

April 2020

Follow [@Paul\\_Hastings](#)



## *Borrower's Guide to PPP Loans*

By [Christopher Austin](#), [Thomas Brown](#), [David Hernand](#) & [Charles Patrizia](#)<sup>1</sup>

A centerpiece of the \$2 trillion stimulus Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), enacted on March 27, 2020, is the new loan program known as the Paycheck Protection Program (the "PPP"). The CARES Act allocated \$349 billion to the PPP with the aim to provide relief to U.S. small businesses expeditiously.

The PPP loans are administered by the U.S. Small Business Administration (the "SBA") and originated by third-party lenders. Eligible companies can borrow up to \$10 million calculated based on payroll records (as described in [Question 17](#)) at a fixed interest rate of 1% for a two-year term.<sup>2</sup> Proceeds of the loans may be used to pay certain enumerated business expenses, including payroll, employee benefits, rent, utilities, and interest on mortgage and debt obligations. The loans may be forgiven in part or whole if they are used to retain and pay employees, rent, utilities and interest on mortgage obligations during the 8 week period following loan origination (as described in [Question 18](#)).

The U.S. Department of the Treasury (the "Treasury") and the SBA have continued to issue guidance on the PPP program as recently as April 6, 2020.<sup>3</sup> These newly published FAQs and guidelines have materially changed the terms of the loans and the application process.

### **1. What basic things should you know about a PPP loan?**

**Timing:** Eligible companies are encouraged to apply as soon as possible because PPP loans are given out on a "first-come, first-served" basis and the funding is limited. You may submit a PPP loan application to any lender that participates in the SBA's 7(a) loan program, starting on April 3, 2020 (if you are a small business and sole proprietorship) or April 10, 2020 (if you are an independent contractor and self-employed individual). The last day to apply is June 30, 2020. Many banks started accepting applications the week of Monday, April 6 but in many cases just for existing customers. For more information, see [Question 14](#).

**Limited Use of Loan Proceeds:** Proceeds from a PPP loan may be used for limited purposes: payroll costs, costs related to the continuation of healthcare benefits and insurance premiums, employee salaries and commissions, interest on mortgage obligations, rent and utility payments, interest on debt incurred before February 15, 2020, and refinancing an SBA EIDL loan made between January 31, 2020 and April 3, 2020. Additional guidance further makes clear that no more than 25% of the proceeds may be used towards the foregoing non-payroll costs. Using PPP funds for any other purpose may result in criminal liability in addition to an obligation to repay the SBA the misused amounts. For more information, see [Question 3](#) and [Question 4](#).

**Documentations Required:** As a part of your application, you will be asked to supply documentation substantiating your eligibility as well as your payroll records. Gathering these documents may take some time. Some lenders may require additional documentation if you are a new customer to a lending institution, so you should consult with your lender as to the documentation it requires as a part of the PPP loan application process. For more information, see [Question 15](#).

**Loan Forgiveness:** If you take out a PPP loan, you can submit a request to the lender that is servicing the loan for part or all of the loan to be forgiven. You will need to satisfy certain requirements, such as maintaining your staff and payroll, in order to be eligible for the maximum forgiveness amount. The maximum forgiveness amount, which must be substantiated by documentation, is the sum of expenses you incur or pay during the 8 week period following loan origination to cover payroll costs and mortgage interest, rent and utilities payments; provided, however, that not more than 25% of the forgiven amount may be for non-payroll costs.<sup>4</sup> A third party lender must make a determination on your loan forgiveness request within 60 days of receiving your request. For more information, see [Question 18](#).

**Basic Terms of PPP Loan:** 1.00% fixed interest rate; 2-year term; no collateral is required; no personal guarantee is required; no prepayment penalty. For more information, see [Question 19](#).

## 2. Where can you apply for a PPP loan?

You can apply for a PPP loan through any third-party lender or any federally insured depository institution, federally insured credit union, and Farm Credit System institution that has executed a participation agreement with the SBA under its 7(a) loan program.<sup>5</sup> Other regulated lenders will be available to make these loans once they are approved and enrolled in the program. You should consult with your local lender as to whether it is participating in the SBA's 7(a) loan program. You can find eligible lenders in your area by visiting this [SBA online resource](#) or reviewing the [SBA's list of 100 most active SBA 7\(a\) lenders](#).

## 3. What can you use the PPP loans for?

PPP loans can be used for "payroll costs" (defined in [Question 17](#)); costs related to the continuation of group health benefits during periods of paid sickness, medical, or family leave, insurance premiums; mortgage interest payments (but not prepayments or principal payments); rent payments; utility payments; interest payments on any other debt obligations that were incurred before February 15, 2020; and refinancing an SBA EIDL loan made between January 31, 2020 and April 3, 2020. Note that no more than 25% of the proceeds may be used towards non-payroll costs. More guidance on the relation between EIDL loans and PPE loans is provided below in [Question 16](#).

## 4. What are the consequences of misusing the PPP loan proceeds?

If you use PPP loan proceeds for any purpose other than those listed immediately above, the SBA will direct you to repay those misused amounts. If you knowingly use the PPP loan proceeds for an unauthorized purpose, you may be subject to additional criminal liability, such as charges for fraud. If one of your shareholders, members, or partners uses PPP loan proceeds for unauthorized purposes, the SBA will have recourse against such shareholder, member, or partner for the unauthorized use.<sup>6</sup>

## 5. Can you get more than one PPP loan?

No. Each eligible company may only apply for one PPP loan. This means that if you apply for a PPP loan, you should consider applying for the maximum amount.

## 6. Who determines eligibility—the SBA or the lenders? Are you eligible for a PPP loan?

The SBA has delegated authority to lenders to make eligibility determinations based on the criteria explained below. A borrower's ability to repay the loan is not a factor in eligibility consideration.

Furthermore, the [Interim Final Rule](#) published to the Treasury's website on April 2, 2020 (the "Interim Final Rule") indicates that the SBA will allow lenders to rely on certifications of the borrower in order to determine eligibility of the borrower and use of loan proceeds and to rely on specified documents provided by the borrower to determine qualifying loan amount and eligibility for loan forgiveness.<sup>7</sup> Lenders must comply with the applicable lender obligations set forth in the Interim Final Rule but lenders will be held harmless for borrowers' failure to comply with program criteria. Remedies for borrower violations or fraud are separately addressed in the Interim Final Rule.

