



Treasury Issues Guidance on CARES Act's Paycheck Protection Program; SBA issues Interim Final Rule regarding the Paycheck Protection Program and Interim Final Rule on Affiliation

April 2020

On March 31, 2020 and April 2, 2020, the Treasury Department issued implementation guidance (the "Treasury Guidance") regarding the Paycheck Protection Program (the "PPP"), which was created under the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), and the application form for obtaining PPP funds. On April 2, 2020, the Small Business Administration (the "SBA") issued an Interim Final Rule regarding the Paycheck Protection Program and supplemented it on April 3, 2020 with an Interim Final Rule on Affiliation (together, the "Interim Final Rules"). The PPP authorizes the SBA to make loans to businesses with 500 or fewer employees resident in the U.S. for payroll costs and other PPP approved expenses. Subject to certain restrictions, the funds available under the PPP are forgivable. See the Treasury Guidance [here](#) and SBA's Interim Final Rule [here](#) and Interim Final Rule on Affiliation [here](#). See our prior client alert on the CARES Act (which included an overview of the PPP) [here](#) and its implications on emerging companies [here](#). Summarized below are updates for borrowers based on the Treasury Guidance, the Interim Final Rules and updated PPP application form.

Affiliation rules applicable to PPP borrowers clarified and confirmed. For purposes of the determining the number of employees of an applicant for the Paycheck Protection Program, the applicant is generally considered together with its affiliates. The Treasury provided additional guidance on April 3, 2020 that "... [T]he detailed affiliation standards contained in section 121.103 currently do not apply to PPP borrowers, because section 121.103(a)(8) provides that applicants in SBA's Business Loan Programs (which include the PPP) are subject to the affiliation rule contained in 13 CFR 121.301." Under 13 CFR 121.301 ("Section 301"), 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. Four tests for affiliation based on control apply to participants in the Paycheck Protection Program.

(1) **Affiliation based on ownership.** For determining affiliation based on equity ownership, a concern is an affiliate of an individual, concern, or entity that owns or has the power to control more than 50 percent of the concern's voting equity. If no individual, concern, or entity is found to control, 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 concern) to be in control of the concern. SBA will deem a minority shareholder to be in control, if that individual or entity has the ability, under the concern's charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders. SBA case law regarding affiliation also governs the PPP loans and, as a result, to the extent a minority stockholder can block operational or ordinary actions, it will be deemed to have control, resulting in a determination of affiliation.

(2) Affiliation arising under stock options, convertible securities, and agreements to merge.

(a) In determining size, 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. SBA treats such options, convertible securities, and agreements as though the rights granted have been exercised.

(b) 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.

(c) Options, convertible securities, and agreements that are subject to conditions precedent which are incapable of fulfillment, speculative, conjectural, or unenforceable under state or Federal law, or where the probability of the transaction (or exercise of the rights) occurring is shown to be extremely remote, are not given present effect.

(d) An individual, concern or other entity that controls one or more other concerns cannot use options, convertible securities, or agreements to appear to terminate such control before actually doing so. SBA will not give present effect to individuals', concerns', or other entities' ability to divest all or part of their ownership interest in order to avoid a finding of affiliation.

(3) Affiliation based on management. Affiliation arises where the CEO or President of the applicant concern (or other officers, managing members, or partners who control the management of the concern) also controls the management of one or more other concerns. Affiliation also arises where a single individual, concern, or entity that controls the Board of Directors or management of one concern also controls the Board of Directors or management of one of more other concerns. Affiliation also arises where a single individual, concern or entity controls the management of the applicant concern through a management agreement.

(4) Affiliation based on identity of interest. Affiliation arises when there is an identity of interest between close relatives, as defined in 13 CFR 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 SBA determines that interests should be aggregated, an individual or firm may rebut that determination with evidence showing that the interests deemed to be one are in fact separate.

The Treasury Guidance adds that religious organizations are exempt from the affiliation rules noted above, and that the affiliation rules are waived for any business (1) in the hotel and food services industries, (2) that are franchises in the SBA's Franchise Directory or (3) that receive financial assistance from small business investment companies licensed by the SBA.

