

## **Congress Approves New Funding for PPP Loans and EIDLs; SBA Issues Updated FAQ Regarding “Necessity”**

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act), signed into law on March 27, 2020, established the Paycheck Protection Program (PPP), a loan program that made \$349 billion available to small businesses using the Small Business Administration's (SBA) existing 7(a) loan program. Applications for the PPP loans became available on April 3, 2020, and the program ran out of funds within 13 days. The PPP and Health Care Enhancement Act (H.R. 266) was approved by the U.S. Senate on April 21, 2020, and by the U.S. House of Representatives on April 23, 2020, and is expected to soon be signed into law by the president. This may make it possible for the SBA to recommence accepting PPP applications as early as Friday, April 24, 2020. This bill expands the PPP and Economic Injury Disaster Loan (EIDL) loan programs and provides additional funding for healthcare providers and testing capabilities. This expansion provides for an additional \$310 billion for PPP loans. Of the additional amounts available for PPP loans, \$60 billion will be set aside for small lenders (split between lenders with less than \$10 billion of assets and those with between \$10 billion and \$50 billion of assets). The bill also includes an additional \$50 billion for EIDLs and \$10 billion for emergency EIDL grants.

On April 23, 2020, the SBA and U.S. Department of the Treasury also issued a new FAQ regarding the "necessity" certification that borrowers are required to make for PPP loans. This FAQ highlights the requirement that this certification be made in good faith and that borrowers may be scrutinized and subject to liability for making this certification when the underlying facts of their business do not support the certification. The SBA announced that any borrower that applied to a PPP loan prior to the issuance of this FAQ and repays the loan in full by May 7, 2020, will be deemed to have made the required certification in good faith.

No changes were made to the application certifications or eligibility requirements for PPP loans and the only change to the EIDL program is to include agricultural enterprises as eligible. The information below is a comprehensive summary of the two programs that updates our prior blog posts regarding PPP loans and EIDLs and incorporates our other updates and FAQs. This information is current as of April 23, 2020, and is subject to change as additional regulatory guidance is provided.

### **PPP Loan Program Overview**

#### **PPP Loan Terms**

The loan terms are as follows. Note that lenders are permitted to use their own online portals to process loan applications and their own form of promissory notes to document PPP loans. This has resulted in some variation in application requirements and loan terms among differing lenders (please see the FAQ section below).

- **Interest rate is 1.00%.** The CARES Act provides for interest at a rate of up to 4.00%, and prior guidance issued by the SBA and the U.S. Department of the Treasury had said that the interest rate would be 0.50%. The SBA justified the 1.00% interest rate by reference to the yields available to lenders on CD deposits

and treasury securities of comparable maturity.

- **Loan maturity date is at least two years.** Consistent with guidance provided shortly after the CARES Act was signed into law, an initial interim final rule released by the SBA on April 2, 2020, but effective as of April 3, 2020 (the Initial Interim Final Rule) confirmed that the maturity date for the portion of PPP loans that will not be forgiven is two years. There was no guidance as to whether the two-year period commences on the date of origination or on the forgiveness-determination date, but it is likely that most notes will start the clock on the origination date.
- **Payment of principal and interest is deferred for six months.** Payments will be deferred for six months and interest will accrue during this deferral period. The majority of notes we have reviewed contain an amortization schedule that starts six months after the origination date. In some of the notes we have reviewed, the amortization schedule is based on the full amount of the loan. Other notes we have reviewed expressly provide that the amortization schedule will be calculated after the portion of the loan to be forgiven has been determined. Where this is not expressly addressed, we anticipate that the amortization schedule will generally be recalculated after the forgiveness determination date.
- **No collateral or personal guaranties will be required.** If a member of a borrower's existing bank group provides the funding, the PPP loan would likely be secured by the loan agreement as a result of the terms of the existing loan documents. There is no guidance as to whether such a PPP lender should be required to specifically carve out these proceeds (and any segregated account) from the liens granted in the existing loan documents.
- **Permitted uses of proceeds for PPP loans will be:**
  - Payroll Costs (defined in Maximum Loan Amount section below), and the borrower is required to use at least 75% of the proceeds for such costs
  - Costs related to the continuation of group healthcare benefits during periods of paid sick, medical, or family leave, and insurance premiums
  - Interest payments on mortgage obligations
  - Rent payments on leases in effect before February 15, 2020
  - Utility payments for services that began before February 15, 2020
  - Interest payments on other debt existing before February 15, 2020
  - Refinancing an SBA EIDL made between January 31, 2020, and April 3, 2020
  - Other uses permitted for loans under the SBA's Section 7(a) loan program

## Maximum Loan Amount

The specific calculations associated with determining the maximum amount that may be borrowed have been a significant source of questions, and the guidance and clarifications regarding these calculations is summarized below:

- **Loan Amount.** The maximum amount of a PPP loan will be equal to the lesser of (1) 2.5x average Payroll Cost (as defined below) and (2) \$10 million. For most companies, this monthly average is calculated based on a 12-month period (see below for additional information). For companies that were not in business during the period beginning on February 15, 2019, and ending on June 30, 2019, this monthly average can be calculated based on the average monthly payroll for the period from January 1, 2020, to February 29, 2020. For seasonal businesses, the monthly average monthly Payroll Cost can be calculated using a 12-week period beginning February 15, 2019, or March 1, 2019, whichever the seasonal employer chooses. To the extent that an EIDL loan obtained between January 21, 2020, and April 3, 2020, is refinanced by the PPP loan, the loan amount may still not exceed \$10 million.
- **Payroll Costs may be calculated on a trailing 12-month basis or based on 2019 Payroll Cost data.** Applicants are permitted to calculate their borrowing amount based on either a trailing 12-month period or based on their average monthly payroll for 2019. Some lenders may require payroll documentation that is not available on a trailing 12-month basis but is available for calendar year 2019. With respect to this

calculation, it will be important for applicants to work closely with their specific lender to ensure that the information provided is consistent with their lender's documentation requirements.

