

COVID-19 NEWS OF INTEREST

CARES Act and SBA Guidance Expand SBA Business Loan Program

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On March 27, 2020, Congress passed and the President signed into law the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”). The CARES Act provides an approximately \$2 trillion stimulus package that includes direct payments to individual tax payers, small business loans, increased unemployment benefits, and a variety of tax breaks. The bill includes the Paycheck Protection Program, which expands eligibility for Small Business Administration (“SBA”) loans under Section 7(a) of the Small Business Act, making \$349 billion available for eligible small businesses. The SBA has recently posted a description and brief outline of the [Paycheck Protection Program](#) as well as an overview of the [SBA’s COVID-19 response programs](#) on its website, [sba.gov](#).

The threshold issue for most potential borrowers under the Paycheck Protection Program will be whether they are eligible for the loans under the program and the SBA’s existing regulations. In particular, those rules limit eligibility for many businesses with a parent company or significant investor. Businesses seeking potential relief under the program should carefully assess their eligibility under these rules.

I. Eligibility for the SBA Loans

In order to be eligible to receive a Section 7(a) loan under the Paycheck Protection Program, applications must be submitted during the period between February 15, 2020 and June 30, 2020 (“Covered Period”) to a lender that has been

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approved by the SBA or the Treasury Department¹ to make SBA loans under the Paycheck Protection Program.² Additionally, an applicant must either:

- Have no more than 500 employees;
- Qualify under otherwise existing eligibility rules for SBA loans based on applicable industry size standard or annual receipts threshold. The table in 13 C.F.R. § 121.201 will list for each North American Industry Classification code (“NAICS code”) whether the size standard is receipts-based or employee-based.
 - If the applicable size standard is employee-based, the SBA counts the average number of employees, including part-time and temporary, for each pay period in the last 12 calendar months from the date the application is accepted for processing.³ The applicable size standards range up to 1,500 employees.
 - If the applicable size standard is receipts-based, then the business will need to calculate its annual receipts for its three most recently completed fiscal years and divide by three.⁴ The highest threshold for annual receipts in the regulations is \$41.5 million.
- Meet the SBA’s “alternative size standard.”⁵ A business may be eligible for a Section 7(a) loan under the alternative size standard if:
 - the maximum tangible net worth of the applicant is not more than \$15 million; and
 - the average net income after federal income taxes (excluding any carry-over losses) of the applicant for the two full fiscal years before the date of the application is not more than \$5 million.

¹ There are approximately 800 lenders that are currently approved by the SBA to issue the SBA Loans and the SBA and Treasury Department hope to significantly expand that network in the coming weeks.

² The CARES Act requires the SBA to enact new guidelines and regulations within 15 days of its enactment to streamline, simplify and shorten the application and approval process for SBA Loans, so the specific application process and requirements have yet to be determined. Further, at the White House’s daily press briefing on Wednesday (3/25), Treasury Secretary Steven Mnuchin stated that he expects for the Treasury Department to have new regulations in place by (but no earlier than) the end of next week that he hopes will create a simple process that allows SBA Loans to be applied for, approved and received in the same day.

³ 13 C.F.R. § 121.106.

⁴ 13 C.F.R. § 121.104.

⁵ 15 U.S.C. § 632 (a)(5).

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II. Affiliation Rules

In almost all cases, these calculation will be made using the SBA's existing rules on affiliation. This means that when determining the total annual receipts, the number of employees, or the alternative size standard, the SBA aggregates the total across the applicant business and all its affiliates.⁶

The SBA regulations provide that 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.⁷ In other words, a business owned or "controlled" by another must count the employees and finances of its parent company or other "control" person against its threshold numbers when determining eligibility under the thresholds described above.

In determining "affiliate" status, the SBA applies an un rebuttable presumption that any person owning 50 percent or more of a business's voting stock is an affiliate. In addition, any entity owning a large block of voting stock, or that otherwise has governance rights, negative or positive, to exercise control over the business, may also be an affiliate. In determining control, the SBA utilizes subjective judgment and considers a number of factors listed in its regulations such as ownership, management, previous relationships with or ties to another concern, and contractual relationships.⁸

The CARES Act provides that, for Section 7(a) loans made under the Paycheck Protection Program, the affiliation rules are waived for:

- Any business concern with 500 employees or fewer that operates under NAICS code 72 (the Accommodation and Food Services sector). Additionally, the CARES Act also provides that during the Covered Period, any business operating under NAICS code 72 that has 500 or fewer employees per physical location will be eligible to receive a Section 7(a) loan under the Paycheck Protection Program;
- Any business concern operated as a franchise that is assigned a franchise identifier code by the SBA; and
- Any business concern that receives financial assistance from a company licensed to operate as a small business investment company ("SBIC") under section 301 of the Small Business Investment Act of 1958 (15 U.S.C. § 681).⁹

⁶ 13 C.F.R. § 121.301(f).

⁷ 13 C.F.R. § 121.103.

⁸ 13 C.F.R. § 301(f).

⁹ CARES Act, section 1102(a)(2)(D)(iv). An SBIC is a privately owned and managed investment fund licensed and regulated by the SBA.