Based on what we are hearing in the market, we understand that some major banks have opened their online portals for submission of applications but that they are only accepting applications from customers with pre-existing business lending and deposit relationships.

Companies must generally (i) have fewer than 500 employees whose principal place of residence is in the United States or (ii) be a "small business" under the applicable NAICS code employee size standard to be eligible for a PPP loan.<sup>8</sup> The SBA further clarified that a business otherwise ineligible can additionally qualify for a PPP loan as a small business concern if it meets both tests in SBA's "alternative size standard" 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.<sup>9</sup>

## 7. How should the Borrower Application Form be filled out?

In this section, we provide practice tips and guidelines for certain complicated portions of the final Borrower Application Form that was posted to the Treasury's website as of April 2, 2020 (the "Borrower Application Form") (starting from the beginning of the Borrower Application Form):

### **Average Monthly Payroll**

Please see [Question 16](#) for a description of how to calculate average monthly payroll.

### **Number of Employees**

The Small Business Act provides that the term 'employee' includes individuals employed on a full-time, part-time, or other basis. The Interim Final Rule provides that independent contractors should not be counted when calculating a borrower's number of employees for PPP loan purposes because independent contractors have the ability to apply for their own PPP loans.<sup>10</sup> Moreover, section 2(a) of the Interim Final Rule also provides that only those employees whose residence is within the United States should be counted when calculating a borrower's (and the borrower's affiliates', if any) number of employees.<sup>11</sup>

Furthermore, the SBA's recent FAQ dated April 6, 2020 indicates that an applicant, when determining the number of its (and its affiliates', if any) employees, may use the same time period that it uses to calculate its monthly average payroll for the maximum loan amount (i.e., the time period identified in the applicable Step 1 in [Question 16](#)).<sup>12</sup> For most business applicants, such time period would be the last 12 months (e.g., calendar year 2019 or March 2019 to March 2020). Alternatively, an applicant



may elect to use the average number of employees per pay period in the 12 completed calendar months prior to the date of the loan application (or the average number of employees for each of the pay periods that the business has been operational, if it has not been operational for 12 months).

The calculation of “number of employees” also depends on application of affiliation principles described in [Question 13](#) below.

### ***Questions 1, 2, 5 and 6***

These are all relatively straightforward questions, but answers may need to be confirmed with the applicant’s owners. The [Borrower Application Form](#) defines “owners” as they are defined in 13 C.F.R. § 120.10:

- For a sole proprietorship, the sole proprietor;
- For a partnership, all general partners, and all limited partners owning 20% or more of the equity of the firm;
- For a corporation, all owners of 20% or more of the corporation;
- For limited liability companies, all members owning 20% or more of the company; and
- Any Trustor (if the applicant is owned by a trust).

### ***Question 3***

*Is the Applicant or any owner of the Applicant an owner of any other business, or have common management with, any other business? If yes, list all such businesses and describe the relationship on a separate sheet identified as addendum A.*

The purpose of this question is not entirely clear. As the National Venture Capital Association noted in its letter to the Treasury dated April 1, 2020, it is strange that 20+% owners and descriptions of their other owned businesses must be described in an addendum to the Borrower Application Form when the affiliation for investors with less than 50% ownership is likely to be determined by the control rights of individual investors or specific funds and not solely by a minority owner’s percentage ownership (as we explain in further detail in [Question 13](#) below).

Based on the [Interim Final Rule on Affiliation](#) posted to the Treasury’s website on April 3, 2020 (the “Interim Final Rule on Affiliation”), it appears that this question is related to the “common management” prong of affiliation analysis<sup>13</sup> (as we explain in further detail in [Question 13](#) below). As such, responding to this question may be fairly daunting for venture capital—and private equity-backed applicants and will require applicants to request a fair amount of information from such owners. For example, if Fund Company A is a 20+% owner of the applicant, then it is fairly clear that all portfolio companies of Fund Company A in which it has a 20+% ownership stake are meant to be identified in Addendum A to the Borrower Application Form. However, often times, Fund Company A may be connected to a number of other funds, all of which have portfolio companies of their own, in light of the “common management” language included in this question. Accordingly, all portfolio companies of the “Fund Companies” (i.e., the portfolio companies of Fund Company A, Fund Company B, etc.) would have to be identified if the “Fund Companies” are under common management, which may be the case.

# STAY CURRENT

---



In light of the foregoing, we recommend that all venture capital, private equity, and similar investment firms have at the ready a list of all companies in which the firm holds a 20+% interest and a short description of the firm's relationship with such companies along the lines of: "All of the below companies are owned 20% or more by [Fund]. [Fund] is involved on the board of directors of the companies marked below with an asterisk, but there are no other common control relationships between or among these portfolio companies."

Some venture, private equity, and other investments funds have indicated that they are uncomfortable listing all of their other portfolio companies in which they hold more than 20% of the ownership. We are seeking guidance from lenders to see if they will accept some less detailed statement regarding ownership (such as listing the number of companies in which they hold more than 20%, and maybe only listing by name those companies with common directors) but are not aware of the SBA or any lender agreeing to abbreviated disclosure.

Certifications and Authorizations – The [Borrower Application Form](#) requires the authorized representative of the applicant signing the application to make various certifications and authorizations. Many of these are straightforward; others are more complicated. We have listed some of the noteworthy certifications below.

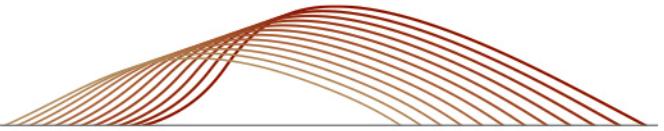
The following are the eligibility criteria based on the status of the applicant as of the date the applicant applies for the PPP loan (i.e., criteria not related to how the applicant plans to use loan proceeds):

- The applicant was in operation on February 15, 2020 (first item in the "Certifications" section); **and**
- The applicant had employees for whom it paid salaries and payroll taxes or paid independent contractors, as reported on Form(s) 1099-MISC (first item in the "Certifications" section); **and**
- Current economic uncertainty makes the loan request necessary to support the ongoing operation of the applicant (second item in the "Certifications" section); **and**
- The applicant **(1)** is an independent contractor, eligible self-employed individual, or sole proprietor, **OR (2)** employs no more than the greater of 500 employees or, if applicable, the size standard in number of employees established by the SBA in 13 C.F.R. § 121.201 for the applicant's industry (third item in the "Certifications and Authorizations" section).