- **Payroll Costs include up to \$100,000 of cash compensation for employees with annual salaries above \$100,000.** Compensation in excess of an annual salary of \$100,000 is excluded, prorated as necessary. That exclusion does not apply to non-cash benefits, including: (1) employer contributions to defined-benefit or defined-contribution retirement plans; (2) payment for the provision of employee benefits consisting of group healthcare coverage, including insurance premiums; and (3) payment of state and local taxes assessed on the compensation of employees.
  - Payroll Costs include the following:
    - Salary, wages, commissions, or tips
    - Employee benefits including costs for vacation, parental, family, medical, or sick leave, and allowance for separation or dismissal
    - Payments required for the provisions of group healthcare benefits including insurance premiums
    - Payment of any retirement benefit
    - State and local taxes assessed on compensation
- Payroll Costs exclude the following:
  - Cash compensation above \$100,000 per annum for any person (prorated for the applicable period)
  - Federal wage withholding taxes and certain federal employment taxes for the period
  - Sick leave and family leave wages for which a credit is allowed under the Families First Coronavirus Response Act
  - Any compensation of an employee whose principal place of residence is outside of the United States
  - Payments to independent contractors and sole proprietors

## Applying for a PPP Loan

### Overview and Preliminary Observations

The SBA released a PPP loan application form (Form 2483, which is available [here](#)) on April 2, 2020. This application and other information may be gathered by a lender via an online portal, and the details of the loan application process may vary from lender to lender. Since applicants are required to submit PPP loan applications to lenders approved to issue PPP loans, applicants should work directly with their lenders to determine the specific bank certifications or other application requirements that the lender may ask for, but note the following with respect to the application process:

- **First-come, first-served.** The Initial Interim Final Rule confirmed that PPP loans will be made on a first-come, first-served basis. There has been concern on behalf of the public and the U.S. Congress that banks processed applications from existing customers first. Although the bill did not include any additional rules on this point, lenders' compliance with this requirement is likely to be highly scrutinized.
- **One application per borrower.** The Initial Interim Final Rule confirmed that no eligible borrower may receive more than one PPP loan. Accordingly, the SBA encourages borrowers to consider applying for the maximum amount (for more on how to calculate the maximum amount, see the "Maximum Loan Amount" section above).
- **Permitted lenders.** Existing SBA-certified lenders were given delegated authority to process PPP loans. In addition, the following institutions may participate in the program after applying and being approved by

the SBA: all federally insured depository institutions, federally insured credit unions, Farm Credit System institutions, non-bank lenders, and non-insured depository institutions.

- **Payment of agent fees.** The interim final rule included guidance providing that lenders, and not borrowers, should be paying any agent fees associated with applying for PPP loans. The SBA has provided for fees to be paid to SBA lenders, and lenders are to pay the agent fees out of the fees the lender receives from the SBA.

## Application Form

- **Required certifications.** In preparing and signing the Form 2483, an authorized representative of the applicant must certify in **good faith** that the following are each true and correct in all material respects as of the date of the application under penalty of federal criminal prosecution:
  - 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
  - The current economic uncertainty makes this loan request necessary to support the ongoing operations of the applicant (for additional guidance on what constitutes a "necessity" that is sufficient to make this certification, please see the FAQ section below)
  - The funds will be used to retain workers and maintain payroll or make mortgage interest payments, lease payments, and utility payments, and that if the funds are knowingly used for unauthorized purposes, the federal government may hold such business or representative legally liable, including for fraud
  - The applicant has not and will not receive another loan under the PPP loan program
  - To the extent feasible, it will only purchase American-made equipment and products
  - That it is eligible to receive the loan under the rules in effect **at the time of** the application (companies with VC/PE investors should take note of this and the potential penalties described below in the "Borrower Eligibility" section)
  - The applicant is not engaged in any activity that is illegal under federal, state, or local law
  - That the applicant has not already and will not receive another PPP loan

In addition, an authorized representative of the applicant must certify in **good faith** that documentation supporting the following is true and correct in all material respects under penalty of federal criminal prosecution, including the potential for imprisonment and/or fines:

- The number of full-time equivalent employees on payroll as well as the dollar amounts of payroll costs
- Covered mortgage interest payments
- Covered rent payments
- Covered utilities (each of the foregoing with respect to the eight-week period following the loan disbursement)
- Tax documents confirming the eligible loan amount
- **Questions 1 through 3 of the PPP loan application ask information about "owners."** The instructions to the application describe the following as owners: (1) for a sole proprietorship, the sole proprietor, (2) for a partnership, all general partners, and all limited partners owning 20% or more of the equity of the partnership, (3) for a corporation, all owners of 20% or more of the corporation, (4) for limited liability companies, all members owning 20% or more of the company, and (5) if the applicant is a trust, any trustor.

- **Question 3 requires the applicant to disclose on Addendum A any other business that is controlled or under common management with the applicant or the owner of an applicant.** The applicant should include a list of all affiliates of the applicant and a description of their relationships to the applicant. The applicant is also required to list all other businesses owned by any 20% direct owner. In cases where this list would be extensive or difficult to track down, applicants are urged to consult with counsel to determine what information to provide.
- **Borrowers and their owners may have liability for knowingly using PPP loans for unauthorized purposes or for making false statements or otherwise acting in bad faith in applying for a PPP loan.** The Initial Interim Final Rule provided that, "If you use PPP funds for unauthorized purposes, SBA will direct you to repay those amounts." It also provided that, if funds are knowingly used for unauthorized purposes, businesses and individuals may be subject to additional liability, such as fraud charges. The applicant and/or the individual certifying the application may be subject to civil and/or criminal liability (e.g., under the False Claims Act) for false statements made knowingly, recklessly, or with deliberate ignorance of the truth. If an equity holder, member, or partner of an applicant business uses PPP funds for unauthorized purposes, the SBA will have recourse against such individual for the unauthorized use. Borrowers will be required to deliver evidence to support the use of proceeds possibly including IRS payroll tax filings, state income, payroll, and unemployment insurance filings, and cancelled checks. For this reason, we encourage applicants to deposit the proceeds of PPP loans in a segregated account that will only be used for payroll and other permitted uses (note that at least 75% of the proceeds must be used for payroll costs). This will also streamline the forgiveness calculations.
- **Guidance on required documentation.** The Initial Interim Final Rule included suggestions regarding the kinds of documentation that could be used to establish eligibility for a PPP loan. This includes payroll processor records, payroll tax filings, Form 1099-MISC for independent contractor applicants, or records of income and expenses from a sole proprietorship applicant. In the absence of such documentation, lenders may rely on other supporting documentation, such as bank records, that are sufficient to demonstrate the qualifying payroll amount. For businesses involving tipped employees, the records could include the employer's records of past tips or, in the absence of such records, a reasonable, good-faith employer estimate. It will be important for borrowers to ensure that this documentation is consistent with any tax reporting to the IRS. An additional interim final rule issued on April 14, 2020, offered guidance for documentation to be provided by individuals with self-employment income who file a Form 1040, Schedule C with the IRS, calling for them to calculate their loan amount based on their 2019 IRS Form 1040, Schedule C, line 31 net profit amount. The April 14, 2020, interim final rule also clarified that partnerships may apply for PPP loans without requiring each individual partner to apply for their own PPP loan.
- **Form of promissory note varies by lender.** Since the terms of the promissory note may be determined by the lender, it is important to carefully review the specific terms included. We have noted important variations in sample promissory notes we have seen, and the sample promissory note made available by the SBA did not comply with the terms of the PPP loans, in that it refers to personal guarantees and collateral.