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In addition to the waiver of specified affiliation rules above, the CARES Act also waives the requirement that a small business concern first establish that it is unable to find alternate funding, or that it provide collateral, pay fees generally collected on Section 7(a) loans, or pay penalties for prepayments made on a loan under the program.¹⁰

III. Benefits of the Loan

The CARES Act increases the maximum loan amount for loans made under the Paycheck Protection Program of Section 7(a) of the Small Business Act to \$10 million and states that eligible applicants will receive the lesser of:

- The average monthly “payroll costs”¹¹ for the one-year period ending on the date the loan was made multiplied by 2.5; or
- \$10 million.¹²

The maximum loan amount is determined on the basis of total monthly payroll costs, although the CARES Act does carve out the compensation of an individual employee in excess of the annual salary of \$100,000.

Applicants who receive a Section 7(a) loan under the Paycheck Protection Program created by the CARES Act, in addition to the uses already allowed under the SBA’s Business Loan Program, are permitted to use the funds for:

- Payroll costs, as defined in section 1102(a)(2)(A)(viii) of the CARES Act;
- Costs related to the continuation of group healthcare benefits during periods of paid sick, medical, or family leave, and insurance premiums;
- Employee salaries, commissions, or similar compensations;

¹⁰ *Id.* at section 1102(a)(2)(H)-(J).

¹¹ Payroll costs are defined in the CARES Act at section 1102(a)(2)(A)(viii) as the sum of (i) all compensation of any kind paid to any employee, including (a) salaries, wages, commissions and similar compensation, (b) paid leave (vacation, parental, family, medical or sick leave), (c) severance payments, (d) payments for group health care benefits, including insurance premiums, (e) retirements benefits and (f) state and local payroll taxes *plus* (ii) compensation or income paid to a sole proprietor or independent contract (including commission-based compensation and earnings from self-employment) up to \$100,000 in one year (prorated for the Covered Period); however, “**Payroll Costs**” **do not include** (1) compensation to an individual employee above \$100,000 per year, prorated for the Covered Period (meaning only the first \$100,000 of an employee’s total compensation may be included for determining a borrower’s Payroll Costs), (2) federal withholding taxes, (3) compensation to employees whose principal place of residence is outside of the United States or (4) qualified sick leave or family leave wages for which a credit is allowed under the Families First Coronavirus Response Act.

¹² CARES Act, section 1102(a)(2)(E).

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- Payments of interest on any mortgage obligations;
- Rent and utilities; and
- Interests on any other debt obligations incurred before the Covered Period.¹³

Note that the allowable use of proceeds includes uses already allowed under the SBA's Business Loan Program.

Section 1106 of the CARES Act provides that a loan under the Paycheck Protection Program is eligible for loan forgiveness¹⁴ equal to the following costs incurred and payments made during the eight-week period beginning on the date of the origination of the loan:¹⁵

- Payroll costs, as defined in section 1102(a)(2)(A)(viii) of the CARES Act;
- Payments on interest on mortgage obligations incurred before February 15, 2020;
- Payments on rent obligations in force before February 15, 2020; and
- Payments on utilities in service before February 15, 2020.¹⁶

It is important to note that other uses of the funds, even if they are generally permitted under the SBA's Small Business Loan programs, will not be eligible for forgiveness.

However, the amount of forgiveness will be reduced based on reductions in employee headcount or payroll. The forgiveness will be reduced both: (1) proportionally by the reduction in headcount in the eight-week period from the date the loan originates compared to the period from February 15 to June 30, 2019 or, if the borrower prefers, January 1 to February 29, 2020; or (2) on a dollar for dollar basis for any reduction of more than 25% of any employee's compensation other than a portion of salary above \$100,000.¹⁷

¹³ *Id.* at section 1102(a)(2)(F).

¹⁴ In general, the forgiven amounts will be considered cancelled indebtedness by a lender authorized under Section 7(a) of the Small Business Act.

¹⁵ The covered period for section 1106 is different than for the Paycheck Protection Program in section 1102. CARES Act, section 1106(a)(3) (defining the "covered period" for Section 1106 Loan Forgiveness as "the 8-week period beginning on the date of the origination of a covered loan").

¹⁶ *Id.* at section 1106(b).

¹⁷ *Id.* at section 1106(d)(2).

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The CARES Act allows a borrower to cure any reductions to the amount of forgiveness by re-hiring or hiring new full-time equivalent employees and/or by eliminating the reduction in the salary or wages of its employees, in either case, not later than the June 30, 2020.¹⁸

IV. Applying for a Section 7(a) Loan

The SBA itself does not provide direct loans. The SBA works with lenders who provide the loans, process the applications, and submit the applications to the SBA. After determining if your business may be eligible for the Section 7(a) loan under the Paycheck Protection Program, the first step will be finding a lender to discuss eligibility. The SBA website has several resources that will aid in working with your lender to file a loan application, including a [Section 7\(a\) Loan Application Checklist](#).

The Paycheck Protection Program and Loan Forgiveness provision in the CARES Act are intended to allow businesses to continue functioning while maintaining their current work force during the period of uncertainty caused by the COVID-19 pandemic. While beneficial, the CARES Act forces businesses to wrestle with both their eligibility under the CARES Act itself and the applicable SBA rules and regulations. The rules on affiliation are likely to exclude a significant number of businesses with investors. However, those businesses may be able to seek assistance through other provisions of the CARES Act, including a \$500 billion fund for support to local governments and certain industries to be administered by the Department of the Treasury, or a future stimulus package.

¹⁸ *Id.* at section 1106(d)(5).

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