of such costs may not be eligible for loan forgiveness.

[13] Note that, among other certifications, the application form requires the applicant to certify in good faith that (i) the PPP loan is necessary to support the ongoing operations of the business due to the uncertainty of current economic conditions, (ii) funds will be used to retain workers, maintain payroll or make mortgage payments, lease payments and utility payments, and (iii) the applicant is eligible to receive a loan under the rules in effect at the time this application is submitted that have been issued by the SBA implementing the PPP. Please note that the application form also requires the applicant to acknowledge that knowingly making a false statement to obtain an SBA loan is punishable (potential imprisonment and/or fines) under various laws.

[14] Where not otherwise specified, each of the following parties are considered "owners" of the applicant business: (i) for a sole proprietorship, the sole proprietor; (ii) for a partnership, all general partners, and all limited partners owning 20% or more of the equity of the firm; (iii) for a corporation, all owners of 20% or more of the corporation; (iv) for limited liability companies, all members owning 20% or more of the company; and (v) any trustor (if the applicant is owned by a trust).

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