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Summary of Paycheck Protection Program under Title I of the CARES Act of 2020

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On March 27, 2020, President Trump signed the Coronavirus Aid, Relief, and Economic Stimulus Act of 2020 (the "CARES Act"). Title I of the CARES Act establishes, among other things, the Paycheck Protection Program (the "Paycheck Program") providing for up to $349,000,000,000 in forgivable loans to business concerns which are backed by the United States Small Business Administration (the "SBA"). The Paycheck Program is a short-term program for the "Covered Period" from February 15, 2020 until June 30, 2020 and loans are capped at the lesser of 2.5x a borrower's LTM average monthly payroll or $10,000,000 per borrower.

All page references below correspond to the attached draft version of the CARES Act bill.

Not EIDL Program or Other Fed Lending Programs

The Paycheck Program is separate from the $3,500,000,000 expanded SBA Disaster Relief Loan program established in prior weeks (the "EIDL Program"). EIDL Program loans are not forgivable and the EIDL Program is mutually exclusive from the Paycheck Program (meaning a borrower cannot avail themselves of both programs)[1]. The CARES Act also provides for acceleration of up to $10,000 of an EIDL Program loan (Pages 64-70). The EIDL Program applies the SBA's current small business concern eligibility requirements and not the expanded eligibility created by the CARES Act for the Paycheck Program. A potential borrower should confirm its eligibility under the SBA regulations, found here: https://www.sba.gov/document/support--table-size-standards.

The Paycheck Program is also separate from the Main Street Lending Program and other lending programs previously announced by the Federal Reserve on March 23, 2020. The details of these Federal lending programs are not currently available and this analysis will be supplemented when more information is available.

Eligibility for Paycheck Program

The CARES Act, however, does ease the current SBA small business concern requirements for loans requested during the Covered Period. A potential borrower may ordinarily not qualify for SBA loans under the normal rules if it is not a “small business concern” (as determined by revenue or employee number thresholds set forth in the SBA regulations and based on the business’ applicable NAICS code). However, the Paycheck Program is explicitly available to all business concerns that employ not more than the greater of (I) 500 employees and (II) the size standard for the business established by the SBA (Page 13-14). There are existence and operational requirements described on pages 20-21 of the CARES Act.

The test for a potential borrower’s number of employees is generally still subject to the SBA’s affiliation rules (which may aggregate the number of employees at the potential borrower with employees of its investors’ other investments). However, the Paycheck Program waives the affiliation rules for certain business concerns, namely (I) businesses in the restaurant and hotel industry (with NAICS code beginning with 72) regardless of the number of employees, so long as each physical location of those businesses has no greater than 500 employees, (II) franchise business listed on the SBA’s Franchise Directory, and (III) businesses which receive financial support from certain licensed Small Business Investment Act companies.

The Paycheck Program requires a borrower to certify, among other things, that (I) the loan is necessary to support ongoing operations due to economic uncertainty and (II) the funds will be used to retain workers and maintain payroll or make mortgage, lease and utilities payments. See Page 22 of the CARES Act. A potential borrower should ensure it is able to make the necessary certifications.

Loans under the Paycheck Program are expressly non-recourse (Page 21) and the Paycheck Program waives the typical requirements that credit not be available from other sources and does not require personal guarantees or collateral (Pages 23-24).

Basic Loan Terms

For a summary of the loan forgiveness process, please see "Loan Forgiveness" below.

Paycheck Program loans are usable for a variety of non-CAPEX purposes, including payroll and compensation, healthcare costs, mortgage payments, rents, utilities, and interest on existing debt. (Pages 19-20). Any amounts outstanding after application of the loan forgiveness amount have a maturity date of ten (10) years from the date of borrowing (Page 24). Interest rates shall not exceed 4% per annum (Page 24). No principal or interest is due until the expiration of the Covered Period (Pages 24-26) and the loans are freely pre-payable without penalty (Page 30).

The maximum loan amount of a Paycheck Program loan is based on a 2.5x multiple of LTM average monthly payroll as of the borrowing date (Pages 17-18). The maximum amount can also be used to refinance an EIDL loan which was previously obtained and unrelated to COVID-19, if any. Paycheck Program loans are *capped at $10,000,000 in the aggregate*.