Most of the criteria are objective and subject to calculation. However, many companies and investors have asked about interpretation of the certification regarding "current economic uncertainty" requiring the loan, which is a subjective and future-looking certification. This is a "facts and circumstances" test, and there has been a great deal of debate among institutional investors about this issue. We recommend having a board level discussion of the actual need, whether the applicant would otherwise impose significant salary cuts or furlough or lay off employees without the PPP loan, the potential reputational risk to the applicant and its investors if it is later determined that there was no such need, and if the company expects to achieve a positive exit in the relatively near term.

# STAY CURRENT

---



The calculation of “number of employees” depends upon the application of the affiliation principles described in [Question 13](#) below.

- All SBA loan proceeds will be used only for business-related purposes as specified in the loan application and consistent with the Paycheck Protection Program Rules (fifth item in the “Certifications and Authorizations” section).

This certification, along with certain others provided in the Borrower Application Form, relate to eligibility based on the intended uses of proceeds of the loan. Please see [Question 3](#) for a description of permitted uses.

- The applicant is eligible to receive a loan under the rules in effect at the time this application is submitted that have been issued by the Small Business Administration (“SBA”) implementing the Paycheck Protection Program under Division A, Title I of the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) (the Paycheck Protection Program Rule) (second item in the “Certifications and Authorizations” section).

Among other things, this certification incorporates the affiliation principles described in further details in [Question 13](#) below.

## **8. When must the Certifications and Authorizations under the Borrower Application Form be true?**

The [Borrower Application Form](#) obligates the applicant to certify as of the date of submission that the applicant is eligible to receive a loan under the rules in effect at the time the Borrower Application Form is submitted that have been issued by the SBA implementing the PPP under Division A, Title I of the CARES Act (the Paycheck Protection Program Rule). Accordingly, any measures to become eligible should be taken prior to application submission.

## **9. If an applicant meets the eligibility requirements for a PPP loan, can the applicant still be deemed ineligible?**

Yes. Section 2(c) of the [Interim Final Rule](#) excludes persons from obtaining PPP loans if they are ineligible to obtain SBA loans generally pursuant to existing regulations under 13 C.F.R. § 120.110.<sup>14</sup> Section 120.110(b) explicitly excludes “financial businesses primarily engaged in the business of lending, such as banks, finance companies, and factors (pawn shops, although engaged in lending, may qualify in some circumstances).” The statute also excludes passive businesses owned by developers and landlords that do not actively use or occupy assets acquired or improved with the loan proceeds, life insurance companies, businesses located in a foreign country, pyramid sale distribution plans, businesses deriving more than a specified amount of annual revenue from legal gambling activities and private clubs, and businesses, which limit the number of memberships for reasons other than capacity.<sup>15</sup> For a full list of excluded businesses, see 13 C.F.R. § 120.110. However, although non-profit businesses are listed among the types of excluded persons in such federal regulation, both the CARES Act and the [Interim Final Rule](#) explicitly override this and provides eligibility for non-profit businesses.

## **10. Do affiliation principles apply when calculating the number of employees?**

Yes. Title I of the CARES Act provides that statutory provisions relating to affiliations apply to determinations of employee headcount. Under the Small Business Act, affiliated businesses, including other businesses owned by a controlling entity, are aggregated for purposes of counting employees,

calculating revenue, or otherwise testing the size of a small business. Before the SBA published additional guidance in various FAQs most recently on April 6, 2020, there were different schools of thought among practitioners on which affiliation tests should apply. More detail on the affiliation rules is laid out in [Question 13](#) below, but note that, as a general matter, the affiliation rules are not bright line tests, but have been developed over time in response to various factual circumstances. Therefore, consultation with your attorneys at Paul Hastings or elsewhere is highly recommended. These rules are very complicated.

## **11. Do any waivers apply to affiliation?**

Yes—for purposes of the PPP, the SBA's affiliation standards are waived for (1) any business concern with not more than 500 employees that, as of the date on which the loan is disbursed, is assigned a North American Industry Classification System code beginning with 72; (2) any business concern operating as a franchise that is assigned a franchise identifier code by the Administration; and (3) any business concern that receives financial assistance from a company licensed under section 301 of the Small Business Investment Act of 1958 (15 U.S.C. 681).

## **12. What is an “affiliate?” How is control determined?**

The SBA's internal compliance manual for assessing affiliation<sup>16</sup> provides that (1) affiliation exists when one business controls or has the power to control another or when a third party (or parties) controls or has the power to control both businesses, (2) control may arise through ownership, management, or other relationships or interactions between the parties, and (3) control may be affirmative or negative (such as instances where a minority shareholder has the ability, under the business' charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders).

In determining whether affiliation exists, the SBA may consider all connections between the concern and a possible affiliate. Even though no single factor is sufficient to constitute affiliation, the SBA may find affiliation on a case-by-case basis where there is clear and convincing evidence based on the totality of the circumstances.

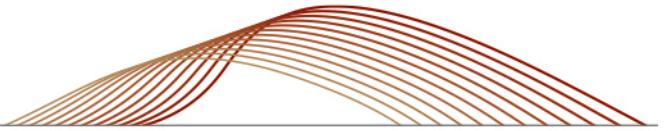
## **13. How do the SBA affiliation rules apply to a business?**

### ***Majority owner? (Potential affiliation based on §301(f)(1) voting equity ownership)***

Ownership, or the power to control, 50% or more of a business's voting stock constitutes a showing of ownership and accordingly, triggers affiliation between the business and its majority owner. The SBA's internal compliance manual provides the following example:

Company A is the majority owner of Companies B, C and D (54.5%, 81%, and 60% respectively). Company A has the power to control Companies B, C and D. The companies (A, B, C, and D) are all affiliated.

In the foregoing example, each company will be ineligible for PPP on the basis of number of employees if the aggregate number of employees among the four entities is greater than 500. Note that affiliation will extend to businesses deemed to be controlled by the same owner, even if the control is due to position/negative controls (which we explain in further detail below). Accordingly, in the foregoing example, if Company A held less than 50% of the voting stock of Company B, but nonetheless has significant positive/negative controls over governance activity, then Company B's employees would still be aggregated for purposes of the calculation.



