

COVID-19 NEWS OF INTEREST

CARES Act Expansion of SBA Business Loan Program

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AUTHORS

David Mortlock | John Joy | Ahmad El-Gamal

On March 27, 2020, Congress passed and the President signed into law the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”). The CARES Act provides an approximately \$2 trillion stimulus package that includes direct payments to individual tax payers, small business loans, increased unemployment benefits, and a variety of tax breaks. The bill includes the Paycheck Protection Program, which expands eligibility for Small Business Administration (“SBA”) loans under Section 7(a) of the Small Business Act, making \$349 billion available for eligible small businesses.

The threshold issue for most potential borrowers under the Paycheck Protection Program will be whether they are eligible for the loans under the program and the SBA’s existing regulations. In particular, those rules limit eligibility for businesses with a parent company or significant investor. Businesses seeking potential relief under the program should carefully assess their eligibility under these rules.

I. Eligibility for the SBA Loans

In order to be eligible to receive a Section 7(a) loan under the Paycheck Protection Program during the covered period,¹ an applicant must either:

- Have no more than 500 employees.

¹ February 15, 2020 to December 31, 2020.

CARES Act Expansion of SBA Business Loan Program

- Qualify under otherwise existing eligibility rules for SBA loans based on applicable industry size standard or annual receipts threshold.
 - If the applicable size standard is employee-based, the SBA counts all individuals employed on a full-time, part-time, or other basis.² The table in 13 C.F.R. § 121.201 will list for each North American Industry Classification code (“NAICS code”) whether the size standard is receipts-based or employee-based. The applicable size standards range up to 1,500 employees.
 - If the applicable size standard is receipts-based, then the business will need to calculate its annual receipts for its three most recently completed fiscal years and divide by three.³ The highest threshold for annual receipts in the regulations is \$41.5 million.
- Meet the SBA’s “alternative size standard.”⁴ A business may be eligible for a Section 7(a) loan under the alternative size standard if:
 - the maximum tangible net worth of the applicant is not more than \$15 million; and
 - the average net income after Federal income taxes (excluding any carry-over losses) of the applicant for the two full fiscal years before the date of the application is not more than \$5 million.

II. Affiliation Rules

In almost all cases, these calculation will be made using the SBA’s existing rules on affiliation. This means that when determining the total annual receipts, number of employees, or the alternative size standard, the SBA aggregates the total across the applicant business and all its affiliates.⁵

The SBA regulations provide that entities are affiliates of each other when one controls or has the power to control the other, or a third party or parties controls or has the power to control both.⁶ In other words, a business owned or controlled by another must count the employees and finances of its parent company against its threshold numbers when determining eligibility under the thresholds described above.

² 13 C.F.R. § 121.106.

³ 13 C.F.R. § 121.104.

⁴ 15 U.S.C. 632 (a)(5).

⁵ 13 C.F.R. § 121.301(f)(8).

⁶ 13 C.F.R. § 121.103.

CARES Act Expansion of SBA Business Loan Program

In determining ownership, the SBA applies an un rebuttable presumption that person owning 50 percent or more of a business's voting stock is an affiliate. However, any entity owning a large block of voting stock, or otherwise has governance rights, negative or positive, to exercise control over the business, may also be an affiliate. In determining control, the SBA exercises subjective judgment and considers a number of factors listed in its regulations such as ownership, management, previous relationships with or ties to another concern, and contractual relationships.⁷

The CARES Act does provide that, for Section 7(a) loans made under the Paycheck Protection Program, the affiliation rules are waived for:

- Any business concern with 500 employees or fewer that operates under NAICS code 72 (the Accommodation and Food Services sector). Additionally, the CARES Act also provides that during the covered period, any business operating under NAICS code 72 that has 500 or fewer employees per physical location will be eligible to receive a Section 7(a) loan under the Paycheck Protection Program;
- Any business concern operated as a franchise that is assigned a franchise identifier code by the SBA; and
- Any business concern that receives financial assistance from a company licensed to operate as a small business investment company ("SBIC") under section 301 of the Small Business Investment Act of 1958 (15 U.S.C. 681).⁸

In addition to the affiliation rules above, applicable businesses must comply with other conditions present in the SBA loan program regulations. Of note, an applicant must obtain complementary funds from any individual or entity owning 20 percent or more of the applicant. The SBA requires the use of liquid assets from any such owner as an injection to reduce the SBA loan amount when that owner's liquid assets, either cash or cash equivalent, exceed the amounts specified below, based on the following available liquidity of the owner:

- If \$350,000 or less, each 20 percent owner of the applicant must inject any liquid assets that are in excess of two times the total financing package, or \$500,000, whichever is greater;
- If between \$350,001 and \$1,000,000, each 20 percent owner of the applicant must inject any liquid assets that are in excess of one and one-half times the total financing package, or \$1,000,000, whichever is greater; or

⁷ 13 C.F.R. § 301(f).

