Questions and Answers Regarding the CARES Act PPP Loan

Tenley A. Carp and Joel N. Gossner

Providing critical guidance to millions, the U.S. Small Business Administration (“SBA”) issued two Interim Final Rules (collectively, the “Rules”) relating to the Paycheck Protection Program (the “PPP”), and its Office of General Counsel issued an interpretative memorandum (the “Memo”)about the PPP, all in an three-day span beginning on April 2, 2020. The Rules implement Sections 1102 and 1106 of the Coronavirus, Aid, Relief, and Economic Security Act (the “CARES Act”) and help clarify (along with the Memo) some of the questions on the minds of businesses, financial institutions, and their respective stakeholders. At the same time, the guidance received to-date leaves many questions unanswered and suggest further SBA guidance in key areas, including the forgiveness of PPP loans.

We tailored the questions and answers below to businesses seeking relief under the PPP. They give an overview of the PPP and the key terms of loans made under it. We based them on questions we have received, as well as the Rules, the Memo, the CARES Act, and relevant information that the U.S. Department of the Treasury (“Treasury”) has made available.

We continue to monitor SBA and Treasury publications and pronouncements, because new PPP-related information continues to be released on a near daily basis.

1. What is the PPP?

The PPP is a brand-new loan program created by the CARES Act. The PPP expands SBA’s 7(a) loan program for the time period of February 15, 2020, through June 30, 2020. SBA guarantees 100% of each PPP loan, and as further described below, up to 100% of each PPP loan (plus any accrued interest) may be forgiven.

2. How much money is available for loans under the PPP?

The CARES Act designated $349 billion for the PPP.

3. Who administers and makes loans under the PPP?

SBA’s network of around 1,800 financial institutions administers and may make loans under the PPP, rather than SBA. Additional financial institutions may participate in the PPP once SBA approves and enrolls them as approved lenders.

4. Who is generally eligible to obtain loans under the PPP (subject to the below-described waivers)?[1]

- “Small businesses concerns” (the traditional recipients of 7(a) loans);
- Any other business concern (“Applicant”) that employs not more than 500 employees;

1 We’ve focused on business concerns, but sole proprietors, independent contractors and self-employed individuals who would be eligible for emergency sick pay under the Families First Coronavirus Response Act (“FFCRA”) are also eligible for PPP loans. They are not included in the term “Applicant” as used in this Q&A.

- Any Applicant that employs not more than the number of employees set forth in the size standard established by SBA for the Applicant's industry; and[2]
- An Applicant whose headcount exceeds the limits described in the preceding two bullets if the Employer has (a) multiple physical locations, with no location having more than 500 employees, and (b) a North American Industry Classification System ("NAICS") code beginning with 72 at the time of disbursal of a Program loan.

Applicants must have been in operation as of February 15, 2020, and have had employees (or independent contractors) for whom they paid salaries and payroll taxes (or, for independent contractors, payments reported on a 1099-MISC). For purposes of the preceding sentence and the remainder of this Q&A, the term "Applicant," includes the small business concerns referenced in the first bullet of this answer.

5. How should an Applicant calculate the number of employees of the Applicant for purposes of applying the employee-based size limits described above?

An Applicant should determine the average number of employees of the Applicant by calculating the number of employees it employed on a full-time, part-time or other basis for each pay period in the 12-month period immediately preceding the date on which it submits an application for a PPP loan. SBA's regulations provide additional guidance for these calculations.

6. Will employees of an Applicant's affiliates count toward the normal employee limits mentioned above?

Yes, generally, but even if those employees would normally count under the SBA's affiliation rules, the PPP waives those rules for the following Applicants:

- Applicants with no more than 500 employees whose NAICS code begins with "72" (which includes the entire "Accommodation and Food Services" (as defined in the 2017 NAICS) sector, e.g., full-service and fast-food restaurants, bars, hotels, food service providers, among others).
- Applicants operating as a franchise for which SBA has assigned a franchise identifier code (e.g., Orange Theory Fitness, Homewood Suites by Hilton, Ace Hardware, The UPS Store, Great Clips, GNC, Homewatch Caregivers).
- Applicants that receive financial assistance from a company licensed under section 301 of the Small Business Investment Act of 1958 (i.e., from a Small Business Investment Company ("SBIC")). The waiver applies regardless of the amount of such assistance and regardless of whether the Applicants have non-SBIC investors.

In addition to the above-described exceptions, SBA has confirmed that its ordinary affiliation rule exceptions apply to Applicants. Importantly, since the CARES Act rescinded a February 10, 2020 change to those affiliation rules, Applicants should review the exceptions as in effect on December 31, 2019.