The foregoing analysis does not change where the majority owner is a “holding” company. The SBA has previously determined that a holding company owning 50+% of a business’s stock, despite characterizing itself as an “investment entity” without an active role in the management or operation of the contractor’s business, was nonetheless an affiliate for purposes of the SBA size determination—which would mean that all of the holding company’s various majority-owned subsidiaries would be aggregated for these purposes of determining eligibility of a PPP loan.

Majority owners, by definition, would be disclosed on Addendum A to the Borrower Application Form (as discussed in [Question 7](#) above).

***Significant but not majority owner? (Potential affiliation based on §301(f)(1) voting equity ownership)***

Certain SBA affiliation rules provide that ownership of, or the power to control, a block of voting stock *that is large compared to all other outstanding blocks of stock* constitutes a showing of ownership and accordingly, triggers affiliation between the business and such significant owner. However, in the [Interim Final Rule on Affiliation](#), posted to the Treasury’s website on April 3, 2020, the Treasury clarified that the SBA affiliation rules applicable to PPP loan eligibility are contained within 13 C.F.R. §121.301(f) (“§301(f)”).

In §301(f), a significant minority holding (according to percentage ownership) alone does not alone constitute affiliation. However, a minority investor may still be affiliated with a company based on the minority investor’s common management with the business or control rights over the business (each as discussed in further detail below).

Significant minority owners would be disclosed on Addendum A to the Borrower Application Form (as discussed in [Question 7](#) above), which requires disclosure of all 20+% owners. However, the disclosure of such owners on Addendum A would not alone mean that they are affiliated with the applicant (and thus may not require aggregation of employees of such owners’ other affiliated businesses with those of the applicant).

***Multiple minority owners that together own a large share? (Potential affiliation based on §301(f)(1) voting equity ownership)***

Certain SBA affiliation rules provide that if two or more persons each owns or controls (or has the power to control) less than 50% of voting stock and (i) the minority holdings are all approximately equal in size, and (ii) all of the minority holdings taken together are large compared to any other stock holdings, affiliation is presumed to exist with each of those persons.

However, based on the clarification provided in the [Interim Final Rule on Affiliation](#), minority holdings (according to percentage ownership) will not alone constitute affiliation for purposes of PPP loan eligibility. However, a minority investor may still be affiliated with a company based on the minority investor’s common management with the business or control rights over the business (each as discussed in further detail below).

Minority owners, so long as they hold 20+% of voting interest, would be disclosed on Addendum A to the Borrower Application Form (as discussed in [Question 7](#) above). However, the disclosure of such owners on Addendum A would not alone mean that they are affiliated with the applicant (and thus may not require aggregation of employees of such owner’s other affiliated businesses with those of the applicant).

## ***Voting stock is widely held? (Potential affiliation based on §301(f)(1) voting equity ownership)***

If no individual, business, or entity is found to control an applicant, the SBA will deem the Board of Directors or President or Chief Executive Officer ("CEO") (or other officers, managing members or partners who control the management of the applicant business) to be in control of the applicant. The SBA's compliance manual provides the following example:

In a widely held corporation where no one stockholder has a block of voting stock sufficient to give it control or the power to control the concern, control instead rests in the Board of Directors and the CEO or President. This means that any business controlled by the Board or by the CEO or President is an affiliate of the business concern in question, unless the Board and CEO or President can rebut this presumption.

## ***Minority owner with control rights? (Potential affiliation based on §301(f)(1) minority control)***

§301(f)(1) provides that the SBA will deem a minority shareholder to be in control, if that individual or entity has the ability, under the applicant's charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders.

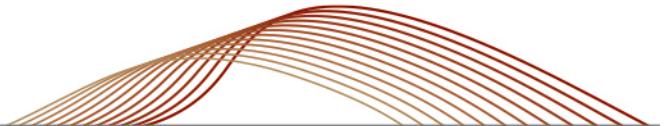
The SBA, through various guidance and case law from the Office of Hearings and Appeals ("OHA"), has accepted that certain customary negative commitments—i.e., the power to block certain decisions contained in so-called "protective provisions"—do not in and of themselves give shareholders control. The fine line appears to be the control over extraordinary decisions vs. day-to-day operations, wherein the investor's ability to "block ordinary actions essential to operating the company" becomes problematic.<sup>17</sup>

Specifically, the SBA has recognized via OHA case law that a minority investor's control over or ability to block any of the following decisions or actions of a company (including through a director that is required to approve or holds a veto) may constitute "negative control":<sup>18</sup>

1. Making, declaring, or paying distributions or dividends other than tax distributions;
2. Establishing a quorum at a meeting of stockholders (and likely, by extension, at a meeting of the board);
3. Approving or making changes to the company's budget or approving capital expenditures outside the budget;
4. Determining employee compensation;
5. Hiring and firing officers and executives;
6. Blocking changes in the company's strategic direction;
7. Establishing or amending an incentive or employee stock ownership plan;
8. Incurring or guaranteeing debts or obligations;
9. Initiating or defending a lawsuit;

# STAY CURRENT

---



10. Entering into contracts or joint ventures;
11. Amending or terminating leases; or
12. Incurring expenses over \$5,000.

Conversely, the SBA has recognized via OHA case law that the following controls or supermajority provisions do not necessarily constitute “negative control” of the minority investor (designed to prevent the majority’s ability to control the company’s operations or to conduct the company’s business) and instead are simply protective of the minority shareholders’ investment:<sup>19</sup>

1. Selling all or substantially all of the company’s assets;
2. Placing an encumbrance or lien on all or substantially all of the company’s assets;
3. Engaging in any action that could result in a change in the amount or character of a company’s capital contributions;
4. Changing the company’s line of business or entering into a substantially new business;
5. Engaging in a merger transaction;
6. Issuing additional stock/equity;
7. Adding new members;
8. Amending the organizational documents of a company, including bylaws;
9. Filing for bankruptcy;
10. Amending the governing documents to materially alter the rights of the existing owners;
11. Dissolving the company;
12. Increasing, decreasing, or reclassifying the authorized capital of the company;
13. Increasing or decreasing the size of the board;
14. Entering into a confession of judgment;
15. Disposing of the goodwill of the company;
16. Committing to take any action that would make it impossible for the company to carry on its ordinary course of business; or
17. Accepting additional capital contributions from a member.

