SQUIRE PATTON BOGGS

Updated Guidance on Securing CARES Act Stimulus Funding for Small Businesses

April 24, 2020

On March 27, 2020, President Donald Trump signed the Coronavirus Aid, Relief, and Economic Security Act of 2020 (CARES) Act after the Act received overwhelming bipartisan support from both the US Senate and the US House of Representatives.

As part of an overall package expected to cost more than US$2 trillion, the CARES Act provides more than US$360 billion in immediate loan assistance for small businesses, including (a) an expanded Economic Injury Disaster Loan (EIDL) program and (b) the Paycheck Protection Program (PPP), administered under the Small Business Administration's (SBA's) 7(a) program.

While the PPP will provide small business owners with forgivable, low-interest, no-collateral loans to provide the liquidity that businesses need to support employees during the impacts related to the coronavirus disease 2019 (COVID-19) pandemic, the EIDL program will help small businesses recover for broader economic injury related to the outbreak.

On April 4, 2020, the President signed into law the Paycheck Protection Program and Health Care Enhancement Act, which provides another US$484 billion in aid in response to the COVID-19 pandemic. That law, among other things, provides US$380 billion for small businesses, specifically, US$321 billion to stabilize the depleted PPP and another US$60 billion in loans and grants for economic disaster assistance, including US$10 billion for the EIDL program.

Of the amounts authorized for the PPP, about US$60 billion is set aside for smaller lending facilities, including "community financial institutions, small insured depository institutions and credit unions with assets less than $10 billion" to help small businesses concerns in rural areas and minority communities access these COVID-19 relief programs. Below is updated guidance for small businesses seeking to secure stimulus funding to stay afloat during this unprecedented pandemic.

Economic Injury Disaster Loan (EIDL) Program

Economic Injury Disaster Loans help entities stay afloat during the declared disaster, ready to "restart" their operations once circumstances allow.

What Is the Eligibility Period?

The EIDL eligibility period ends December 31, 2020.

What Businesses Are Eligible for an EIDL?

EIDLs are generally available to a business (including a sole proprietorship, independent contractor, self-employed individual, or a qualifying nonprofit organization) if it:

- Meets the applicable North American Industry Classification System (NAICS) code-based size standard or other applicable SBA 7(a) loan size standard, both alone and together with its affiliates
- Has an employee headcount that is lower than the greater of (a) 500 employees or (b) the employee size standard, if any, under the applicable NAICS Code

Whether the 500-employee headcount cap applies to qualified nonprofits is unclear.

Finally, the CARES Act provides that businesses that received a PPP Loan (defined below) **are not** eligible for EIDLs for the same purpose. However, businesses receiving an EIDL are eligible for a PPP loan.

Am I a Small Business?

Pursuant to the SBA's "affiliation rules," applicants for EIDL loans must include their affiliates when applying size tests to determine eligibility. Accordingly, employees of other businesses under common control will be counted toward the maximum number of permitted employees.

While Section 121.103 of Title 13 of the Code of Federal Regulations sets forth the general principles SBA uses to determine affiliation, for purposes of EIDL program (and the Paycheck Protection Program), 13 CFR § 121.301, which notes that entities may be considered affiliates based on factors including stock ownership, overlapping management and identity of interest, applies. Please see below for a fuller discussion on the "affiliation rules".

How Much Can Be Borrowed?

Up to US$2 million.

What Collateral and Guarantees Are Required?

EIDLs of over US$25,000 require collateral. However, the SBA will not decline a loan for lack of collateral, but requires borrowers to pledge what is available.

EIDLs of greater than US$200,000 must be guaranteed by any owner having a 20% or greater ownership interest in the borrower.

What Can the EIDL Proceeds Be Used For?

Proceeds can be used for working capital (including fixed debts, payroll, accounts payable and other bills that cannot be paid because of the disaster's impact). Proceeds may not be used for refinancing of long-term debt, expanding facilities, paying dividends or bonuses, or relocation.

Can Loan Payments Be Deferred?

EIDL borrowers may defer payment of remaining principal, interest and fee balances for at least six months and up to one year after any loan forgiveness.

What Is the Maturity and Interest of the Loan?

EIDLs have variable maturity dates and have a maximum interest rate of 4%. However, the SBA has advised that interest rates on the EIDL are expected to be 3.75% for small businesses and 2.75% for nonprofit organizations.

Where Can You Apply for EIDLs?

You can apply from the SBA directly online

Can I Get an Advance on My EIDL?

