Investment Management Alert

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The Paycheck Protection Program: New Stimulus Package Contains Forgivable Emergency Loan Program For Certain Firms

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Key Points

- The Paycheck Protection Program (PPP), contained within the stimulus package signed by President Trump on March 27, 2020, creates a $349 billion loan facility to help "small" businesses make payroll and pay certain other costs over the next few months.
- Fund managers with fewer than 500 employees, and certain of their portfolio companies, may qualify for forgivable loans under this program, depending on the particular facts and circumstances.
- A PPP loan will be forgiven to the extent firms (a) use the loan for certain "allowable uses" in the eight (8) week period following the issuance of the loan, and (b) maintain certain conditions regarding the size and compensation of their workforce.
- Where applicable, PPP loans create a *disincentive* to laying off staff in the coming weeks, as the federal government largely would be stepping in to subsidize the applicable payroll costs.
- Firms considering seeking a PPP loan should move quickly, and should ensure they also understand the impact of such a loan on the availability to other relief under the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act" or the "Act").

The CARES Act and the Paycheck Protection Program

On March 27, 2020, President Trump signed the CARES Act as the latest and boldest federal governmental response to the novel coronavirus (COVID-19).

The Paycheck Protection Program, contained within the Act, offers a potential lifeline to small firms facing headwinds as a result of ongoing market disruption. The PPP is an emergency loan program intended to allow borrowers to continue to make payroll and pay other "allowable" costs over an eight (8) week period. So long as loans are utilized for an "allowable use" during this time period, including paying employee salaries, providing group health benefits, and paying rent and utilities, the loans are forgivable, subject to certain reductions discussed in item 8 below. Where applicable, the PPP provides a disincentive to laying off staff over the coming weeks, as the government largely would be subsidizing the cost of employing such personnel.

The PPP amends the Small Business Act, 15 U.S.C. § 636(a), and is administered by the Small Business Administration (SBA). In total, the Act authorizes $349 billion for applicable loans, with individual loan amounts to be based on the borrower's payroll costs over a two-and-a-half (2½) month period, up to a maximum loan of $10 million. The deadline for obtaining a loan under the Program is June 30, 2020. The SBA will be issuing regulations regarding the PPP by April within 15 days of enactment. Firms that qualify for a PPP loan may be ineligible for certain other relief provided by the CARES Act, including the payroll tax credit and tax deferral programs discussed below.

This Alert addresses some anticipated questions in connection with the PPP. Because the availability, terms and conditions of a loan for any particular business will depend upon the relevant facts and circumstances – and on the language of the forthcoming SBA regulations – firms should consult counsel to further understand their rights and options.

1. What businesses are eligible to receive loans under the PPP?

The following businesses are eligible to receive loans under the Program: (i) businesses that already qualify as small businesses based on revenue or employee thresholds under the SBA's size standards;[1] (ii) businesses with 500 or fewer employees (unless the SBA requires a different threshold for the applicable industry),[2] and (iii) certain businesses in the hospitality and restaurant industries that employ no more than 500 employees per physical location. Sole proprietors, independent contractors and other self-employed individuals also are eligible for these loans, as are certain nonprofits, veterans' organizations and Tribal-owned businesses.

2. How are employees counted for purposes of determining eligibility under the PPP?

For purposes of the PPP, "employees" include individuals employed on a full-time, part-time, or other basis. The number of employees is determined based on the business' average number of employees for each pay period over the previous twelve (12) months. Importantly, under the applicable "affiliation" rules, the employees of affiliated companies are generally aggregated in applying the 500-employee (or other applicable) ceiling. Thus, a firm with fewer than 500 employees may nevertheless be disqualified if the firm and its affiliates collectively have more than 500 employees (or cross the applicable industry-specific threshold). The PPP does contain exceptions from this general rule, as discussed in item 4, below.

3. What is the definition of "affiliate"?

Businesses may be considered affiliated where one controls, or has the ability to control, the other. Affiliation can be based on any of the following: (i) equity ownership of one entity in another, (ii) an identity (or substantial identity) of business or economic interests, (iii) common general partners, managing members, directors, or officers, (iv) stock options, convertible securities, or agreements to merge, or (v) a totality of the circumstances. There is considerable authority under the existing SBA regulations and case law applying this definition, thus requiring a "case-by-case" analysis to assess affiliation in any particular circumstance. Private equity firms and their portfolio

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companies will want to pay particular attention to this guidance, and to the forthcoming SBA implementing regulations.