7. Can private equity or venture capital-backed Applicants obtain loans under the PPP?

Potentially. The analysis is highly fact dependent and complex. We expect it will typically require (a) that an exception described in the answer to question 6 applies or (b) that the fund (or its investment vehicle) does not have a controlling interest in the Applicant (or a minority interest that permits it to prevent a quorum or block shareholder or director actions, as is commonly true in venture capital investments)[3] and does not otherwise have the power to control the Applicant.

For example, an Applicant that is a portfolio company of a private-equity fund is potentially eligible to obtain a loan under

---

2 Nonprofit organizations described in a Section 501(c)(3) of the Internal Revenue Code, veterans organizations described in Section 501(c)(19) of the IRC, and a Tribal businesses described in Section 31(b)(2)(C) of the Small Business Act are also generally eligible subject to the same limits on number of employees, but they are not included in the term "Applicant" as used in this Q&A.

3 However, some minority investments that include veto rights may not make the investor an affiliate of the Applicant if such rights are designed to protect the minority investor (e.g., a right veto extraordinary or unusual actions) rather than give it some form of "negative control." We expect some venture investments would fall into this category, while many other venture investments may not.

the PPP if the Applicant is a franchise to which SBA has assigned a franchise identified code. Such is true even if the employees of other companies in the fund's portfolio would normally be viewed under the affiliation rules as causing the Applicant's headcount to exceed the usual limits.

See our article "Despite Contrary Reports, Many PE and VC-Backed Companies May Be Eligible for Forgivable PPP Loans During the COVID-19 Crisis" for more information about portfolio company eligibility for PPP loans.

There are some key items private equity and venture capital-backed companies need to consider when deciding to pursue a loan under the PPP. We expect to address them in a separate Q&A.

8. Could an Applicant be ineligible even if it meets the eligibility requirements described above?

Yes, Applicants that are otherwise eligible as described above (particularly in question 4) are ineligible if:

- The Applicant is a household employer;
- The Applicant's business is illegal under federal, state or local law;
- Any owner of 20% or more of the equity of the Applicant is (a) incarcerated, on probation, or on parole, (b) presently subject to an indictment, criminal information, arraignment, or other means by which formal criminal charges are brought in any jurisdiction, or (c) has been convicted of a felony within the last five years; or
- The Applicant, or any business owned or controlled by the Applicant or any of its owners, has as ever obtained a direct or guaranteed loan from SBA or any other federal agency that is currently delinquent or has defaulted within the last seven years and caused a loss to the government.

9. How much can an Applicant borrow under the PPP?

Applicants can generally borrow up to 2.5 times the average monthly "payroll costs" (explained below) incurred during the one-year period immediately before funding of a PPP loan. Such amount is increased by the outstanding amount of an Economic Injury Disaster Loan ("EIDL") made between January 31, 2020 and April 3, 2020 (less the amount of any "advance" under an EIDL COVID-19 loan). However the maximum loan amount is capped at $10,000,000.

A different formula applies to Applicants who were not in business during the period February 15, 2019–June 30, 2019.

10. How can an Applicant use proceeds of a loan made under the PPP?

Applicants can generally use proceeds of a PPP loan for "payroll costs" and the following (though no more than of 25% of the loan's proceeds may be used for non-payroll costs):

- Costs related to group healthcare benefits during a period of paid sick, medical, or family leave, and insurance premiums;
- Employee salaries, commissions, or other compensations;
- The interest on mortgage payments (but not principal payments or prepayments);
- Rent (including rent under an existing lease agreement);
- Utilities (e.g., electricity, gas, water, transportation, telephone, or internet);
- Interest on any other debt obligations incurred prior to February 15, 2020; and
- Refinancing an SBA EIDL loan made between January 31, 2020, and April 3, 2020.

11. What constitute "Payroll Costs?"

"Payroll costs" generally mean the following compensation for employees (any not any independent contractors) whose principal place of residence is in this U.S.:

- Salary, wage, commission, or similar compensation (capped at $100,000 on an annualized basis for each em ployee);
- Cash tips or equivalents;
- Payment for vacation, parental, family, medical, or sick leave;
- Allowance for dismissal or separation;
- Payment required for the provision of group healthcare benefits, including insurance premiums;
- Payment of any retirement benefit; and
- Payment of state and local taxes assessed in connection with the foregoing.