Yes. An applicant for an EIDL may receive, within three days after applying, an emergency advance of **up to** US$10,000. This advance will provide economic relief to businesses that are currently experiencing a temporary loss of revenue and funds will be made available after a successful application. This loan advance will not have to be repaid and can be used for payroll costs, increased material costs, rent or mortgage payments, or for repaying obligations that cannot be met due to revenue loss.

Paycheck Protection Program (PPP)

On April 3, 2020, the SBA issued an Interim Final Rule that provides additional guidance regarding the application of certain affiliate rules. It supplements the Initial Rule, originally issued on April 2, 2020 that implements sections 1102 and 1106 of the CARES Act relating to the PPP and forgiveness of loans under the PPP. This section reflects those developments.

What Is the Eligibility Period?

The PPP eligibility period ends on June 30, 2020.

What Businesses Are Eligible for a PPP Loan?

An entity generally is eligible for the PPP if it, combined with its affiliates, is a small business as defined in section 3 of the Small Business Act (15 U.S.C. 632), or (1) has 500 or fewer employees whose principal place of residence is in the US or is a business that operates in a certain industry and meets applicable SBA employee-based size standards for that industry, and (2) is a tax-exempt nonprofit organization described in section 501(c)(3) of the Internal Revenue Code (IRC), a tax-exempt veterans organization described in section 501(c)(19) of the IRC, a Tribal business concern described in section 31(b)(2)(C) of the Small Business Act, **or any other business concern**.

You must have been in operation on February 15, 2020 and either had employees for whom you paid salaries and payroll taxes or paid independent contractors, as reported on a Form 1099-MISC. In addition, if you file a Form 1040, Schedule C, you may be eligible to apply for a PPP Loan.

You can also qualify for the PPP as a small business concern if it meets both tests in SBA's "alternative size standard" as of March 27, 2020: (1) maximum tangible net worth of your business is not more than US$15 million; and (2) your average net business income after federal income taxes (excluding any carry-over losses) for the two previous years before the date of the application is not more than US$5 million.

You are also eligible for a PPP loan if you are an individual who operates under a sole proprietorship or as an independent contractor or eligible self-employed individual, you were in operation on February 15, 2020.

Notably, the employee limit does not apply for businesses that (a) are in the " accommodation and food services" sector under the NAICS (NAICS codes beginning with 72) and (b) maintain more than one physical location, in which case the 500-employee cap applies for each physical location. It is unclear as of what date the size test will be applied; however, historically, SBA size tests have been applied on the date of application for financing.

As to nonprofits, in an April 3, 2020, Interim Final Rule, the SBA notes that before the CARES Act, nonprofit organizations were not eligible for 7(a) small business loans – only for-profit small business concerns. But, the Act made such nonprofit organizations not only eligible for the PPP, but also subjected them to the SBA's affiliation rules. Specifically, section 1102 of the Act provides that the provisions applicable to affiliations under 13 CFR 121.103 apply with respect to nonprofit organizations and veterans organizations in the same manner as with respect to small business concerns. However, according to the Interim Final Rule, the detailed affiliation standards contained in section 121.103 currently do not apply to PPP borrowers, as applicants in 7(a) programs, which include the PPP, are subject to the affiliation rule contained in 13 CFR 121.301.

Affiliation Considerations Related to Eligibility

Pursuant to SBA "affiliation rules," applicants for PPP loans must include their affiliates when applying size tests to determine "small business" status. A business that is controlled by a private equity sponsor would likely be deemed an affiliate of the other businesses controlled by that sponsor and would, thus, be ineligible for PPP loans, under the new regulations, if those affiliations bring it above the relevant size standard for its industry.

The CARES Act waives the affiliation requirement for the following applicants:

- Businesses within NAICS Code 72 with no more than 500 employees
- Franchises with codes assigned by SBA, as reflected on SBA franchise registry
- Businesses that receive financial assistance from one or more small business investment companies (SBIC)

Section 121.103 of Title 13 of the Code of Federal Regulations sets forth the general principles SBA uses to determine affiliation. But, for purposes of the PPP, guidance in the SBA's Interim Final Rule on affiliation points to 13 CFR § 121.301, which notes that entities may be considered affiliates based on factors including stock ownership, overlapping management, and identity of interest. This is important because § 121.301 is generally regarded as less restrictive as § 121.103— allowing, for example, a finding of no control where multiple parties each have less than a 50% ownership in a given business concern.