## **Borrower Eligibility**

Only the types of business concerns described below are eligible to receive PPP loans:

- A business (or 501(c)(3) nonprofit organization or 501(c)(19) veterans' organization) that, together with its affiliates, has 500 or fewer employees whose principal place of residence is in the United States
- A business whose **primary** NAICS code starts with 72 (accommodations and food service), and that has, together with its affiliates, 500 or fewer employees **per location**

- A business (or 501(c)(3) nonprofit organization or 501(c)(19) veterans' organization) that, on its own, meets the size standard (employee-based or receipts-based) established by the SBA for the NAICS code applicable to its **primary industry, and**, together with its affiliates, meets the size standards established by the SBA for the NAICS code applicable to its primary industry or the primary industry of itself and its affiliates on a combined basis, whichever is higher ([see SBA size standards](#))
- A business that, together with its affiliates, is a "small business concern" in that it has a tangible net worth not in excess of \$15 million as of March 27, 2020, and an average net income after federal income taxes (excluding carry-over losses) for the two full fiscal years before the date of the application not in excess of \$5 million<sup>[1]</sup>
- Sole proprietors, independent contractors, and self-employed persons
- A business operating as a franchise that is assigned a franchise identifier code by the SBA
- Any business that has received financial support from a Small Business Investment Company (SBIC)

## Affiliation Analysis

For purposes of determining the number of employees that an applicant has in order to evaluate whether it is eligible for a PPP loan, the applicant must aggregate its employees with all of the employees of its affiliates. The affiliation analysis is focused on whether another entity has the right to control the applicant, whether through its ownership of voting securities or negative control covenants over ordinary course business decisions (as opposed to extraordinary business decisions). As a general matter, the SBA deems entities to be affiliated with each other when one controls or has the power to control the other, or when a third party controls or has the power to control both. It does not matter whether control is exercised, so long as the power to control exists. This topic was a source of concern for many companies with institutional investors, including venture capital and private equity funds, and the National Venture Capital Association (NVCA) requested rulemaking to clarify the application of the affiliation rules under to PPP loans.

On April 3, 2020, the SBA published an interim final rule addressing that issue, but the affiliation interim final rule did not provide an exception to affiliation rules for companies with venture capital or private equity fund investors. The affiliation rules are critical to an applicant's analysis of whether it is eligible for a PPP loan based on its size status. For example, to determine whether an applicant meets the first test above, i.e., 500 or fewer employees, the applicant must aggregate its own number of employees with the number of employees of all of its affiliates for purposes of determining eligibility. The affiliation rules applicable to PPP loan eligibility are summarized as follows:

- **Affiliation based on ownership.** Any individual or entity that owns more than 50% of the **voting** securities of an applicant is deemed an affiliate. Such individual or entity must aggregate together its employees, along with the employees of any other entities that it controls, together with the number of employees employed by the applicant, in order to determine whether the applicant has more than 500 employees.
- **Treatment of options, convertible securities, and agreements to merge.** Note that in determining whether any equity holder owns more than 50% of the voting securities, options/convertible securities/agreements to merge (provided they are "agreements in principle" and not agreements that are open or under negotiations towards the possibility of a merger) are given present effect, and treated on a fully vested and/or on an as-exercised basis. Options, convertible securities, and agreements that are subject to conditions precedent which are incapable of fulfillment or are speculative or legally unenforceable are not given present effect.

- Equity holders seeking to sever affiliation through the relinquishment of control should be mindful that temporary relinquishment of control, combined with a provision that restores the prior status quo once it is no longer necessary for PPP loan eligibility, very likely would not prevent affiliation.
- **Negative control by minority equity holders.** The SBA will deem a minority equity holder to be in control if that individual or entity has the ability, under the concern's operating agreement, charter, by-laws, shareholder's agreement, or similar document, to prevent a quorum or otherwise block action by the board of directors or the equity holders. Negative control can also result from a minority equity holder's ability to block ordinary actions essential to the company's operations. In *Size Appeal of Southern Contracting*, the SBA's Office of Hearings and Appeals (OHA) explained that a company giving minority owners the ability to block certain extraordinary actions of the company did not provide negative control to the minority owners, if those blocking rights function to protect the investment of the minority owners, and not to impede the majority's ability to control the company's operations or to conduct the company's business as it chooses. See *Size Appeal of Southern Contracting Solutions, LLC*, SBA No. SIZ-5956, 2018 (S.B.A.), 2018 WL 4492382.
- The chart below describes rights that the OHA has found in particular cases to indicate affiliation, as well as the rights that do **not** typically create affiliation. However, note that the OHA has suggested that a single indication of negative control is not necessarily, by itself, sufficient to find affiliation. Thus, whether negative control exists depends on the specific facts and circumstances of the individual company. Determining whether a particular company has affiliates under the negative control test thus requires a case-by-case analysis.

#### Ordinary Decisions (Indicating Affiliation)

- Taking on new debt
- Issuing dividends (other than tax distributions)
- Establishing or amending the applicant's employee incentive plan
- Setting officers' compensation
- Hiring and/or firing officers and executives
- Purchasing equipment
- Making changes to a budget or approving capital expenditures outside of the budget
- Incurring expenses over \$5,000
- Entering into contracts or joint ventures
- Incurring or guaranteeing debts or obligations
- Initiating or defending a lawsuit
- Amending or terminating leases

#### Extraordinary Decisions (Indicating No Affiliation)

- Adding new members
- Dissolving the company
- Filing for bankruptcy
- Amending the organizational documents of the company (e.g., certificate of incorporation/formation, bylaws or operating agreement)
- Issuing additional capital stock
- Increasing or decreasing the size of the board
  - Entering into a substantially new business
- Selling all or substantially all the company's assets
- Disposing of the company's goodwill
- Submitting a company's claim to arbitration or entering into a confession of a judgment
- Entering into a change of control transaction
- Mortgaging or encumbering all or substantially all of the company's assets
- Committing any act that could result in a change in the amount or character of the company's contribution to capital

- **Affiliation based on common management.** Affiliation based on common management arises where the CEO or president of the applicant (or other officers, managing members, or partners who control the management of the applicant) also controls the management of one or more other businesses. Affiliation also arises where a single individual, concern, or entity that controls the board of directors or management of one applicant also controls the board of directors or management of one or more other businesses.

Affiliation also arises where a single individual, concern or entity controls the management of the applicant concern through a management agreement. Therefore, prospective applicants should carefully evaluate with their management team and controlling board members, and with any entities which have control over the applicant pursuant to a management agreement, whether any such persons control any other entities.