We note that OHA case law explaining what may or may not constitute negative control, including the cases cited above, are generally pursuant to the SBA’s general affiliation rules under 13 C.F.R. § 121.103, not §301(f) (the applicable standard of PPP loan eligibility). Although the rules and language pertaining to minority control rights in the two sections are quite similar, the SBA may nonetheless apply different standards to §301(f) analysis. Accordingly, the lists above of “problematic

vs. unproblematic" negative controls may be over- or under-inclusive. It should be noted as well, that the SBA may look at the overall set of rights and that no one right in and of itself may tip the balance.

Many companies are examining their charters and various stockholders agreements and seeking to amend or waive control provisions. In an FAQ issued on April 6, 2020 (the "FAQ"), the SBA clarified that in order for a waiver or relinquishment of control rights to be effective for a determination of non-affiliation, that waiver must be "irrevocable" (assuming no other relationship triggers the affiliation rules).<sup>20</sup> Therefore, a "springing" waiver that goes away upon payment of the loan would not be effective.

### ***Certain ownership/equity rights (e.g., options, convertible securities, etc.) (Potential affiliation based on §301(f)(2))***

§301(f) provides that in determining size, the SBA considers stock options, convertible securities, and agreements to merge (including agreements in principle) to have a present effect on the power to control a concern. The SBA treats such options, convertible securities, and agreements as though the rights granted have been exercised. The SBA's compliance manual provides the following example:

If Company A holds an option to purchase a controlling interest in Company B, the situation is treated as though Company A had exercised its rights and had become owner of the controlling interests in Company B. Company A and B are affiliates. In addition, all companies controlled by Company A will be considered affiliates of Company B.

However, agreements to open or continue negotiations towards the possibility of a merger or a sale of stock at some later date are not considered "agreements in principle" and are thus not given present effect.

Significantly, §301(f)(iv) provides that (1) an individual, business, or other entity that controls one or more other businesses cannot use options, convertible securities, or agreements to appear to terminate such control before actually doing so and that (2) the SBA will not give present effect to individuals', businesses' or other entities' ability to divest all or part of their ownership interest in order to avoid a finding of affiliation. This may impact certain measures that applicants may consider taking in order to become eligible, as discussed above.

### ***Common management with another business?***

§301(f)(3) provides that affiliation arises where (i) the CEO or President of the applicant business (or other officers, managing members, or partners who control the management of the business) also controls the management of one or more other businesses, (ii) a single individual, business, or entity that controls the Board of Directors or management of one business applicant also controls the Board of Directors or management of one of more other businesses or (iii) a single individual, business, or entity controls the management of the applicant business through a management agreement.

The SBA's internal compliance manual provides the following examples:

Controlling members of Company A's Board of Directors occupy three out of five positions in Company B's Board of Directors. The two companies (A and B) are affiliated. In addition, all businesses controlled by Company A will be considered affiliates of Company B.

A controlling member of Company A's Board of Directors has veto rights over the majority decisions of Company B's Board of Directors. By possessing such negative control, Company A has control of the Board of Directors of Company B and the two companies (A and B) are affiliated. In addition, all companies controlled by Company A will be considered affiliates of Company B.

### ***Identity of interest between other businesses or individuals?***

§301(f)(4) provides that affiliation also may exist when there is an identity of interest between close relatives, as defined in 13 C.F.R. § 120.10, with identical or substantially identical business or economic interests (such as where the close relatives operate concerns in the same or similar industry in the same geographic area). Where the SBA determines that interests should be aggregated, an individual or business may rebut that determination with evidence showing that the interests deemed to be one are in fact separate. The SBA's internal compliance manual provides the following examples:

Company A performs subcontracts for Company B, and Company B accounts for 90% of Company A's revenues. Company A's existence depends on work from Company B, and the two companies (A and B) are deemed affiliates.

Company A provides significant loans to Company B and guarantees other loans to Company B. Company B's over reliance of dependence on Company A's financial support (both direct and indirect) results in their affiliation.

### **14. When does the loan application begin? Do you need to apply as soon as possible?**

Small businesses and sole proprietorships can apply for and receive loans to cover their payroll and other certain expenses through existing SBA lenders starting **April 3, 2020**. For independent contractors and self-employed individuals, the starting date is **April 10, 2020**. Other regulated lenders will be available to make these loans as soon as they are approved and enrolled in the program. It is recommended to apply as soon as possible because funds are limited, and it will take time for lenders to process applications. Applications may be accepted until June 30, 2020.

### **15. What is the loan application process?**

You can apply for a PPP loan through any third party lender or any federally insured depository institution, federally insured credit union, and Farm Credit System institution that has executed a participation agreement with the SBA under its 7(a) loan program.<sup>21</sup> You can find eligible lenders in your area by visiting this [SBA online resource](#) or reviewing the [SBA's list of 100 most active SBA 7\(a\) lenders](#).

Your PPP loan request must include documents that verify the number of full-time equivalent employees and pay rates, as well as the payments on eligible mortgage, lease, and utility obligations.<sup>22</sup> As a part of the PPP loan application form, you must certify that the documents you provide are accurate and that the proceeds and the forgiveness amount will only be used for the permitted purposes (as described in [Question 3](#)).

Depending on the circumstances of the business and the specific lender's requirement, you may need to submit additional documentation. As a borrower, you will be asked to submit such documentation as is necessary to establish eligibility such as payroll processor records, payroll tax filings, or Form 1099-MISC, or income and expenses from a sole proprietorship. If you do not have any the

aforementioned documentation, then you will need to provide other supporting documentation, such as bank records, sufficient to demonstrate the qualifying payroll amount.

## 16. What is the maximum amount you can borrow?

You may borrow up to 250% of your business's average monthly "payroll costs" (explained in [Question 17](#)) from the year prior to the loan, up to a total maximum of \$10 million. To calculate your business's average monthly "payroll costs," follow the steps listed below that are applicable for your situation.

### ***Most Case Scenario (for non-seasonal businesses formed for at least a full year):***

- **Step 1:** Aggregate "payroll costs" from the last 12 months (e.g., calendar year 2019 or March 2019 to March 2020) for employees whose principal place of residence is the United States. For what constitutes "payroll costs," see [Question 17](#) below.
- **Step 2:** To the extent not already taken into account when calculating Step 1, make sure the annualized cash compensation for each employee is capped at \$100,000. Subtract the amount of cash compensation paid to each employee in excess of \$100,000, for each such employee.

