Pratt's Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT®

JUNE 2020

LexisNexis

Pratt's Journal of Bankruptcy Law

VOLUME 16	NUMBER 4	June 2020

LexisNexis®

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:

Kent K. B. Hanson, J.D., at 415-908-3207
Email: .... kent.hanson@lexisnexis.com
Outside the United States and Canada, please call . . . . (973) 820-2000

For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at . . . . (800) 833-9844
Outside the United States and Canada, please call . . . . (518) 487-3385
Fax Number . . . . (800) 828-8341
Customer Service Website . . . . http://www.lexisnexis.com/custserv/

For information on other Matthew Bender publications, please call
Your account manager or . . . . (800) 223-1940
Outside the United States and Canada, please call . . . . (937) 247-0293

Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)
ISBN: 978-0-7698-7988-8 (eBook)
ISSN: 1931-6992

Cite this publication as:

[author name], [*article title*], [vol. no.] PRATT'S JOURNAL OF BANKRUPTCY LAW [page number] ([year])

Example: Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the "Rescue and Recovery" Culture for Business Recovery*, 10 PRATT'S JOURNAL OF BANKRUPTCY LAW 349 (2014)

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

MATTHEW BENDER

(2020–Pub.4789)

Editor-in-Chief, Editor & Board of Editors

Direct any editorial inquiries and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway, No. 18R, Floral Park, NY 11005, smeyerowitz@meyerowitzcommunications.com, 646.539.8300. Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher. POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, Attn: Customer Service, 9443 Springboro Pike, Miamisburg, OH 45342-9907.

The CARES Act: Paycheck Protection Program Provides Historic Aid for Small Businesses

By Martin Teckler and Grant E. Buerstetta*

The authors discuss the key elements of the Paycheck Protection Program for small businesses and lenders.

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act[1] (the "CARES Act") was signed into law. The CARES Act provides significant new funding to small businesses in the United States for the period covering March 1, 2020 through December 31, 2020. The provisions of the CARES Act directed at small businesses provide a significant increase in the funding that will immediately become available through use of the existing 7(a) loan program, which is administered by the United States Small Business Administration (the "SBA").

KEY PROVISIONS

Title 1 of the CARES Act (the "Keeping American Workers Paid and Employed Act") adds a new program (the "Paycheck Protection Program" or "PPP") to Section 7(a) of the Small Business Act of 1953, as amended (the "Small Business Act"). The legislation modifies certain existing limitations on the 7(a) loan program for PPP loans while also providing an unprecedented expansion of the scope of the 7(a) loan program—with an additional $349 billion in available funding over the next three months in a program that traditionally has funded approximately $20-25 billion per year. The interest from eligible small businesses is already intense, particularly as loans used to retain and pay employees will be eligible for whole or partial forgiveness.

The PPP will be administered through the SBA 7(a) loan program. The loans under the PPP will be underwritten and extended by financial institutions that are authorized to participate in the 7(a) loan program and will be guaranteed 100 percent by the SBA. Borrowers will not pay any fees associated with the making of these loans.

Some of the key points that interested small businesses should be aware of include:

---

* Martin Teckler, a partner in the Washington, D.C., office of Blank Rome LLP, may be contacted at mteckler@blankrome.com. Grant E. Buerstetta, a partner in the firm's New York City office, may be contacted at gbuerstetta@blankrome.com.

[1] Pub. L. No. 116-136 (2020).

- Loan amounts will be determined based on a business's average payroll costs during the one-year period prior to the date on which the loan is made, with a limit of 2.5 times average monthly payroll costs or $10 million, whichever is less;
- Loan proceeds, in addition to permitted purposes under the existing 7(a) loan program, must be used for payroll, certain employee expenses, mortgages, rent, utilities, and interest on indebtedness incurred before February 15, 2020;
- Borrowers must certify that economic conditions make the loan necessary to support operations, acknowledge that the funds will be used to retain workers or make mortgage, lease, and utility payments, and the recipient does not have an application pending for (or received funding under) another 7(a) loan for the same purpose;
- A loan will be eligible for forgiveness, but only to the extent that the loan is used for eligible purposes;
- The amount of forgiveness will be reduced as a result of workforce reductions or certain reductions in salaries, although businesses may rehire or reinstate salary reductions during the relevant period in order to attain full forgiveness;
- Borrowers will not be required to post collateral or provide personal guarantees to support repayment and loans will be non-recourse to individual shareholders, members, or partners so long as the covered loan is used for authorized purposes; and
- Loans will have a maximum interest rate of four percent and the unforgiven portions will have a maximum maturity of 10 years.

Key points of interest that 7(a) lenders, including banks and non-bank financial institutions and additional lenders that are authorized by the SBA, should be aware of include:

- Lenders will have delegated authority to make all credit and eligibility determinations and otherwise approve and fund all PPP loans;
- Loans under the PPP will be 100 percent guaranteed by the SBA;
- The SBA will not re-underwrite covered loans; and loans will not be subject to standard underwriting criteria (primarily because the loans will not be collateralized and are intended to be disbursed quickly to encourage retention of employees);
- Lenders will obtain documentation to establish the payroll costs of borrowers as part of the process of establishing permitted loan amounts;

- Lenders must agree to provide full deferment for six months to one year;
- Lenders may sell guaranteed loans, less any forgiveness amount, on the secondary market; and
- The SBA will pay certain fees to lenders in conjunction with funding the loans.