Contractors Not Counted as "Employees" for calculating the PPP loan or "payroll costs." The Interim Final Rules provide that independent contractors do not count as employees for purposes of PPP loan calculations, nor do payments to independent contractors constitute "payroll costs" (except in the case of an application by an independent contractor for a PPP loan). The SBA notes that independent contractors have the ability to apply for a PPP loan independently so they do not count for purposes of a borrower's PPP loan calculation.

Use of PPP funds for mortgage interest, rent and utilities only if obligation prior to February 15, 2020. As stated in the CARES Act, PPP funds can be used for payroll costs (including benefits), interest on mortgage obligations, rent and utilities. The Treasury Guidance provides that mortgage interest, rent and utilities are eligible only if the underlying obligation was entered into before February 15, 2020.

Funds may continue to be used for interest on other debt. The CARES Act also permits funds to be used for costs related to interest on any other debt obligations incurred before February 15, 2020. This item is not mentioned on the application form. However, the application form includes an “Other” box for borrowers to insert any other intended use of funds. While uses which are not specifically permitted under the CARES Act should not be added by borrowers, those who intend to use PPP funds for interest on debt obligations may still be able to reference this use in the application.

Calculation of Loan Amount. The CARES Act calculates a borrower’s loan amount as 2.5x “Average Monthly Payroll”, up to a maximum loan of \$10 million. For purposes of calculating Average Monthly Payroll, the PPP guidance and the application form now provide that most applicants will reference the average monthly payroll for U.S. employees from 2019, excluding costs over \$100,000 on an annualized basis for each employee (which differs from the CARES Act which states that Average Monthly Payroll would be based on a trailing 12-month average from the time that funds were made). The original bill language may have been intended to incentivize companies from laying off employees by requiring that the payment amount be connected to recent payroll. However, the Treasury guidance now allows companies to more easily reference their recent historical payroll.

Payroll costs include:

- Salary, wages, commissions, or tips (capped at \$100,000 on an annualized basis for each employee);
- Employee benefits including costs for vacation, parental, family, medical, or sick leave; allowance for separation or dismissal; payments required for the provisions of group health care benefits including insurance premiums; and payment of any retirement benefit;
- State and local taxes assessed on compensation; and
- For a sole proprietor or independent contractor: wages, commissions, income, or net earnings from self-employment, capped at \$100,000 on an annualized basis for each employee.

Under the CARES Act, there was potential ambiguity around treatment of employees with compensation in excess of \$100,000. The Interim Final Rules clarify that for these employees, only the excess above \$100,000 is excluded when calculating payroll costs for purposes of determining the amount that can be loaned as well as the portion of the PPP loans that can be forgiven.

Loan terms. Loan terms in the Treasury Guidance and Interim Final Rules include the following:

- Interest rate: 1% fixed rate (subject to forgivable amounts). This clarifies the CARES Act provision which states that the PPP interest rate would not exceed 4% and prior Treasury guidance providing a 0.5% fixed rate. The increase to the interest rate was designed to make it easier for banks to participate.
- All payments are deferred for 6 months. However, interest will continue to accrue over this period.
- Any non-forgiven loan will be due in 2 years and there are no early prepayment penalties or fees. This clarifies the CARES Act provision which states that PPP maturity would not exceed 10 years.
- Loans are non-recourse and do not require personal guarantees or collateral.

Loans continue to be forgivable 100% for payroll costs; potentially less for non-payroll costs. The CARES Act provided that *any* PPP funds would be forgivable if used for payroll costs, interest on mortgage obligations, rent or utility payments. PPP loans continue to be forgivable to the extent used for payroll costs, mortgage interest, rent and utilities payments over the eight-week period after receiving the loan to the extent, during that same period following the making of the loan, the borrower (1) maintains its levels of full-time employees, (2) does not reduce salaries and wages by more than 25% for any employee making less than \$100,000 and (3) restores its full-time employment and salary levels for any changes made between February 15, 2020 and April 26, 2020 by June 30, 2020. Borrowers should be careful to document that funds are being used for payroll, mortgage interest, rent or utilities to ensure forgiveness. As PPP subscription is expected to be high, the Treasury Guidance anticipates that no more than 25% of the forgiven amount may be for non-payroll costs. Accordingly, borrowers are now incentivized to maximize all funds received toward payroll.

Loan Forgiveness Process. Following the eight-week period, borrowers will be able to submit a loan forgiveness request to the lender servicing the loan, which will 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. Borrowers will need to certify that the documents are true and that the borrower used the forgivable amount to keep employees and make eligible mortgage interest, rent, and utility payments. The lender must make a decision on the forgiveness within 60 days.