12. Are there exceptions to the permissible use of loan proceeds as described above?

Yes, Applicants can't use proceeds of a PPP loan for:

- Compensation to an employee whose principal place of residence is outside the US;
- Compensation to an individual employee in excess of $100,000 per year;
- Qualified sick and family leave wages for which a credit is allowed under sections 7001 and 7003 of the FFCRA; and
- Federal employment taxes imposed or withheld between February 15, 2020, and June 30, 2020 (including the employee's and Applicant's share of Federal Insurance Contributions Act and Railroad Retirement Act taxes) and income taxes required to be withheld from employees.

13. Are PPP loans eligible to be forgiven?

Yes. Subject to some exceptions, Applicants who receive PPP loans are eligible to have up to the entire principal amount (plus any accrued interest) of their loans forgiven. The debt eligible for forgiveness is equal to the amount of Applicant payments for the following during the eight week-period beginning on a PPP loan's origination date (the "Covered Period"):

- Applicant of payroll costs (as defined above);
- Interest on Applicant mortgage obligations incurred before February 15, 2020;
- Rent under an Applicant lease in force before February 15, 2020;
- The utilities expressly listed above for which service began prior to February 15, 2020; or
- Refinancing an SBA EIDL loan made between January 31, 2020, and April 3, 2020 (less the proceeds of any advance on the EIDL loan up to $10,000).

No more than 25% of the forgiven amount may be attributable to non-payroll costs.

Importantly, SBA has said it will issue additional guidance regarding forgiveness.

14. Are there reductions to the amount of a PPP loan that is otherwise eligible for forgiveness?

Yes. Even if an Applicant uses PPP loan proceeds as described above, there are two potential sources of reduction in loan forgiveness:

- Salary-Based Reduction - Generally, if the Applicant meaningfully lowers employee salaries or wages (excluding those of some high earners) during the Covered Period, a dollar-for-dollar forgiveness reduction may apply. More precisely, the forgivable amount of the loan is reduced, on a dollar-for-dollar basis, by the amount of any cut during the Covered Period in the salaries or wages of the Applicant's employees (excluding those of some high earners) that exceeds 25%. The reduction is determined by comparing the Covered Period to the most recent quarter. We are still analyzing the impact, if any, of (a) Covered Period changes in non-salary or wage benefits and (b) changes in salaries, wages, or other benefits outside of the Covered Period, among other things.

- Headcount-Based Reduction – Generally, if the Applicant cuts the number of its employees during the Covered Period, a proportionate forgiveness reduction may apply. More precisely, the forgivable amount of the loan is reduced by multiplying it by a percentage. The percentage is calculated by dividing the average number of the Applicant's full-time-equivalent employees ("FTEs") during the Covered Period by the number of Applicant's FTEs during a previous period. That period is either February 15, 2019–June 30, 2019, or January 1, 2020–February 29, 2019, as selected by the Applicant, with seasonal employers being required to use the first-listed period.

15. Can an Applicant avoid salary or headcount-based forgiveness reductions even if the Applicant has already cut employee headcount or salaries/wages or cuts them in the future?

Yes, even if those reductions would otherwise apply to the forgiveness of any or all of PPP loan, there are two exemptions:

- Salary-Based Exemption - Generally, Applicants may be able to increase salaries to avoid forgivable amount reductions due to a salary cut. If an Applicant meaningfully lowers salaries or wages during the period that begins on February 15, 2020, and ends on April 26, 2020 (the "Reduction Period"), as compared to the salaries or wages in effect on February 15, 2020, the change won't reduce the forgivable amount of a PPP loan if it is eliminated by June 30, 2020.
- Headcount-Based Exemption - Generally, Applicants may be able to increase headcount to avoid forgivable amount reductions due to a headcount cut. If an Applicant reduces its FTEs during the Reduction Period, as compared to February 15, 2020, the change won't reduce the forgivable amount of a PPP loan if it is eliminated by June 30, 2020.

Critically, neither of the above exemptions will apply to an Applicant (a) that makes a reductions outside of the Covered Period or (b) if the Reduction Period has no overlap with the Covered Period applicable to an Applicant's PPP loan.

We're still analyzing (among other things) whether partially eliminating a reduction in pay or headcount proportionately increases the forgivable amount or if the exemptions are an all-or-nothing proposition.

16. When do Applicants have to start repaying, and is there a payment deferral period for a PPP loan?

Applicants don't have to make any payments of principal or interest for six months after a PPP loan is disbursed. But interest accrues during the deferral period.

17. Do an Applicant's owners have to personally guarantee a PPP loan?

No. SBA has waived the requirement to provide a personal guarantee, a key requirement for traditional 7(a) loans.