- **Affiliation based on identity of interest.** Affiliation based on identity of interest arises when there is an identity of interest between close relatives, as defined in 13 CFR 120.10, with identical or substantially identical business or economic interests (such as where the close relatives operate concerns in the same or a similar industry in the same geographic area). Where the SBA determines that such interests between close relatives should be aggregated, an individual or firm may rebut that determination with evidence showing that the interests deemed to be one are in fact separate. For example, two family members who collectively own 60% of the voting securities of an applicant may be deemed affiliates of each other, and since they own more than 50% of the voting securities of the applicant, each would need to add the employees of any other entities they respectively control to the number of employees employed by the applicant, for purposes of determining eligibility for a PPP loan.[\[2\]](#)
- **Severing affiliation.** The SBA has provided [guidance](#) that a minority equity holder can sever its affiliation with an applicant by irrevocably waiving or relinquishing any existing rights specified in 13 CFR 131.301(f)(1), assuming that such rights were the only rights causing the affiliation. Venture capital and private equity-backed companies should take note that such rights must be irrevocably waived. Any rights that "snap back" are likely to be given present effect, and the affiliation would not be severed.
- **Affiliation as applied to the Alternative Size Standards.** As noted under "Eligibility" above, a business that, together with its affiliates, is a "small business concern" is also an eligible borrower if it meets both tests in the SBA's "alternative size standard". In an FAQ released on April 8, the SBA provided that a business could meet those tests if, as of March 27, 2020: (1) maximum tangible net worth of the business is not more than \$15 million; and (2) the average net income after federal income taxes (excluding any carry-over losses) of the business for the two full fiscal years before the date of the application is not more than \$5 million. The SBA clarified in the April 8 FAQ that the affiliation rules must be applied to the alternative size standard. This has provided an opening for private equity and venture capital investors to consider whether, after applying the affiliation rules, a portfolio company will meet those tests because the tangible net worth and net income of the entire affiliated group meets those standards. The SBA has not issued any guidance on this approach, but absent additional guidance, it appears that institutional investors may rely on the alternative size standard for portfolio companies that are otherwise able to make the necessary certifications. This raises questions, such as whether to count the funds, whether to count the management company, whether to calculate net income on a book or tax basis and whether negative amounts can be netted against positive amounts. There is no place on the application for the alternative size standard so applicants relying on the alternative size standard should use Addendum A to articulate the basis of its eligibility. Addendum A should clearly describe the calculations as applied to each affiliate company, descriptions of any assumptions it is making and any other relevant facts.

## Excluded Borrowers

The following types of businesses are specifically excluded from PPP loan eligibility by one of the recent interim final rules, or are ineligible to receive such a loan based on statute:

- **No PPP loans for "illegal" businesses.** The Initial Interim Final Rule confirmed that businesses engaged in any activity that is illegal under federal, state, or local law are ineligible for PPP loans. For example,



this may prevent cannabis companies from obtaining PPP loans.

- **No PPP loans for businesses or business owners with prior government loan delinquencies or defaults.** The Initial Interim Final Rule stated that any applicant, or any other businesses such applicant owns or that is controlled by it or any of its owners, is disqualified from a PPP loan if such applicant is currently delinquent on, or has defaulted within the last seven years on, a direct or guaranteed loan from the SBA or any other federal agency. For businesses with institutional investors, this may require diligence regarding whether any portfolio companies of such institutional investors are or have been delinquent or in default under any loans obtained from or guaranteed by the SBA or any other federal agency.
- **Ineligible borrowers.** The following non-exhaustive list of businesses are generally ineligible for SBA loans pursuant to 13 CFR §120.110, and they are also ineligible to receive PPP loans:
  - Financial businesses primarily engaged in lending (e.g., banks)
  - Life insurance companies
  - Businesses located in another country or owned by undocumented aliens
  - Pyramid sale distribution plans
  - Businesses involved in any illegal activity
  - Businesses in which the lender or an associate owns an equity interest
  - Businesses that derive more than one-third of their gross annual revenue from legal gambling
  - Private clubs and businesses which limit the number of memberships for reasons other than capacity
  - Government-owned entities (except businesses owned or controlled by a Native American tribe)
  - Businesses with an associate who is incarcerated, on probation or parole, or who has been indicted for a felony or crime of moral turpitude
  - Businesses primarily engaged in political or lobbying activities
  - Businesses which have a prurient or sexual nature
- Companies considering a PPP loan should review the entire list of ineligible businesses in 13 CFR § 120.110 and determine that they are not among the businesses made expressly ineligible.

## Use of Proceeds and Loan Forgiveness

The CARES Act generally provides for forgiveness of loan proceeds that are used for permitted purposes. It is anticipated that the rules regarding forgiveness will be supplemented and may change as further rulemaking and guidance is issued. Such additional guidance is due to be issued by April 26, 2020.

- **At least 75% of PPP loan proceeds must be used for Payroll Costs and no more than 25% of loan forgiveness may be attributable to non-Payroll Costs.** The CARES Act provided that, in addition to Payroll Costs, PPP loans could be used for certain rent, utility, and mortgage interest payments and that all such uses of proceeds during the eight-week period following the disbursement of a PPP loan could be forgiven, subject to certain limitations. The Initial Interim Final Rule confirmed initial SBA and U.S. Department of the Treasury guidance that these non-Payroll Costs may not comprise more than 25% of the loan forgiveness amount and further provided that at least 75% of PPP loan proceeds must be used for Payroll Costs. The CARES Act would also permit PPP loans to be used for other purposes currently permitted for Section 7(a) loans, which include broad categories such as working capital, purchasing furniture and fixtures, inventory, and purchasing machinery or equipment; however, SBA guidance with respect to PPP loans has not provided any clarification as to whether there are PPP-specific limits on such uses that were previously permitted for Section 7(a) loans. Borrowers will be required to provide documentation verifying how proceeds are used. Note that this use of proceeds does not terminate after the eight-week loan forgiveness calculation period. If the proceeds are not fully utilized in those eight weeks,

they still must be used for permitted purposes.