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 control or have the power to control both. It does not matter whether control is exercised, so long as the power to control exists. 13 CFR § 121.301 (f).

Under 13 CFR § 121.301(f)(1) – (7), affiliation can be based on ownership, management, identity of interest, franchise agreements, or a totality of the circumstances, or arise from stock options, convertible securities, and agreements to merge or the application of the "newly organized concern" rule. 13 CFR § 121.301(f)(8) provides that, in determining the concern's size, SBA count the receipts, employees, or the alternate size standard (if applicable) of the concern whose size is at issue and all of its domestic and foreign affiliates, regardless of whether the affiliates are organized for profit.

According to an FAQ sheet published by the Treasury Department on April 6, 2020, borrowers must apply the affiliation rules set forth in the SBA's Interim Final Rule on affiliation. A borrower must certify on the PPP Loan Application that the borrower is eligible to receive a PPP loan, and that certification means that the borrower is a small business concern as defined in section 3 of the Small Business Act, meets the applicable SBA employee-based or revenue-based size standard or meets the tests in SBA's alternative size standard, after applying the affiliation rules, if applicable. SBA's existing affiliation exclusions apply to the PPP, including, for example, the exclusions under 13 CFR 121.103(b)(2).

Notwithstanding the SBA's attempts to clarify under what circumstances a prospective borrower should count the number of workers employed by any affiliate towards the 500-employee headcount cap for purposes of determining eligibility, uncertainty remains. **Subject to anticipated, additional regulations, it is likely the SBA that affiliation rules will apply.** Companies needing assistance in this regard are encouraged to contact us.

Borrower Responsibilities Regarding Application

In connection with applying for a PPP loan, a borrower is required to make a number of certifications (including those certifications described below).

The "Paycheck Protection Program Loans – Frequently Asked Questions (FAQs)," updated as of April 23, 2020, by the Treasury Department, reminds the prospective borrower that it must certify on the borrower application form that it is eligible to receive a PPP loan (with eligibility to be determined as described above and after applying applicable affiliation rules, if applicable).

In its FAQs, the Treasury Department also notes that a borrower (a) is responsible for providing an accurate calculation of payroll costs and (b) must attest to the accuracy of those calculations on the PPP loan application form. These calculations should exclude payments made by an eligible borrower to an independent contractor or sole proprietor. However, an independent contractor or sole proprietor may itself be eligible for a loan under the PPP.

In an April 23, 2020 update to the FAQs, Treasury noted that "all borrowers must assess their economic need for a PPP loan under the standard established by the CARES Act and the PPP regulations at the time of the loan application." Specifically, the PPP loan application includes a certification that "[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant."

As of April 23, 2020, the FAQs indicate that this certification is to be made in good faith, after taking into account the borrower's "current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business." As an example, Treasury specifically cites a public company with substantial market value and access to capital markets as unlikely to being able to make the required certification in good faith. Treasury goes further, noting that such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification. As is the case for eligibility, lenders (under these FAQs) may rely on a borrower's certification regarding the necessity of the loan request. And any borrower that applied for a PPP loan prior to the issuance of this guidance and repays the loan in full by May 7, 2020 will be deemed by SBA to have made the required certification in good faith.

While the full implications of this pronouncement remain unclear, we suggest that it warrants careful consideration by not only public companies, but also other business concerns and nonprofits otherwise eligible for the PPP, on a case-by-case basis.

While lenders are generally permitted to rely exclusively on the borrower's certifications in the PPP loan application, with respect to a borrower's payroll information and related certifications, a lender is required to perform a "good faith review, in a reasonable time, of the borrower's calculations and supporting documentation concerning average monthly payroll costs."

How Much Can I Borrow?

The amount to be guaranteed is an amount equal to 2.5 times the average total monthly payroll costs in the one-year period before the loan is made (or from January 1, 2020 through February 29, 2020, if the business did not exist in the previous year) with **a cap of US$10 million**.

Under the CARES Act and applicable regulations, " payroll costs" is the sum of all payments for compensation to employees (whose principal place of residence is in the US) in the form of (1) salaries, wages, commissions, or similar compensation; (2) payments of cash tip or equivalent (based on employer records of past tips or, in the absence of such records, a reasonable, good-faith employer estimate of such tips); (3) payment for vacation, parental, family, medical and sick leave; (4) allowances for dismissal or separation; (5) payments for group healthcare benefits and premiums; (6) retirement benefits; and[1] (7) state and local tax assessed on employee compensation. For an independent contractor or sole proprietor, payroll costs include wages, commissions, income, or net earnings from self-employment or similar compensation.