18. Does an Applicant have to grant security interests/provide collateral for a loan?

No. SBA has waived the requirement that Applicant's provide collateral for PPP loans, another key requirement for traditional 7(a) loans.

19. Does an Applicant have to be able unable to obtain credit elsewhere?

No. SBA has waived the requirement that Applicant's be unable to obtain credit elsewhere, another key requirement for traditional 7(a) loans. However, as further discussed below, each Applicant, along with each owner of 20% or more of such Applicant, will have to certify that current economic uncertainty make the loan request “necessary to support the ongoing operations” of the Applicant.

20. What interest rate applies to PPP loans?

The interest rate applicable to PPP loans is 1%.

21. What will be the maturity date for PPP loans?

The maturity date applicable to PPP loans is two years. The Rules suggest the two-year period begins running when a PPP loan is made.

22. Are there any pre-payment penalties for PPP loans?

No, there are no prepayment penalties on PPP loans.

23. Are the fees for PPP loans the same as those for other 7(a) loans?

No, PPP loans include no up-front Borrower guarantee fee payable to SBA and no subsidy recoupment fee in connection with prepayments.

24. How many PPP loans can an Applicant obtain?

One. SBA has, therefore, encourage Applicants to apply for the maximum PPP loan amount for which they are eligible.

25. How will PPP loans be allocated if the PPP is oversubscribed?

The Rules provide that the PPP is available on a “first-come, first served” basis. **While that guidance leaves open questions, we suggest applying as soon as possible.**

26. When can Applicants apply?

Applicants can apply from April 3, 2020, to June 30, 2020.

27. What do Applicants need to submit for PPP Loans?

Applicants must initially submit a completed SBA Form 2483 (Paycheck Protection Program Application Form) and payroll and other documentation to a PPP lender. Applicants will later need to submit additional documentation in connection with their loan forgiveness requests.

28. Do Applicant representatives have to respond to questions, or make representations or certifications, for the Applicant to obtain a PPP Loan?

Yes, a representative of the Applicant must answer various questions and make various representations and certifications. **Some questions relate to the Applicant’s affiliates and/or owners of 20% or more of the Applicant’s equity.**

- Representations - The Applicant represents, among other things, that (a) to the extent feasible, it will purchase only American-made equipment and products and (b) Applicant is eligible to receive a PPP loan under the SBA rules in effect at the time Applicant submits an application under the PPP.
- Questions - Key questions include questions about affiliates/common management with other businesses (includ-

ing a requirement to list and describe such relationships) and questions about criminal proceedings relating to the Applicant or such owners.

- Certifications – Key certifications of the Applicant's authorized representative include certifying that:
    - **Current economic uncertainty makes the loan request necessary to support ongoing operations of the Applicant;**
    - The proceeds of a PPP loan will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payment and that such representative may be held legally liable (such as for fraud) if the such proceeds are knowingly used for unauthorized purposes;
    - The Applicant does not have a duplicate loan application pending and has not received amounts duplicative of the amounts applied for under the PPP; and
    - Loan forgiveness will be provided for the sum of documented payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities, subject to the 25 percent cap on non-payroll costs.

For more information, please contact Tenley A. Carp, Partner, AGG or Joel N. Gossner, Senior Associate, AGG.

Authors and Contributors

Tenley A. Carp
Partner, DC Office
202.677.4066
tenley.carp@agg.com

Joel N. Gossner
Associate, Atlanta Office
404.873.8648
joel.gossner@agg.com

not *if*, but *how*.®

About Arnall Golden Gregory LLP

Arnall Golden Gregory (AGG) is an Am Law 200 law firm with offices in **Atlanta** and **Washington, DC**. Our client-service model is rooted in taking a "business sensibility" approach of fully understanding how our clients' legal matters fit into their overall business objectives. We provide industry knowledge, attention to detail, transparency and value to help businesses and individuals achieve their definition of success. Our transaction, litigation and regulatory counselors serve clients in healthcare, real estate, litigation and other dispute resolution, business transactions, fintech, global commerce, economic development, public finance, government investigations and logistics and transportation. With our rich experience and know-how, we don't ask "if," we figure out "how." Visit us at www.agg.com.

Atlanta Office
171 17th Street, NW
Suite 2100
Atlanta, GA 30363

Washington, DC Office
1775 Pennsylvania Avenue, NW
Suite 1000
Washington, DC 20006

To subscribe to future alerts, insights and newsletters: **http://www.agg.com/subscribe/**

©2020. Arnall Golden Gregory LLP. This client alert provides a general summary of recent legal developments. It is not intended to be, and should not be relied upon as, legal advice. Under professional rules, this communication may be considered advertising material.