- **Principal and interest may be forgiven.** The CARES Act provides for forgiveness of all or a portion of the principal amount loaned under the PPP loans. The Initial Interim Final Rule indicated that interest accrued on a PPP loan may also be subject to forgiveness, subject to the limitations set forth in the CARES Act and elsewhere in the Initial Interim Final Rule. Lender promissory notes seem to vary on this point, so the terms of your lender's specific promissory note may affect whether interest is subject to forgiveness.
- **Reduction of the amount eligible for loan forgiveness.** The amount of loan forgiveness may be reduced if a borrower has enacted layoffs, furloughs, or wage or salary reductions prior to its receipt of its PPP loan disbursement. It should not, however, subject the borrower to any specific scrutiny with respect to the loan as long as the borrower uses the proceeds for other permitted purposes. For borrowers that have already reduced their workforce or payroll costs, we see the following two primary considerations from a practical perspective.
  - **First**, reductions in headcount and/or reductions in wages and salaries lower a borrower's "payroll costs" and thus may reduce a borrower's amount of forgivable expenses. Consider how the loan amount compares to (1) the borrower's payroll expenses at current staffing levels (excluding the portion paid as wages or salary to any employee that is paid in excess of \$100,000 on an annualized basis), and (2) the borrower's anticipated rent, mortgage interest, and utilities expenses for the eight-week period after the loan is received. Would eight weeks of payroll costs at the borrower's current payroll rate equal at least 75% of the loan amount? The remainder of the PPP loan proceeds may be used for rent, mortgage interest, or utilities expenses (all for obligations incurred before February 15, 2020) and, as long as they do not exceed 25% of the total loan proceeds, such amounts may be eligible to be forgiven. If a borrower uses less than 75% of the loan proceeds on payroll costs, or if a borrower does not spend the full loan amount on these eligible expenses during the eight-week period, then the borrower will not qualify for full forgiveness. Instead, such borrower would qualify for forgiveness only for a reduced amount based on the amount actually spent on eligible expenses during the eight-week period immediately following the loan disbursement.
  - **Second**, there is a formulaic test under the CARES Act that determines the loan forgiveness amount. The loan forgiveness amount may be reduced if a borrower decreased its employee headcount and/or wages and salaries by more than 25% between February 15, 2020, and April 26, 2020. If the decreases occurred during this period, the additional reduction to the PPP loan amount to be forgiven could be avoided if the borrower reversed the decreases in employee headcount and/or wages and salaries by June 30, 2020. If the employee headcount and/or wage and salary decreases occurred before or after this time period, it is not clear under the CARES Act and subsequent guidance whether the borrower would be able to avoid a reduction to the amount of its PPP loan that would be forgiven. This reduction of loan forgiveness is separate from the practical limitations noted above and is based on a set of formulas contained in the CARES Act. To calculate this further reduction of forgiveness, a borrower would need to compare its average monthly full-time equivalent employee headcount and wage and salary amounts for individual employees in the time periods specified in the CARES Act, against its average monthly full-time equivalent employee headcount and the wage and salary amounts for such employees during the eight-week period after the PPP loan is disbursed. Again, for businesses that have reduced their employee headcount and/or salaries and wages between February 15, 2020, and April 26, 2020, this reduction to the amount of the PPP loan that may be forgiven may be avoided if the employee headcount and/or wage and salary reductions are reversed by June 30, 2020.

As noted elsewhere in this update, further guidance on forgiveness is due to be provided by the SBA through rulemaking to be issued by April 26, 2020, which may clarify or modify the description provided above.

## Endnotes

[1] The SBA FAQ issued on April 8, 2020, confirmed that a business that qualifies as a small business concern under section 3 of the Small Business Act, 15 U.S.C.632 may truthfully attest to its eligibility for PPP loans on the application unless otherwise ineligible. (Please see FAQ below for more information).

[2] Notably, the summary of affiliation rules applicable to the PPP Loans, which was published on the Treasury Department's website on April 3, 2020, does not include the other bases for affiliation based on identity of interest set forth in 13 CFR 121.301(f)(4)(iii) and (iv) (common investments and economic dependence). As explained in an internal SBA memo dated April 4, 2020, the SBA has concluded that those bases for affiliation were made inapplicable to PPP loans by the CARES Act. The failure of the rule to include the common investments and economic dependence factors is more favorable for applicants with VC and PE fund equity holders.

## **Tax Implications for PPP Loan Recipients**

- The amount of the PPP loan which is forgiven is not taxed as cancellation of debt income.
- Any company that receives a PPP loan is ineligible for the refundable employee retention tax credit authorized by the CARES Act.
- Even though the CARES Act permits a deferral of the employer's share of Social Security taxes for this year, once all or a portion of the PPP loan is forgiven, the borrower loses its ability to defer future payments of its portion of Social Security taxes.

## **Frequently Asked Questions**

### **Eligibility**

#### **1. What if I sold or acquired a business in 2019?**

No specific guidance has been provided from the SBA on this topic specifically with respect to PPP loans. Using the same analogies used by the SBA's Office of General Counsel in a letter they sent to Capital Access on April 4, 2020, which can be found [here](#), one could extrapolate from guidance provided in 13 CFR 121.106(b)(4) to say that, (1) for companies that sold off a division in the last 12 months, the division that was sold off would be excluded from the calculation for the full 12 months, regardless of when the sale occurred, and (2) for companies that completed an acquisition in the last 12 months, the employees would be included for the full 12 months. This could affect both the employee count used on the first page of the PPP loan application and the calculation of the average monthly payroll. It is also not clear whether these analogies are applicable to the determination of tangible net worth and net income for purposes of the alternative size standard determination. Additional SBA rulemaking or guidance could come to a different conclusion.

#### **2. What about businesses that are too large to qualify for PPP loans or Economic Injury Disaster Loans?**

For businesses that are too large to qualify for either PPP loans or Economic Injury Disaster Loans

(EIDLs), whether due to their own size or on a combined basis with their affiliates, additional government financing is being made available in the days to come, including an expansion to the Main Street Lending Program, which the Federal Reserve Board announced on April 9, 2020. The portion of the CARES Act referred to as the Coronavirus Economic Stabilization Act of 2020 (CESA) includes approval for a \$500 billion loan and subsidy program for loans, loan guarantees, and other investments in larger businesses. This includes relief for certain specified industries, such as air carriers, as well as a loan program for mid-size businesses with 500-10,000 employees. The loan programs authorized under CESA are separate from the PPP loans and EIDLs described in this update. For more information on these loan programs, see our publication ["Government Financing Options for Mid-Size and Large Companies Impacted by COVID-19."](#) For more information about the Main Street Lending Program, see our publication ["Federal Reserve Board Announces Additional Support for Small and Medium-Sized Businesses."](#) Both remain subject to further rulemaking but offer a source of funding for companies that exceed the limits for PPP loans or that need funding support beyond what they can obtain through PPP loans.

### 3. What is Economic Necessity?

This has been the subject of much confusion. On April 23, 2020, the SBA and Department of Treasury issued a FAQ on this topic. That FAQ focused on businesses owned by large companies that have adequate sources of liquidity to support the business's ongoing operations. The FAQ highlights that the CARES Act suspends the ordinary requirement that borrowers must be unable to obtain credit elsewhere, but notes that borrowers still must certify in good faith that their PPP loan request is necessary. The FAQ states that borrowers must make the following certification in good faith: "[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant." In doing so, borrowers should take into account their 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. The FAQ states that it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith. Such company should be prepared to demonstrate the basis for its certification to the SBA.

The April 23 FAQ also provides borrowers that are uncertain about their ability to make this certification an opportunity to repay their PPP loan and mitigate the risk of liability. Specifically, the FAQ provides that, "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."

Except for the guidance noted above, there is no SBA guidance on what this certification of "necessity" requires. As a result, at least for now, companies will have to rely on common sense and good business judgment and be very transparent and forthright about the nature of the adverse impacts they are experiencing or expecting. It is effectively an honor system (i.e., self-certification of eligibility) at the application stage, but government audits are likely on the back end for companies that receive this funding (not surprisingly).