1 We modified the actual language/punctuation slightly here to ensure clarity.

Payroll costs do not include (1) employee compensation over US $100,000 per year; (2) compensation of an employee whose principal place of residence is outside the US; (3) federal employment taxes imposed or withheld between February 15, 2020 and June 30, 2020, including employees and employer's share of FICA, railroad retirement act, and income taxes required to be withheld from employees; or (4) qualified sick leave or family leave wages for which a credit is allowed under Section 7001 or 7003 of the Families First Coronavirus Response Act.

If a borrower has also obtained an EIDL after January 31, 2020, the outstanding amount of the EIDL if it was used for payroll purposes, will count against the US$10 million cap for purposes of calculating the amount available. EIDL loans made after January 31, 2020, and ending on the date when PPP loans are made available, if used for payroll purposes will be refinanced as part of the PPP loan.

What Collateral and Guarantees Are Required and Fees Incurred?

The PPP loans do not require collateral or personal guarantees. The loans are non-recourse, except to the extent that loan proceeds are used for disallowed costs and expenses.

The guarantee fee and annual servicing fee are waived, as is the requirement that the business is not able to access credit elsewhere.

What Can the Loan Proceeds Be Used For?

Loan proceeds under the PPP must be used to pay allowable payroll costs, costs related to the continuation of group healthcare benefits during periods of paid sick, medical or family leave, and insurance premiums, interest on mortgage obligations (but not principal payments), rent (including utilities), interest on debt that existed as of February 15, 2020 and refinancing an EIDL loan made between January 31, 2020 and April 3, 2020. The loan proceeds may not be used to pay salaries over US$100,000.

PPP loans may not be used for the same purpose as other SBA loans a company may have. For example, if a PPP loan is used to cover payroll for the eight-week covered period, a company cannot use an EIDL for those same payroll costs during that same period, but the company could use it for different payroll period or for different workers. *See* US Senate Committee on Small Business & Entrepreneurship's "The Small Business Owner Guide's to the *CARES Act*".

What Is Forgiven Under the PPP Loans?

PPP loans may be forgiven in whole or in part. The principal amount of a PPP loan may be forgiven for costs incurred and paid during the eight-week period after the origination of the loan for eligible payroll costs, interest payments on mortgages (not including any principal payment), rent payments and utility payments.

Forgiveness for rent under a lease agreement, mortgage interest and utility payments are only allowed for those services and contracts that were in place before February 15, 2020. However, not more than 25% of the loan forgiveness amount may be attributable to non-payroll costs.

To the extent that proceeds of the loan applied to ineligible expenses, that is, expenses other than rent, utility payments, mortgage interest payments or excess compensation (individual employee or 1099M ISC contractor compensation in excess of US$100,000 per year), those expenses are not eligible for forgiveness.

The amount of loan forgiveness may be ratably reduced if the employer reduces the number of full-time equivalent (FTE) employees as compared to either (a) the period February 15, 2019 through June 30, 2019, or (b) the period January 1, 2020 to February 29, 2020 (the employer chooses which period to compare) or if the employer reduces the pay of any employee by more than 25% as of the last calendar quarter.

Employers who re-hire workers previously laid off as a result of the COVID-19 crisis will not be penalized for having a reduced payroll for the beginning of the relevant period. If, during the period from February 15, 2020 through 30 days after enactment of the CARES Act, there is either a reduction in the number of, or wages paid to, FTE employees and the employer eliminates the reduction by June 30, 2020, the amount of loan forgiveness will be determined without regard to the reduction. Forgiveness may also include additional wages paid to tipped workers.

To apply for forgiveness, the PPP loan borrower must submit to the lender an application with the following information: (1) documentation verifying the number of FTE employees on payroll and pay rates for the eight-week period (including payroll tax filings reported to the IRS and state income, payroll, and unemployment insurance filings); (2) documentation (including cancelled checks, payment receipts or other documentation) verifying payments of covered mortgage obligations, covered lease obligations, and covered utility payments; (3) a certification from a company representative that the documentation is true and correct and the amount for requested forgiveness was used to retain employees and make covered payments (mortgage interest, rent and utilities); and (4) any other documentation requested by SBA.

The SBA will issue additional guidance on loan forgiveness.

Can Loan Payments Be Deferred?

The PPP loan recipient may defer payment of remaining principal, interest and fee balances for six months following the date of disbursement of the loan. However, interest will continue to accrue on PPP loans during this six-month deferment.