For example, if there are only 3 employees whose cash compensation exceeds \$100,000, each of whom has cash compensation of \$225,000, then as a part of Step 2, you would subtract \$375,000 because you will need to subtract \$125,000 (which is how much each such employee's cash compensation exceeds \$100,000) 3 times.

- **Step 3:** Divide by 12 to calculate the average monthly "payroll costs."
- **Step 4:** Multiply by 2.5.
- **Step 5:** If you have any outstanding amount of an Economic Injury Disaster Loan ("EIDL"), which you received between January 31, 2020 and April 3, 2020, add the outstanding amount, less the amount of any "advance" under an EIDL COVID-19 loan.

### ***If you are an independent contractor or sole proprietor (self-employed):***

- **Step 1:** Aggregate "payroll costs" from the last 12 months (e.g., calendar year 2019, March 2019 to March 2020). For what constitutes "payroll costs," see [Question 17](#) below.
- **Step 2:** To the extent not already taken into account when calculating Step 1, make sure that the annualized wage, commissions, income, or net earnings paid to yourself is capped at \$100,000. Subtract any amounts paid to you as an independent contractor or sole proprietor in excess of \$100,000.
- **Step 3:** Divide by 12 to calculate the average monthly payroll costs.
- **Step 4:** Multiply by 2.5.
- **Step 5:** If you have any outstanding amount of an Economic Injury Disaster Loan ("EIDL"), which you received between January 31, 2020 and April 3, 2020, add the outstanding amount, less the amount of any "advance" under an EIDL COVID-19 loan.

*If you are a new business that was not in operation during the period from February 15, 2019 and ending on June 30, 2019:*

- **Step 1:** Aggregate “payroll costs” from the period beginning on January 1, 2020 and ending on February 29, 2020 for employees whose principal place of residence is the United States. For what constitutes “payroll costs,” see [Question 17](#) below.
- **Step 2:** To the extent not already taken into account when calculating Step 1, make sure the annualized cash compensation for each employee is capped at \$100,000. Subtract the amount of cash compensation paid to each employee in excess of \$100,000, for each such employee.
- **Step 3:** Divide by 2 to calculate the average monthly “payroll costs.”
- **Step 4-5:** Same as described as for Most Case Scenario.

*If you are a seasonal business (as determined by the SBA):*

- **Step 1:** Aggregate “payroll costs” from the period beginning on your choice of February 15, 2019 or March 1, 2019 and ending June 30, 2019 for employees whose principal place of residence is the United States. For what constitutes “payroll costs,” see [Question 17](#) below.
- **Step 2:** To the extent not already taken into account when calculating Step 1, make sure the annualized compensation for each employee is capped at \$100,000. Subtract the amount of compensation paid to each employee in excess of \$100,000, for each such employee.
- **Step 3:** Divide by 2 to calculate the average monthly “payroll costs.”
- **Step 4-5:** Same as described as for Most Case Scenario.

## 17. What costs are included in payroll costs?

For businesses: “Payroll costs” consist of any compensation to employees (whose principal place of residence is in the U.S.) in the form of:

1. salaries, wages, commissions (as noted above, capped at \$100,000 per employee);
2. cash tips or the equivalent (calculated based on employer records of past tips or, in the absence of such records, a reasonable, good-faith employer estimate of such tips);
3. payments for vacation, parental, family, medical, or sick leave;
4. allowance for separation or dismissal;
5. payments for the provision of employee benefits consisting of group health care coverage, including insurance premiums and retirement; and
6. payments of state and local taxes assessed on compensation of employees.

As noted in [Question 16](#) above, the annualized compensation (cash compensation directly to the employee) for each employee is capped at \$100,000. In other words, for each employee whose compensation is \$100,000 or more, only \$8,333 per month can be included in the calculation of average monthly payroll costs, in addition to the cost of health and retirement benefits and the state

and local taxes assessed on that employee's actual compensation (i.e., not capped at \$100,000), each prorated for the applicable time period.

For an independent contractor or sole proprietor: "Payroll costs" consist of wage, commissions, income, or net earnings from self-employment or similar compensation.

Moreover, the CARES Act expressly excludes from the definition of "payroll costs" (i) any compensation to an employee whose principal place of residence is outside of the United States, (ii) qualified sick and family leave wages for which a credit is allowed under the Families First Coronavirus Response Act, and (iii) federal employment taxes imposed or withheld between February 15, 2020 and June 30, 2020, including the employee's and employer's share of Federal Insurance Contributions Act and Railroad Retirement Act taxes and income taxes required to be withheld from employees.

## 18. How does loan forgiveness work?

### ***Amount of Loan Forgiveness:***

The amount of loan forgiveness can be up to the full principal amount of the loan and any accrued interest, so long as the applicant keeps salary and employee counts the same. Costs eligible for forgiveness include payroll costs, payments of interest on mortgage obligations incurred before February 15, 2020, rent payments on leases dated before February 15, 2020, and utility payments under service agreements dated before February 15, 2020, over the 8-week period following the date of the loan. The Treasury clarified in its [Interim Final Rule](#) that at least 75% of the loan amount must be used for payroll costs, and that no more than 25% of the loan proceeds can be forgiven for non-payroll costs. For purposes of determining the percentage of use of proceeds for payroll costs, the amount of any EIDL refinanced will be included. According to the Treasury guidance, this is to ensure that the core purpose of the statute is effectuated and that these finite sources are devoted primarily to payroll. Independent contractors do not count for determining a borrower's PPP forgiveness. Finally, it's worth noting that the forgivable payroll costs must be used during the covered period.

### ***Loan Forgiveness Amounts can be reduced for two reasons:***

The amount forgiven will be reduced proportionally by any reduction in the number of employees retained during the 8-week period after receipt of the loan compared to one of two prior pay period time periods (described below) determined by the borrower and reduced by the reduction in pay of any employee beyond 25% of their prior year compensation.