The PPP application. The PPP application is based on the application used for SBA Section 7(a) loans with particular modifications and updates, including:

- The application now only needs to be completed and certified by the applicant (it previously required signature by the applicant and its 20% or greater owners). This will make the application more easily complied with by applications with institutional minority investors. An authorized representative of the borrower applicant must certify as to certain factual matters and as to the borrower applicant's eligibility for loans under the program.
- The application now provides for responses regarding entities in addition to individuals and clarifies which questions are intended to be for individuals only as applicable.
- Questions regarding U.S. citizenship now asks whether the U.S. is the principal place of residence for all employees of the Applicant included in the payroll calculation (confirming that only U.S.-resident employees should be included in the payroll calculation).
- The instructions to the form provide explanatory details as to what constitutes payroll costs.
- Borrowers are required to submit any documentation that establishes eligibility and supporting documentation sufficient to demonstrate the qualifying payroll amount.

All parties listed below are considered "owners" as well as "principals" of an applicant:

- 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).

You can find the PPP loan application form [here](#). The completed application must be submitted to an SBA participating lender who will then assess eligibility for financial assistance. Many banks have launched application websites to streamline

this process. As of the time of this alert, some of the larger U.S. lenders were able to launch and were swamped by applications, causing some lenders to limit applications to customers only and some to additionally give preference to digital customers who are recent active borrowers. Other large banks that were expected to participate in making loans under the PPP had not yet launched and are awaiting additional clarification and guidance. We continue to suggest that borrowers contact their regular corporate bank to submit an application as soon as possible.

The Interim Final Rules additionally clarify underwriting expectations of lenders, which are limited to the application form and the certifications in it, the borrower's payroll documentation and applicable Bank Secrecy Act requirements. Lenders may rely on borrower documentation for loan forgiveness, which should make lending easier.

Small businesses and sole proprietorships were able to apply for funding starting April 3, 2020. Starting April 10, 2020, independent contractors and self-employed individuals can apply for funding.

Treasury has encouraged applicants to apply quickly because there will be a funding cap. In addition, the Interim Final Rules clarify that PPP loans will be made on a first come first-served basis. Accordingly, eligible borrowers will want to apply for PPP loans as soon as possible. Banks are reporting an avalanche of applications likely to exceed the funding cap. Some observers believe that any Phase IV legislation will authorize additional funds for the PPP.

Helpful links from the Treasury Department:

- [Overview of the PPP](#)
- [More information for borrowers](#)
- [More information for lenders](#)
- [PPP Borrower Application Form \(Updated 4/2/20\)](#)
- [PPP Lender Application Form](#)
- [PPP New Lender Application Form \(Federally Insured Depository Institutions, Federally Insured Credit Unions, Farm Credit System Institutions\)](#)
- [Paycheck Protection Program – Interim Final Rule](#)
- [Paycheck Protection Program – Interim Final Rule on Affiliation](#)
- [Paycheck Protection Program – Applicable Affiliation Rules](#)
- [Find an eligible lender](#)
- [Frequently Asked Questions](#)

ABOUT BAKER BOTTS L.L.P.

Baker Botts is an international law firm of approximately 750 lawyers practicing throughout a network of 14 offices around the globe. Based on our experience and knowledge of our clients' industries, we are recognized as a leading firm in the energy and technology sectors. Since 1840, we have provided creative and effective legal solutions for our clients while demonstrating an unrelenting commitment to excellence. For more information, please visit bakerbotts.com.

Lawyers in Baker Botts' Corporate Department bring sound commercial judgment to clients' most critical and urgent issues, along with a deep understanding of the varied legal, technical and policy issues that they face. Drawing on our intimate familiarity with clients' needs and the resources of our global platform, we have amassed an enviable record.

[Click here](#) to learn more about our Corporate Practice. Please contact the lawyers below if you have any questions.



Michael Torosian
Partner
T: +1.415.291.6215
michael.torosian@bakerbotts.com



Courtney Fore
Partner
T: +1.512.322.2545
courtney.fore@bakerbotts.com



Brian D. Lee
Partner
T: +1.650.739.7519
brian.lee@bakerbotts.com