What Is the Maturity and Interest of the Loan?

PPP loans mature no later than two years after issuance and have a maximum interest rate of 1%.

When Can You Apply for a PPP Loan?

Starting April 3, 2020, small businesses and sole proprietorships can apply for and receive PPP loans. Starting April 10, 2020, independent contractors and self-employed individuals can apply for and receive PPP loans.

Where Can You Apply for a PPP Loan?

PPP loans are made by SBA-certified lenders (more than 800 financial institutions currently) in all 50 states, through delegated authority from SBA. SBA provides a tool to match you to a SBA-certified lender. The SBA Administrator and Secretary of Treasury authorize additional lenders to join the program, as needed. SBA-certified lenders simply need to verify that a small business was in operation on February 15, 2020, and paid employee salaries and payroll taxes or paid independent contractors, as reported on Form 1099- M ISC, for eligibility in the PPP. Thus, the process should be relatively simple.

What Certifications Must an Applicant Make?

With payroll documentation, the applicant must submit SBA Form 2483 (PPP Application Form). With a signature, the applicant is required to certify to, among other things, the applicant (1) 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 under Division A, Title I of the CARES Act; (2) is an independent contractor, eligible self-employed individual, or sole proprietor, or employs no more than the greater of 500 or employees or, if applicable, the size standard in number of employees established by the SBA in 13 C.F.R. 121.201 for the applicant's industry; (3) will comply, whenever applicable, with the civil rights and other limitations in this form; and (4) will, to the extent feasible, purchase only American-made equipment and products.

The form also requires an authorized representative of the applicant to certify in good faith to the following, separately and with his initials:

i. The applicant was in operation on February 15, 2020, and had employees for whom it paid salaries and payroll taxes or paid independent contractors, as reported on a Form 1099-MISC.

ii. Current economic uncertainty makes this loan request necessary to support the ongoing operations of the applicant.

iii. The funds will be used to retain workers and maintain payroll or make mortgage interest payments, lease payments and utility payments, and that the applicant understands that if the funds are knowingly used for unauthorized purposes, the federal government may hold the applicant legally liable such as for charges of fraud. No more than 25% of the loan proceeds may be used for non-payroll costs.

iv. Documentation verifying the number of FTE employees on payroll, as well as the dollar amounts of payroll costs, covered mortgage interest payments, covered rent payments and covered utilities for the eight-week period following this loan will be provided to the lender.

v. Loan forgiveness will be provided for the sum of documented payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities. Not more than 25% of the forgiven amount may be for non-payroll costs.

vi. During the period beginning on February 15, 2020 and ending on December 31, 2020, the applicant has not and will not receive another loan under this program.

vii. The information provided in the application and the information provided in all supporting documents and forms is true and accurate in all material respects. The applicant understands that knowingly making a false statement to obtain a guaranteed loan from SBA is punishable as a serious crime that may subject the applicant to imprisonment or fines.

viii. The applicant acknowledges that the lender will confirm the eligible loan amount using tax documents the applicant has submitted and affirms that those tax documents are identical to those submitted to the Internal Revenue Service. The applicant also understands, acknowledges, and agrees that the Lender can share the tax information with SBA's authorized representatives, including authorized representatives of the SBA Office of Inspector General, for the purpose of compliance with SBA Loan Program Requirements and all SBA reviews.

Will SBA Issue Further Guidance on the PPP Loans?

Yes. SBA is expected to produce further guidance on the PPP in the coming weeks, in particular the application of the affiliation rules and forgiveness of the PPP loan. The CARES Act specifically requires SBA to provide guidance on the payment deferrals of PPP loans within 30 days of enactment of the CARES Act.

Recently, the Senate recommended that SBA provide guidance to lenders to prioritize PPP loans for small business concerns and entities in underserved and rural markets, including veterans and members of the military community, small business concerns owned and controlled by socially and economically disadvantaged individuals, women and businesses in operation for less than two years.

Contacts

Pablo E. Carrillo
Of Counsel, Washington DC
T +1 202 457 6415
E pablo.carrillo@squirepb.com

Kirk D. Beckhorn
Partner, Washington DC
T +1 202 457 7516
E kirk.beckhorn@squirepb.com

Karen R. Harbaugh
Partner, Washington DC
T +1 202 457 6485
E karen.harbaugh@squirepb.com

Leah G. Brownlee
Of Counsel, Cleveland
T +1 216 479 8549
E leah.brownlee@squirepb.com