Participation in the PPP does not require that an eligible small business has or continues to maintain a particular employee level. Small businesses may be eligible even if they have previously made a reduction in force, furloughed employees, or reduced salaries or if they do so in the future, although those actions may reduce the amount of loans that they may qualify for or their ability to use the loans for permitted purposes or reduce or eliminate their ability to satisfy the requirements for forgiveness.

UPDATE

On April 2, 2020, the SBA promulgated interim final rules implementing Sections 1102 and 1106 of the CARES Act and issued additional guidance on April 3, 2020 regarding application of affiliate rules (collectively, the "Interim Final Rules").

The Interim Final Rules provide important guidance regarding the PPP. Some of the key points for borrowers addressed in the Interim Final Rules include:

- Loans will be issued on a first-come first-serve basis, giving borrowers an incentive to submit their applications promptly;
- Eligibility is generally limited to businesses with fewer than 500 employees, but the SBA has issued special guidance regarding the application of affiliation rules (discussed further below);
- Loan amounts will be determined based on a borrower's average payroll costs during the one-year period prior to the date on which the loan is made (with the SBA suggesting that the 2019 calendar year should be used for this purpose), with a limit equal to the lesser of $10 million or 2.5 times average monthly payroll plus certain amounts of economic injury disaster loans received by the borrower;
- In addition to the permitted purposes under the existing 7(a) loan program, loan proceeds can be used only for payroll, rent, utilities, certain employee expenses, mortgage interest payments, interest on other indebtedness incurred before February 15, 2020, and refinancing

of certain economic injury disaster loans ("EIDL") made between January 3, 2020 and April 3, 2020;

- Borrowers must certify, among other things, that (i) they are eligible to participate in the PPP and had employees for whom they paid salaries and payroll taxes; (ii) current economic conditions make the loan necessary to support ongoing operations; (iii) the funds will be used to retain workers and maintain payroll, or make mortgage interest payments, lease payments, and utility payments; and (iv) they have not and will not receive another loan under the PPP during the period beginning on February 15, 2020 and ending on December 31, 2020;
- A loan will be eligible for complete or partial forgiveness, but only to the extent that the loan is used for eligible purposes during the eight-week period following disbursement of the loan;
- Not more than 25 percent of the amount forgiven may be attributable to non-payroll costs—for example, if a loan amount is $100,000, not more than $25,000 of forgiveness can be received for costs related to permitted non-payroll costs (rent, utilities, and interest on permitted mortgages);
- The amount of forgiveness will be reduced as a result of certain factors, including workforce reductions or certain reductions in salaries in excess of 25 percent, although businesses may rehire or reinstate salary reductions on or before June 30, 2020 in order to attain full forgiveness of the amount subject to forgiveness;
- Borrowers will not be required to post collateral or provide personal guarantees to support repayment and loans will be non-recourse to individual shareholders, members or partners so long as the covered loan is used for authorized purposes;
- The SBA has determined that PPP loans will have an interest rate of one percent and a term of two years; and
- Payments of principal and interest are deferred during the first six months of the term, but interest will accrue during the deferral period.

Some of the key points for lenders addressed in the Interim Final Rules include:

- Authorization to make PPP loans has been expanded beyond presently authorized SBA 7(a) lenders to include, among others, (i) any federally insured depository institutions or federally insured credit unions, and (ii) any depository or non-depository financing provider that originates and services commercial loans to the extent it has serviced more than

$50 million in loans during a consecutive 12 month period in the last three years;

- Lenders' underwriting obligations are limited to (i) confirming receipt of a borrower's application; (ii) confirming receipt of information demonstrating borrower had employees for whom the borrower paid salaries and payroll taxes on or around February 15, 2020; (iii) reviewing payroll documentation to confirm borrower's average monthly payroll costs for the preceding calendar year; and (iv) following applicable Bank Secrecy Act requirements or maintaining a comparable anti-money laundering compliance program;
- When determining eligibility for forgiveness, if a lender has received the documentation required to be delivered by the borrower regarding the covered payments and an attestation by the borrower verifying the payments, then the lender shall be held harmless and not be subject to any penalties or enforcement actions under the CARES Act relating to loan forgiveness;
- Lenders are required to make a forgiveness determination within 60 days following a borrower's application for forgiveness;
- Lenders may sell loans on the secondary market after they are fully disbursed, and such sales may be at a premium or at a discount to par value;
- The SBA will pay certain fees to lenders in conjunction with funding the loans that vary based on the amount of the loans; and
- The following fees payable to the SBA are waived for any PPP loan: up front guarantee payments, annual service fees, subsidiary recoupment fees, and fees for selling loans on the secondary market.

Borrower eligibility for PPP loans is generally determined based on the borrower having fewer than 500 employees (or, if greater, meeting the size standard applicable for the relevant North American Industry Classification System code). This eligibility determination will be made by including the employees of affiliated businesses. The Interim Final Rules establish a more permissive affiliation determination, but the calculations will be more challenging for private equity and venture capital investors who may need to aggregate employees across multiple businesses to the extent that they own 50 percent or more of the equity or have management control of the borrower. There are exceptions to the affiliation rules in certain cases, including if a small business investment company has provided financial assistance to the borrower.