The ambiguity regarding the "necessity" certification on the PPP loan application has caused many PE and VC backed companies (and particularly their investors) to become concerned about the potential for adverse PR if or when these companies are later "outed" as having received bailout funding, particularly if it turns out there are other "more deserving" small businesses who end up failing due to insufficient funding. The April 23 FAQ focused on large companies with access to capital. This was driven by adverse publicity regarding Shake Shack, Ruth's Chris Steakhouse, and other large companies that operate businesses that were able to obtain a PPP loan because their NAICS code begins with 72. There could be a

similar outcry with respect to PE and VC backed funds, although the business models are fundamentally different. The fact that a company is owned by an institutional investor could result in a similar argument regarding access to capital. Although there are some very large PE funds that are publicly traded, most are backed by state pension funds, corporate ERISA funds, and other investors with capital commitments that are capped, must be called with at least ten days' prior notice, and the proceeds of which are to be invested pursuant to carefully negotiated documents.

In addition to (and more serious than) the PR issues, there are legal consequences to making a false certification on a PPP application. Knowingly false certifications violate federal criminal law and can result in jail time and significant financial penalties, and certifications made with reckless disregard for, or intentional ignorance of, the truth can result in civil False Claims Act liability for, as an example, three times the value of the loan plus additional financial penalties. You can read more about these risks in the context of PPP loan applications [here](#).

Consistent with the April 23 FAQ, our general view is that an applicant should carefully assess its circumstances before it submits a PPP loan application and create a record so that the company is prepared to articulate its reasoning and demonstrate the nature of its need and the basis for its certification. We recommend that each applicant make sure it has a reasonable and good faith belief/expectation that the adverse impact on its business from the shutdown would be likely to cause the company to reduce operations (i.e., layoffs/furloughs) over the next several months, and that the PPP funding would enable the company either to avoid those cutbacks or reduce their scope. Applicants should document any decrease in its business due to COVID-19, supply chain issues, loss of revenue, inability to operate at full capacity and any other facts that support the economic necessity. Ultimately, the intent of the PPP program is to prop up employment, so if a company can say reasonably, after considering all of its relevant circumstances, that, in the absence of the program, it would take steps to reduce headcount/expense over the next few months and conversely that with the program those steps would be avoided or mitigated, then the company may have a reasonable basis for certifying its need for the loan request.

#### **4. Can a foreign-owned business obtain a PPP loan?**

There is language in the pre-existing rules related to the SBA's 7(a) loan program (13 CFR 120.110) that specifically states that, although businesses located in a foreign country are not eligible, "businesses in the U.S. owned by aliens may qualify." Guidance from the SBA provided on April 4, 2020, in the context of the PPP loans also reiterated that the SBA defines a "business concern" (which is part of the eligibility criteria) as "an agricultural cooperative or for-profit business entity with a place of business located in the United States, and which operates primarily within the United States or which makes a significant contribution to the U.S. economy through payment of taxes or use of American products, materials or labor."

For a company that does not primarily operate in the U.S. or make a significant contribution to the US economy, the language quoted above could be problematic, but this does not mean that foreign-owned businesses are strictly prohibited from obtaining the loans.

#### **5. Is there a distinction between essential businesses which remain open and keeping some employees working (but also suffering from reduced business and employees taking leave), and non-essential businesses which are completely shut down?**

The SBA guidance and CARES Act do not treat essential businesses differently than non-essential businesses for purposes of the PPP loans.

## **Affiliation**

- 1. Does a private equity investment that is below 50% ownership cause the expansion of the affiliated employee count? What about negative controls that the PE firm has? Can those trigger the affiliation-based employee count?**

While 50% ownership is presumed to mean control, and thus apply the affiliation rules, affiliation can also be applied based on the existence of negative controls held by a minority owner. If affiliation applies under either test, the business will need to include the affiliate companies' employees in the employee count.

With respect to negative controls, the company should think about the potential operational effect if the investor-appointed director or minority owner exercised its right to block the applicable action every time it has the opportunity to do so. If the action is one that the company rarely, if ever, would take, given its particular circumstances (not just given the type of company it is and/or the type of investors it has), then the company might reasonably conclude that the power to block that action does not require a finding of affiliation. If, on the other hand, the blocking right could exert meaningful influence on the way the board or the company's management runs the business, then it is a closer call. For example, is there any reason to think that the power to prevent payment of a dividend would allow the investor to exert outsized influence on operational decision-making? The company should think about each of the veto rights in a similar fashion and reach a reasonable conclusion about each of its minority equity holders.

- 2. Does a waiver signed by all investors of all controlling rights associated with operations exempt the company from being subject to the affiliation rules?**

Based on guidance provided by the SBA on April 6, 2020, if a minority equity holder in a business irrevocably waives or relinquishes any existing rights specified in 13 CFR 121.301(f)(1), the minority equity holder would no longer be an affiliate of the business (assuming no other relationship that triggers the affiliation rules).

- 3. If a VC investor is deemed to be an affiliate and the applicant, including the VC investor's employees and portfolio employees, still has fewer than 500 employees, will that VC's financial info including tax returns need to be included in the application?**

The law does not require the affiliates to submit financial or tax information. However, it is possible a lender may ask for that.

- 4. How do you deal with a restaurant that has 500 or fewer employees but that is part of an affiliated group that has more than 500 employees?**

Assuming the restaurant has a NAICS code starting with 72, then the affiliation analysis would not apply and the restaurant can assess its eligibility without regard to affiliation.

**5. Do the affiliation rules apply to privately or family-held companies with affiliates?**

The affiliation rules apply to all companies, except where a waiver of the affiliation rules has been provided (businesses with NAICS codes starting with 72, franchises, and companies with SBIC financial support). If, for example, an individual or family group owns 50% or more of multiple companies, even though each company has fewer than 500 employees, those companies would be grouped together and subject to the affiliation rules through their common owner for purposes of determining eligibility (unless they are subject to one of the specified waivers of the affiliation rules).

## **Loan Amount**

**1. I have foreign contractors that cannot apply for their own PPP loan, but represent a significant portion of our monthly burn rate. Can my business include those costs in calculating its loan amount?**

No, amounts paid to non-U.S. employees and amounts paid to independent contractors cannot be included in the calculation of a business' loan amount.

**2. Can an owner under an LLC who takes distribution vs. salary as an employee include up to \$100,000 in calculating the potential loan amount?**

Guidance provided by the SBA through an interim final rule issued on April 14, 2020 indicates that partners in a partnership may apply for a PPP loan on behalf of their partnership, rather than applying for PPP loans individually. We believe this would logically apply in a similar fashion for owners of an LLC that is taxed as a partnership. This differs from earlier guidance provided by some SBA practitioners who believed that partners or LLC owners would be treated the same as sole proprietors and be required to apply for a PPP loan individually. Under the April 14 interim final rule, a partner in a partnership would include their IRS Form 1040, Schedule C, line 31 net profit amount, up to \$100,000 annualized, plus the entity's employees' payroll costs (subject to the \$100,000 limitation discussed elsewhere in this update), to calculate the amount of the loan for the partnership.