⁸ CARES Act, section 1102(a)(2)(D)(iv). An SBIC is a privately owned and managed investment fund licensed and regulated by the SBA. An SBIC must invest in "small" businesses, which are defined as those with less than \$19.5 million in tangible net worth and average net income for the preceding two years of less than \$6.5 million; or, businesses qualifying as "small" under the SBA's NAICS Industry Code standards (generally based on annual sales or number of employees).

CARES Act Expansion of SBA Business Loan Program

- If greater than \$1,000,000, each 20 percent owner of the applicant must inject any liquid assets that are in excess of the total financing package, or \$2,500,000, whichever is greater.⁹

III. Benefits of the Loan

The CARES Act increases the maximum loan amount for loans made under the Paycheck Protection Program of Section 7(a) of the Small Business Act to \$10 million and states that eligible applicants will receive the lesser of:

- The average monthly “payroll costs”¹⁰ for the one-year period ending on the date the loan was made multiplied by 2.5; or
- \$10 million.¹¹

Applicants who receive a 7(a) loan under the Paycheck Protection Program created by the CARES Act, in addition to the uses already allowed under the Small Business Administration’s Business Loan Program, are permitted to use the funds for:

- Payroll costs, as defined in the statute;
- Costs related to the continuation of group healthcare benefits during periods of paid sick, medical, or family leave, and insurance premiums;
- Employee salaries, commissions, or similar compensations;
- Payments of interest on any mortgage obligations;
- Rent and utilities; and
- Interests on any other debt obligations incurred before the covered period.¹²

⁹ 13 C.F.R. § 120.102.

¹⁰ Payroll costs are defined in the CARES Act at section 1102(a)(2)(A)(viii)

¹¹ CARES Act, section 1102(a)(2)(E).

¹² *Id.* at section 1102(a)(2)(F).

CARES Act Expansion of SBA Business Loan Program

Section 1106 of the CARES Act provides that the loan is eligible for loan forgiveness¹³ equal to the following costs incurred and payments made during the eight week period after the loan has been granted:

- Payroll costs, as defined in the statute;
- Payments on interest on mortgage obligations incurred before February 15, 2020;
- Payments on rent obligations in force before February 15, 2020; and
- Payments on utilities in service before February 15, 2020.

The CARES Act provides that the amount of loan forgiveness will be reduced proportionally to any reduction in the number of full-time equivalent employees or wages according to the formulas set out in the statute.¹⁴

IV. Applying for a 7(a) Loan

The SBA itself does not provide direct loans. The SBA works with lenders who provide the loan, process the application, and submit the application to the SBA. After determining if your business may be eligible for the 7(a) loan program, the first step will be finding a lender to discuss eligibility. The Small Business Administration website has several resources that will aid in working with your lender to file a loan application, including a [7\(a\) Loan Application Checklist](#).

The small business loan program and loan forgiveness program in the CARES Act are intended to allow businesses to continue functioning while maintaining their current workforce during the period of uncertainty caused by the COVID-19 pandemic. While beneficial, the CARES Act forces businesses to both wrestle with their eligibility under the CARES Act itself as well as the applicable SBA rules and regulations. The rules on affiliation are likely to exclude a significant number of businesses with investors. However, those businesses may be able to seek assistance through other provisions of the CARES Act, including a \$500 billion fund for support to local governments and industry to be administered by the Department of the Treasury, or a future stimulus package.

¹³ In general, the forgiven amounts will be considered cancelled indebtedness by a lender authorized under Section 7(a) of the Small Business Act.

¹⁴ CARES Act, section 1106(c)(2).

CARES Act Expansion of SBA Business Loan Program

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If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

David Mortlock

202 303 1136

dmortlock@willkie.com

John Joy

212 728 8713

jjoy@willkie.com

Ahmad El-Gamal

202 303 1142

ael-gamal@willkie.com

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