**If (X),** which equals the average number of employees in the 8-week period after receipt of the loan, is greater than (Y), determined as either:

- The average number of full-time employees employed by the borrower in the period beginning on February 15, 2019 and ending on June 30, 2019, or
  - If the borrower is a "seasonal employer," the borrower must use this option.
- The average number of full-time employees employed by the borrower in the period beginning on January 1, 2020 and ending on February 29, 2020,

**then** the amount forgiven will not be reduced. The choice of the 2/15/19-6/30/19 or the 1/1/20 - 2/29/20 dates is at the election of the borrower (unless a seasonal business). This means



that companies that grew quickly in the second half of 2019 may be able to reduce their head count *vis a vis* their January 2020 employment without reducing forgiveness. Conversely, businesses that contracted over 2019 will not be adversely impacted by their pre-COVID reductions and would be able to choose the more recent time period.

The amount forgiven will also be reduced by the amount of any reduction in total salary or wages of any employee used to make forgiveness calculations during the covered period that is in excess of 25% of the total salary or wages of the employee during the most recent full quarter during which the employee was employed before the covered period.

#### ***Exceptions to Loan Forgiveness Reductions:***

Businesses that re-hire laid off workers or raise wages to make up for salary reductions during COVID-19 will not be penalized by this loan forgiveness reduction calculation above and are therefore still entitled to full forgiveness, if these reductions are eliminated. This is to incentivize employers not to lay off workers or cut pay but instead use the loan amounts for the specified permitted expenses during this time. Therefore, the reduction in the amount of loan forgiveness calculation above will not apply if either of the following occurs:

- If the reduction in the number of [full time equivalent] employees between February 15, 2020 and April 26, 2020 is completely eliminated by June 30, 2020. This is a simple quantitative test—the SBA will look at the number of employees on February 15 on an full time equivalent (FTE) basis and compare that number to the number of full time equivalent employees at June 30, 2020; or
- If the salary or wages of one or more employees was reduced (this provision does not specify a 25% pay cut requirement) between February 15, 2020 and April 26, 2020, and the employer has subsequently restored pay by June 30, 2020.

Obviously, this is only necessary to calculate, if the loan forgiveness reduction calculations above result in a cut-back in loan forgiveness. We believe, though it has not been confirmed by the SBA, that the full employment restoration test is a binary test—either it is met, in which case there is full forgiveness of loan used for qualified expenses, or it is not, in which case the loan forgiveness reduction calculations are in effect.

#### ***Obtaining Forgiveness:***

A lender originating a loan will need to collect paperwork from the borrower in connection with the forgiveness and essentially make an application to the SBA for that forgiveness. A lender may request that the SBA purchase the expected forgiveness amount of a PPP loan or pool of PPP loans at the end of week seven of the covered period (i.e., the 8-week period immediately following the receipt of the loan).

The Interim Final Rule stated that we can expect additional guidance to come from the SBA on loan forgiveness.<sup>23</sup>

**19. For the remainder of the loan that is not forgiven, what are the key loan terms?**

The loan has a maturity of two years and an interest rate of 1.00%. Please note that the Treasury and the SBA have both updated the terms of the loans as of April 2, 2020, changing the interest rate from 0.50% to 1.00%.<sup>24</sup> There will be no prepayment penalty, meaning you will be able to repay the loan at any time before the maturity date. There is no collateral or personal guarantee required. All loans will be processed by third-party lenders under delegated authority of the SBA, and the lenders are permitted to rely on the certifications of the borrowers in order to determine eligibility of the borrower and the use of loan proceeds.

The PPP loans are 100% guaranteed by the SBA. However, you will not be required to make any up-front guarantee fee payment to the SBA. Moreover, Agents (i.e., someone who assists a lender with originating, disbursing, servicing, liquidating or litigation SBA loans) are not allowed to collect fees from you or be paid out of the PPP loan proceeds. Agent fees will be paid by the third-party lender out of the fees that such lender receives from the SBA.

A PPP loan may be sold on the secondary market after the loan is fully disbursed. The SBA has indicated it will issue guidance regarding purchases of loans sold in the secondary market.<sup>25</sup>

**20. If your business is owned or controlled, in part or in whole, by a foreign person or entity, can you still be eligible for a PPP loan?**

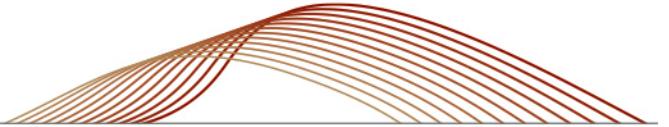
Yes, as long as certain additional requirements are satisfied. As noted above in [Question 7](#), when calculating an applicant business' number of employees, only those of it and of its affiliates, if any, whose residence is within the United States should be counted. In other words, an applicant business which has a foreign affiliate that has 500+ employees living outside of the United States may still be eligible for a PPP loan under the [Interim Final Rule](#).

As a general overview, the PPP is available to "small business concerns." Pursuant to the CARES Act and the Small Business Act, the SBA has the authority to set criteria for what businesses qualify as such. The SBA has defined a "business concern" as "a business entity organized for profit, 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." This means that even if your business is 51% owned and controlled by people or entities who are not U.S. citizens, your business may still be eligible for a PPP loan.

At a very high level, a business must be owned or controlled by persons who are lawfully in the U.S. and have appropriate work visa. Additional specific rules may apply, depending on the person's immigration status and the circumstances of the business. We would suggest that a company owned or controlled by a foreign national to consult with attorneys at Paul Hastings or elsewhere before applying for a PPP loan.



# STAY CURRENT



*If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:*

## **Century City**

David M. Hernand  
1.310.620.5750  
[davidhernand@paulhastings.com](mailto:davidhernand@paulhastings.com)

## **New York**

Christopher Austin  
1.212.318.6092  
[christopheraustin@paulhastings.com](mailto:christopheraustin@paulhastings.com)

## **San Francisco**

Thomas P. Brown  
1.415.856.7248  
[tombrown@paulhastings.com](mailto:tombrown@paulhastings.com)

## **Washington, D.C.**

Charles A. Patrizia  
1.202.551.1710  
[charlespatrizia@paulhastings.com](mailto:charlespatrizia@paulhastings.com)

---

<sup>1</sup> This guide would not have been possible without the significant contributions of Shreya Gupta, Ryan Samii and Vivian Tsai.