**3. Are employer contributions to 401(k) plans included in the calculation of average monthly payroll costs?**

The CARES Act includes as a "payroll cost" "payment of any retirement benefit". This suggests that employer contributions to a retirement account would be included in the "payroll costs" that are used to calculate a borrower's "average monthly payroll costs" and loan amount and would also be a permitted use of loan proceeds.

#### 4. Can the calculation of the loan amount include expenses such as rent?

Rent expense is not taken into account in calculating the maximum amount of a PPP loan that may be borrowed. However, up to 25% of the loan may be used for certain rent, mortgage, utility, and interest payments.

### Existing Indebtedness

#### 1. What if an applicant's existing loan documents prohibit additional indebtedness?

Each company should review its existing debt agreements to determine whether additional indebtedness is permitted. If indebtedness is prohibited and a company wishes to apply for a PPP loan or an EIDL, companies should contact their lenders to confirm the lender's willingness to permit this indebtedness. In most cases, lenders are amenable to the additional debt due to the forgivable nature of all or a portion of the debt, the fact that it is unsecured, and the low interest rate. It may be more difficult to get lenders to agree to accommodate EIDL loans because they must be secured and they are not forgivable.

#### 2. Borrower concerns.

- **PPP loan to be "Permitted Debt" under the loan agreement.** In most cases, this also addresses any mandatory prepayment requirements.
- **PPP loan not to be a mandatory prepayment under the loan facility.** If permitted debt is not carved out of the mandatory prepayment from debt issuances, this requirement needs to be waived. Using PPP loan proceeds to pay down existing debt does not qualify for forgiveness of the PPP loan, and the terms of a PPP loan note may prohibit using proceeds to pay down existing debt.
- **Financial Covenants.** Borrowers are seeking to carve out the PPP loans from debt for financial covenant calculations. Most lenders have agreed to accommodate this request with the caveat that when the forgiveness amount is determined, any remaining PPP debt will count. Some are counting it retroactively to the date of the loan origination, others will start counting it in the third quarter compliance tests. Still others are looking at the amortization on a forward basis.
- **Other financial covenant considerations.**
  - It is reasonable to request that the costs and expenses associated with the amendment and the PPP loan be added back to earnings before interest, taxes, depreciation, and amortization (EBITDA).
  - Some formulations of EBITDA would reduce EBITDA for the loan forgiveness. This should be eliminated.
- **Requirement for loan amount to be deposited in an account that is swept to the revolving loans.** Some loan facilities sweep all cash on a daily basis to be applied to reduce the outstanding revolving loans. These loans can then be reborrowed, but the borrowing is subject to conditions. If the borrower cannot meet the conditions, it will not be able to use these proceeds which will affect the amount of forgiveness. We recommend a separate account for PPP proceeds and an acknowledgment from the lender that the PPP loan is not part of the "Obligations". We are also recommending an acknowledgment from the lender that it will not freeze or foreclose on the account, even if there is a default, unless it is exercising its rights and remedies.



- **Prohibitions on payments of PPP principal.** We have seen some amendments that permit the payment of current interest on the PPP loan, but prohibit principal payments. This could work if the PPP loan only requires a bullet payment at maturity. In that case, the parties can decide at the time to how address the required payment, which could include a variety of solutions. However, many notes require straight-line principal and interest payments during the term of the note (after the six-month deferral). Borrowers should not agree to an amendment that does not permit it to make payments on the PPP loan. These prohibitions are becoming less common, probably because there is more visibility regarding the repayment terms of PPP Loans.
- **Requirement that the PPP loans be applied in a certain order.** Amendments are now starting to require the PPP loan proceeds to be applied **first** to payroll costs, then for other items that can be forgiven under the CARES Act, and then for other permitted 7(a) purposes. The borrower still needs to pay rent, utilities, and other expenses at the same time that is paying payroll costs and this requirement seems to imply that those other costs must be deferred.
- **Representations.** Lenders are including representations by the borrower that the application materials are true and correct. We are recommending that borrowers request that this be modified by "in all material respects as of the date submitted". Because of the confusion and contradictory guidance that accompanied the rollout of this program, it is possible that some immaterial errors may have been made. In addition, borrowers should review the representations and warranties in its existing facility to determine whether certain representations cannot be made (e.g., solvency) and how to address this.
- **Covenants.** Lenders are likely to include covenants requiring the borrower to require compliance with the CARES Act including the use of proceeds. Borrowers should be aware that this is creating an independent default under its existing credit facility if there is non-compliance with the CARES Act, even if the PPP lender or the SBA are not declaring a default. We are recommending that borrowers request materiality with respect to these covenants. Lenders are also likely to include additional covenants including maintaining appropriate records, promptly applying for loan forgiveness, and information requirements.
- **Cross Default.** Most loan agreements have a cross default to other indebtedness in excess of a certain threshold. These cross defaults are broad and include any breach or default of a provision that would entitle the lender to accelerate its loan. We have encouraged borrowers to work with lenders to see if there are reasonable modifications that can be made to the cross default.

### 3. **I received an Economic Injury Disaster Loans (EIDL) loan. Am I still eligible to receive a PPP loan too?**

Borrowers that received an EIDL from the SBA from January 31, 2020 through April 3, 2020 can apply for a PPP loan. If the EIDL was not used for payroll costs, it does not affect the borrower's eligibility for a PPP loan. If the EIDL was used for payroll costs, the PPP loan must be used to refinance the EIDL (if incurred prior to April 3, 2020). Proceeds from any advance up to \$10,000 on the EIDL will be deducted from the loan forgiveness amount on the PPP loan.

## **General/Miscellaneous Questions**

1. **How are the funds distributed? For example, is it purely first-come, first-served, or is the SBA looking to spread the funds out to different lenders, sectors, etc.?**

The SBA has provided guidance that loans will be disbursed on a first-come, first-served basis and will be funded within ten days of being approved. We are not aware of any formal allocation amounts for each bank; however, we have heard that some banks have applied their own internal limits as to the amount they will loan under this program from a liquidity and risk-mitigation perspective.

**2. The program says it applies for sole proprietors, but they do not get payroll. With 2019 tax returns not yet done, can a sole proprietor use 2018 tax returns to support their income?**

The SBA regulations are not clear as to what documentation of income would be acceptable with respect to sole proprietors. We would direct this question to your specific lender to see what documentation they would accept with respect to 2019 income.

**3. It seems very clear to me that phone service (telecommunications) is a "utility". For a SaaS business that purchased data services such as Amazon Web Services, would such data services constitute "utilities"?**

Telephone and internet access are expressly included in the CARES Act provisions regarding forgiveness as "covered utilities".

**4. What happens if you accidentally borrow more than you need to pay the permitted expenses?**

The excess amount will need to be repaid pursuant to the terms of your promissory note. We have seen some promissory notes that impose limitations on the use of proceeds beyond the limits required under the CARES Act and the SBA guidance.