4. Are there exceptions to the general affiliation rule?

Yes. The PPP waives the foregoing affiliation rules with respect to (i) certain businesses in the hospitality and restaurant industries, (ii) certain franchises, and (iii) small businesses that receive financing through the Small Business Investment Company (SBIC) program (which provides access to venture capital from privately-organized and privately-managed investment firms). The potential application of these exceptions to private equity-owned companies will likely be of critical of importance over the coming months.

5. What other conditions must a firm satisfy to receive a loan under the PPP?

A borrower must certify that (i) the loan request is "necessary" to support its ongoing operations, (ii) the funds from the loan will be used to retain workers and maintain payroll or make mortgage, lease, and/or utility payments, and (iii) the firm does not have a pending application with, nor is it receiving funds from, another SBA program for the same purpose and amount as the loan request.

6. Are fund managers eligible to receive loans?

There are no industry-specific exclusions precluding fund managers from qualifying for PPP loans, so long as a firm has 500 or fewer employees and satisfies the other loan criteria. However, to the extent a fund manager has "control" over another company, as defined in the affiliation rules discussed in item 3 above, the employees of such a company would be aggregated with the fund manager's employees for purposes of determining size. Therefore, as a practical matter, it may be easier for hedge fund managers and managers of certain asset classes (e.g., credit, real estate, venture, secondaries and other classes that are not typically focused on control-oriented portfolio interests) to qualify for such loans. Even in the typical private equity buy-out context, certain firms and/or portfolio companies may be eligible for such loans. The application of the affiliation rules, and the limited waiver thereof, is likely to be a focal point of fund managers and portfolio companies over the coming weeks.

7. How much money can businesses receive under the loan program?

Eligible firms can receive up to the lesser of (i) two and a half (2.5) months' worth of certain Payroll Costs, and (ii) $10 million. For purposes of the PPP, "Payroll Costs" include salaries (up to an annualized rate of $100,000 per employee), paid time off (including vacation, parental leave, family leave, and medical leave), severance pay, group health care benefits, retirement benefits, and payment of state and local income tax on employee compensation. Payroll Costs do not include (a) salary for any employee in excess of an annualized rate of $100,000, (b) certain taxes imposed or withheld, including disability insurance tax and federal income tax, (c) compensation of employees based outside the U.S., and/or (d) paid leave that is eligible for a credit under the Families First Coronavirus Response Act (discussed here).

8. Under what circumstances will a PPP loan be forgiven?

PPP loans generally will be forgiven to the extent that they are used for the following purposes during the eight (8) week period after the loan originates: (i) Payroll Costs, (ii) interest payments on mortgage obligations, (iii) rent payments, and/or (iv) utility payments; provided that the amount of loan forgiveness will be reduced based on any reduction to the number of employees and/or to employee compensation over the loan period.

9. What are the other terms of a PPP loan?

PPP loans have several borrower-friendly terms. Borrower and lender fees are waived, as are collateral and personal guarantee requirements. The maximum interest rate is four (4) percent, and loan maturity can be as long as ten (10) years. No prepayment fees are charged. Loan payments can be deferred for six (6) to twelve (12) months.

10. Will my firm's receipt of a forgivable PPP loan disqualify it from receiving tax credits under the CARES Act?

Yes. A firm that receives a PPP loan is ineligible for the CARES Act's Employee Retention Payroll Tax Credit[3] and/or the Act's Delay of Payment of Employer Payroll Taxes program.[4] Those tax-related provisions of the Act are discussed here.

11. What lenders can issue a PPP loan?

The SBA lender list can be found here. Firms should navigate to the link of their local SBA office, which will have a resource guide listing the relevant information.

12. Are certain businesses more likely to receive loans than others?

The Senate recommends that the SBA Administrator issue guidance "prioritize[ing] small business concerns and entities in underserved and rural markets, including veterans and members of the military community, small business concerns owned and controlled by socially and economically disadvantaged individuals . . ., women, and businesses in operation for less than 2 years." But this list is by no means exclusive, and other businesses will be eligible for PPP loans as well.

1 See https://www.sba.gov/document/support--table-size-standards.

2 Certain industries are not subject to the 500-employee ceiling, and instead are subject to different SBA size or revenue standards. See 13 C.F.R. § 121.201. For example, certain oil and gas and manufacturing businesses have an employee threshold of between 1000 and 1500 employees, rather than 500, and e-commerce companies are subject to a revenue threshold of $41.5 million per year.

3 See CARES Act § 2301; Internal Rev. Code § 3111.

4 See CARES Act § 2302; Internal Rev. Code §§ 3111(a) and 1401(a).

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