For purposes of the calculation, LTM average monthly "payroll" is based on (x) payments for compensation, benefits and leave for full time and part-time employees and (y) payments to any independent contractor up to $100,000 per year (Pages 10-11).[2] As noted above, whether or not certain individuals (like partners or non-employee owners) constitute "employees" for purposes of the Paycheck Program is outside the scope of this analysis. Payroll expressly does not include the amount of salaries/wage in excess of $100,000 per employee and is subject to certain other exceptions, such as COVID-19 tax breaks (Page 12).

Loan Forgiveness

The Paycheck Program expressly contemplates that a portion of the loan is forgivable under certain circumstances (See Page 40 onward). Forgivable portion of the loan is calculated as the sum of the following amounts incurred during the Covered Period: (1) Payroll costs, plus (2) payments of interest on covered mortgage obligations, plus (3) payments of covered rent obligations, plus (4) covered utility payments (Page 41-42). However, the amount eligible for forgiveness is capped at the principal amount of the loan (Page 43-44).

The forgivable amount is prorated based on reductions in employees or employee wages in excess of 25% during the covered period (Pages 43-45).

The calculation used to determine a reduction in forgiveness based on a reduction in headcount takes into account whether the potential borrower is a seasonal employer. Specifically, the proration is calculated based on a fraction (all averages are calculated by pay period per month):

- the numerator of which is the average number of *full-time equivalent ("FTE") employees* per month employed by the borrower during the covered period; and

- the denominator of which is, at the option of the borrower:

    - the average number of *FTE employees* per month employed during the period beginning February 15, 2019 and ending on June 30, 2019 (i.e., a look back to last year), OR

    - the average number of *FTE employees* per month employed during the period beginning January 1, 2020 and ending on February 29, 2020 (i.e., a look back to the pre-COVID-19 portion of this year).

It appears that part-time employees are excluded from the pro-ration calculation.

In addition, the forgivable amount is reduced, dollar for dollar, by the amount of salary/wage reductions for certain employees during the covered period in excess of 25% of the most recent fiscal quarter of the borrower before the covered period (page 45-46). For purposes of testing these reductions, *all* employees making $100,000 or less count for the calculation (Page 46), regardless of part-time or full-time status.

There is an exemption to the pro-ration and reduction described above for FTE employees who are laid off or for any employees for whom compensation is reduced during the period from February 15, 2020 and ending on the date that is 30 days after enactment of the CARES Act (Page 46). The reduction in FTE employees or salaries will not count against the loan forgiveness amount if the applicable reduction is eliminated by June 30, 2020 by rehiring of workers or raising of salaries/wages, or both (Pages 47-48). There may also be *de minimis* exceptions set by the Treasury.

Conclusion

The Paycheck Program under the CARES Act of 2020 could be a significant resource for qualifying business concerns in the short term. While it is not guaranteed that any potential borrower would actually receive any Paycheck Program funds, on the face of the CARES Act, eligible borrowers have little to lose by applying for a Paycheck Program loan.

The Paycheck Program loan forgiveness rules provide flexibility to reduce workforce for non-FTE employees without reducing the forgivable portion of the loan. In addition, eligible borrowers could reduce salaries up to 25% across the board without incurring penalties, and cuts beyond 25% for those making over $100,000 do not affect the forgivable portion of the loan. In any event, if the reductions happen in the short term, there is ability to cure any reductions by rehiring or reinstating higher salaries by June 30, 2020.

[1] In certain cases, a borrower with an existing EIDL loan may be eligible for a Paycheck Program loan. However, that EIDL loan must have been made between January 31, 2020 and the date on which Paycheck Programs loans are made available and have been made for purposes other than paying payroll or costs and other obligations covered by the Paycheck Program.

[2] The term “payroll costs” includes “salary, wage, commission, or similar compensation” among others. Thus, the true scope of what can qualify as a “payroll cost” remains to be determine based on how “similar compensation” is defined in the implementing regulations.

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