<sup>2</sup> The U.S. Department of the Treasury and the SBA issued new guidance on April 2, 2020, setting the interest rate to 1.0%, which is lower than the maximum interest rate specified in the CARES Act and higher than the 0.5% rate established in earlier published guidance. The Small Business Administration, Interim Final Rule, 13 CFR Part 120, Business Loan Program Temporary Changes, Payment Protection Program, RIN 3245-AH34. The Interim Final Rule can also be accessed at: <https://home.treasury.gov/system/files/136/PPP--IFRN%20FINAL.pdf>.

<sup>3</sup> Small Business Administration, Paycheck Protection Program Loans Frequently Asked Questions (FAQs), which can be accessed at: <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>.

<sup>4</sup> On the final Borrower Application Form, which was posted to the Treasury's website as of April 2, 2020, the certification clearly states that "not more than 25% of the forgiven amount may be for non-payroll costs." The application can be accessed at: <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Application-3-30-2020-v3.pdf>. This change also was described on page 13-14 of the Interim Final Rule, 13 CFR Part 120, Business Loan Program Temporary Changes; Payment Protection Program, RIN 3245-AH34.

<sup>5</sup> See Paycheck Protection Program (PPP) Information Sheet: Borrowers: <https://home.treasury.gov/system/files/136/PPP--Fact-Sheet.pdf>.

<sup>6</sup> Small Business Administration, Interim Final Rule, 13 CFR Part 120, Business Loan Program Temporary Changes; Payment Protection Program, RIN 3245-AH34, page 17. The Interim Final Rule can be accessed at: <https://home.treasury.gov/system/files/136/PPP--IFRN%20FINAL.pdf>.

<sup>7</sup> *Id.* page 5, section III.1.

<sup>8</sup> *Id.* page 5, section III.2(a).

<sup>9</sup> See footnote 3; Small Business Administration, Paycheck Protection Program Loans Frequently Asked Questions (FAQs): pages 1-2, Question 2.

<sup>10</sup> See footnote 6; Small Business Administration, Interim Final Rule, 13 C.F.R. Part 120, Business Loan Program Temporary Changes; Payment Protection Program, RIN 3245-AH34, page 11, section 2(h).

<sup>11</sup> *Id.*, page 5, section III.2(a).

<sup>12</sup> See footnote 3; Small Business Administration, Paycheck Protection Program Loans Frequently Asked Questions (FAQs): pages 4-5, Question 14.

## **Paul Hastings LLP**

Stay Current is published solely for the interests of friends and clients of Paul Hastings LLP and should in no way be relied upon or construed as legal advice. The views expressed in this publication reflect those of the authors and not necessarily the views of Paul Hastings. For specific information on recent developments or particular factual situations, the opinion of legal counsel should be sought. These materials may be considered ATTORNEY ADVERTISING in some jurisdictions. Paul Hastings is a limited liability partnership. Copyright © 2020 Paul Hastings LLP.



<sup>13</sup> Small Business Administration, Interim Final Rule on Affiliation, 13 CFR Part 121, Business Loan Program Temporary Changes, Payment Protection Program, RIN [\_\_\_\_], which can be accessed at: <https://home.treasury.gov/system/files/136/SBA%20IFR%202.pdf>. "In order to help potential borrowers identify other businesses with which they may be deemed to be affiliated under the common management standard, the Borrower Application Form, SBA Form 2483, released on April 2, 2020, requires applicants to list other businesses with which they have common management. The information supplied by the applicant in response to that information request should be used by applicants as they assess whether they have affiliates that should be included in their number of employees reported on SBA Form 2483." Small Business Administration, Interim Final Rule on Affiliation, 13 CFR Part 121, Business Loan Program Temporary Changes, Payment Protection Program, RIN [\_\_\_\_], p5.

<sup>14</sup> Interim Final Rule, 13 C.F.R. Part 120, Business Loan Program Temporary Changes; Payment Protection Program, RIN 3245-AH34, pages 7-8.

<sup>15</sup> 13 C.F.R. § 120.110.

<sup>16</sup> See U.S. Small Business Administration, *Small Business Compliance Guide Size and Affiliation* (March 2014) (available at [https://www.sba.gov/sites/default/files/affiliation\\_ver\\_03.pdf](https://www.sba.gov/sites/default/files/affiliation_ver_03.pdf)).

<sup>17</sup> Size Appeal of Southern Contracting Solutions III LLC, SBA No. SIZ-5956, at 10 (2018).

<sup>18</sup> See, e.g., Size Appeal of Team Waste Gulf Coast LLC, SBA No. SIZ-5864, at 7 (2017); Size Appeal of DHS Systems LLC, SBA No. SIZ-5211 (2011); Size Appeal of Environmental Restoration LLC, SBA No. SIZ-5395, at 7 (2012); *Size Appeal of: Carntribe-Clement 8ajv # 1, LLC, Appellant*, SBA No. SIZ-5357 (June 13, 2012); Size Appeal of: Southern Contracting Solutions, LLC, SBA No. SIZ-5956, 2018 (S.B.A.), 2018 WL 4492382.

<sup>19</sup> Size Appeal of S. Contracting Sols. III LLC, SBA No. SIZ-5956, at 12 (2018); Size Status of Carntribe-Clement 8AJV # 1 LLC, SBA No. SIZ-5357, at 15 (2012); Size Appeal of EA Engineering, SBA No. SIZ-4973, at 3 (2008); Size Appeal of Dooleymack Government Contracting LLC, SBA No. SIZ-5086, at 7 (2009).

<sup>20</sup> Small Business Administration, Paycheck Protection Program Loans Frequently Asked Questions (FAQs): <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>.

<sup>21</sup> See Paycheck Protection Program (PPP) Information Sheet: Borrowers: <https://home.treasury.gov/system/files/136/PPP--Fact-Sheet.pdf>.

<sup>22</sup> *Id.*

<sup>23</sup> Interim Final Rule, 13 C.F.R. Part 120, Business Loan Program Temporary Changes; Payment Protection Program, RIN 3245-AH34, page 14.

<sup>24</sup> Interim Final Rule, 13 CFR Part 120, Business Loan Program Temporary Changes; Payment Protection Program, RIN 3245-AH34, pages 11-12.

<sup>25</sup> Interim Final Rule, 13 C.F.R. Part 120, Business Loan Program Temporary Changes; Payment Protection Program, RIN 3245-AH34, page 26.