**5. If a company has laid off employees already and cannot hire everyone back who counted for the payroll calculations, it sounds like that affects forgiveness but does it further subject borrower to scrutiny for not following the guidelines of the loan?**

This may likely affect forgiveness but should not subject the company to any specific scrutiny with respect to the loan as long as the company uses the proceeds for other permitted purposes. Additional guidance regarding forgiveness is anticipated from the SBA.

**6. If additional funds are allocated to the PPP loan program, what should companies do next if they are interested in obtaining a PPP loan?**

- Perkins Coie can help answer questions about your eligibility for a PPP loan, including how the affiliation rules may apply to your business.
- Contact an SBA lender in your area or with whom you may have an existing relationship (this is the SBA lender match website: <https://www.sba.gov/funding-programs/loans/lender-match>). Eligible applicants who wish to apply should move quickly to claim their place in line if/when additional funds are allocated to the PPP loan program.
- Consider what consents will be required to obtain a PPP loan, including from any existing lenders.

## EIDL Loan Program Overview

Economic Injury Disaster Loans (EIDLs) are loans made directly by the SBA to business that have suffered substantial economic injury from COVID-19 such that they are unable to meet their obligations as they mature or to pay their ordinary and necessary operating expenses (loss of profits/sales alone insufficient). The CARES Act modifies the SBA's EIDL program by offering expanded eligibility and loosening requirements for borrowers. The original allocation of \$10 million for this program has now been increased to \$20 billion.

### Loans

Specific terms and amounts of EIDLs will be determined by the SBA on a case-by-case basis, but general information on EIDLs is summarized below.

- **Maximum Loan Amount and Term.** The EIDL program provides loans of up to \$2 million with a maximum term of 30 years, each determined by the SBA on a case-by-case basis for eligible entities.
- **Interest.** Interest rates for EIDLs are 3.75% for for-profit organizations and 2.75% for private nonprofit organizations, and there are no upfront charges or prepayment penalties.
- **Use of Proceeds.** EIDLs may be used for working capital purposes necessary to carry on the organization's business, which include the payment of fixed debts, payroll, accounts payable, sick leave, and other obligations that cannot be met because of COVID-19's impact. EIDLs may not be used to refinance debt incurred prior to the disaster event, to make payments on other loans owed to a federal agency, to pay tax penalties or government fines, repair physical damages, or pay dividends to owners (except for reasonable payments directly related to their performance of services for the company).
- **Collateral and Guarantees.** Loans over \$200,000 will require collateral and may require personal guarantees from principals. The SBA will not decline a loan for lack of collateral but will require the borrower to pledge what is available. Loans under \$200,000 will not require personal guarantees or collateral.
- **Forgiveness.** EIDLs will not be forgiven and thus must be repaid.

### Emergency Grants

In addition, small business concerns and private nonprofit organizations may apply for EIDL emergency grants of up to \$10,000, which the SBA intends to disburse in as few as three days after receiving a qualified application. Unlike the loans, these grants do not have to be repaid. EIDL emergency grants may be used for the following purposes:

- Providing paid sick leave to employees unable to work due to COVID-19
- Maintaining payroll to retain employees during business disruptions or substantial slowdowns
- Meeting increased costs to obtain materials due to interrupted supply chains
- Rent or mortgage payments
- Repayment of obligations which cannot be met due to revenue loss

### Eligibility

All small business with fewer than 500 employees (or larger businesses that are designated as small by virtue of the size test for its [NAICS code](#)) (including sole proprietorships, independent contractors and self-employed

persons, or private nonprofit organizations). Such small businesses must have been in operation since at least January 31, 2020, and must have suffered substantial economic injury from COVID-19, to be eligible for loans and grants under the EIDL program. Private nonprofit organizations include tax-exempt organizations under 501(c), (d), and (e) of the Internal Revenue Code and nonprofits under state law. The SBA has clarified that faith-based organizations that are otherwise eligible to receive loans are eligible regardless of whether they provide secular social services. Certain federal nondiscrimination requirements apply while the organization has an outstanding obligation to the government. The bill approved by the Senate on April 21, 2020 would also permit agricultural enterprises to receive EIDL grants and loans. The SBA has clarified that for faith-based organizations that receive loan proceeds, these requirements apply to goods, services, or accommodations offered generally to the public (e.g., a restaurant or thrift store), but that it is not the federal government's intent to limit most other activities or impose substantial burdens on faith-based loan recipients. Certain eligibility requirements are waived from now until December 31, 2020, including, for example, that organizations be in operation for a year and show they could not obtain funds from elsewhere. The CARES Act also waives the requirement of a personal guarantee on loans of up to \$200,000.

Eligible entities are no longer required to submit tax returns to the SBA to prove their ability to repay the loans. Instead, the SBA will assess the ability of an eligible entity to repay the loan solely through the applicant's credit score, or "alternative appropriate methods to determine an applicant's ability to repay."

Private nonprofit organizations that are principally engaged in teaching, instructing, counseling, or indoctrinating religion or religious beliefs, whether in a religious or secular setting, or primarily engaged in political or lobbying activities, however, are not eligible under the EIDL program.

## **Frequently Asked Questions**

### **1. What should companies do next if they are interested in obtaining an EIDL?**

As with PPP loans, Perkins Coie can help answer questions about your eligibility for an EIDL, including how the affiliation rules may apply to your business. Applications for EIDLs can be made directly through the SBA's website. As with PPP loans, applicants for EIDLs will need to consider what consents will be required to obtain an EIDL, including from any existing lenders.

### **2. Can a business obtain both a PPP loan and an EIDL?**

Yes, a company can obtain both a PPP loan and an EIDL, so long as any portion of an EIDL that was obtained between January 31, 2020 and April 3, 2020 and used for payroll costs is refinanced into a PPP loan. If your EIDL was not used for payroll costs, it does not affect your eligibility for a PPP loan.

## **Resources**

- [CARES ACT](#)
- PPP Initial Interim Final Rule - Effective April 3, 2020
- PPP Affiliation Interim Final Rule - Effective April 3, 2020
- [PPP Interim Final Rule - Additional Eligibility Criteria and Requirements for Certain Pledges of Loans](#) - Effective April 14, 2020
- FAQ Regarding Participation of Faith-Based Organizations in PPP and EIDL - Published April 3, 2020
- SBA PPP Loan FAQ - Published on an incremental basis beginning on April 8, 2020
- SBA Standard Note Form

- [PPP Borrower Application Form](#)
- [Economic Injury Disaster Loans](#)
- [Paycheck Protection Program and Health Care Enhancement Act](#) - approved by the Senate on April 21, 2020, and by the House of Representatives on April 23, 2020

**As illustrated by the many changes noted above, eligibility requirements for PPP loans, the process for obtaining a PPP loan, and the terms of the PPP loans are all rapidly evolving. For the latest information and clarification regarding specific circumstances, please contact your Perkins Coie lawyer.**

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