

Memorandum

Congressional COVID-19 Stimulus: Small Business Loan Expansions

March 30, 2020

On March 6th, the Coronavirus Preparedness and Response Supplemental Appropriations Act (“Phase I Bill”) was signed into law and addressed the Small Business Administration (the “SBA”) Economic Injury Disaster Loan Program (the “EIDL”). On March 25th, by a vote of 96-0, the Senate passed the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”), a sweeping \$2.2 trillion stimulus package, which includes a \$350 billion SBA loan guarantee program established under the “Paycheck Protection Program” to help small business pay for payroll and other necessary overhead expenses such as rent and mortgage interest and which will be available during the period beginning February 15, 2020 through June 30, 2020 (the “Covered Period”).¹ The House approved the CARES Act on Friday, March 27th and the legislation was signed into law on the same day. This memorandum covers the 7(a) Loan Program and EIDL loans which are impacted by the recent legislation.

Background of SBA Loan Programs

SBA programs offer a variety of loans for small businesses. The SBA does not lend directly to small businesses, but instead guarantees loans made through a broad network of financial institutions under the SBA. SBA loan programs include:

- **7(a) Loan Program:** A program through which the SBA guarantees loans (“7(a) Loans”) made by approved lenders to eligible small businesses within the United States and its territories.
- **EIDL:** A program through which eligible small businesses may be provided with working capital loans of up to \$2 million in the event of substantial economic injury due to a declared disaster. The Phase I Bill increases funding for the EIDL and explicitly declares coronavirus disease 2019 (“COVID-19”) a “disaster” for which funding may be provided under the EIDL.²

Eligibility

- **Business Concerns:** The 7(a) Loans are available to small “business concerns” which previously qualified for 7(a) Loans under the SBA loan program. A “business concern” eligible for assistance from the SBA is a business entity organized for profit, with a place of business located in the United States, and which

¹ Coronavirus Aid, Relief, and Economic Security Act, H.R. 748, 116th Con. (2020) § 1101, 1107.

² Coronavirus Preparedness and Response Supplemental Appropriations Act, H.R. 6074, 116th Con. (2020).

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.³

In addition, the CARES Act expands eligibility for said loans to include any business concern, nonprofit organization, veterans organization, or Tribal business concerns employing not more than the greater of (a) 500 employees or (b) the size standard in number of employees established by the SBA (each, an “Eligible Business”).⁴ The test for expanded eligibility under the CARES Act only focuses on the number of employees and not revenue.

Lastly, the legislation provides that during the Covered Period, (i) any business concern that employs not more than 500 employees per physical location and is assigned as a North American Industry Classification System Code 72 (“Accommodation and Food Services Business”)⁵ and (ii) individuals who are sole proprietors, independent contractors and eligible self-employed individuals will also be eligible to receive a 7(a) Loan.⁶

- **Size of Eligible Business:** In order to qualify for any SBA loan program, an Eligible Business must first qualify as a “small business”. The SBA maintains size standards (stated in number of employees or average annual receipts) for a “small business”, and these vary by industry. As indicated above, the expanded eligibility rules under the CARES Act solely focus on the number of employees of an Eligible Business.⁷
- **SBA Affiliation Rules:** For the purposes of determining size and the number of employees of an Eligible Business, the SBA includes annual receipts and employees of all the domestic and foreign affiliates of a business, regardless of whether the affiliates are organized for profit.⁸

The SBA considers concerns/entities to be “affiliates” 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.⁹ Ownership, management, negative or affirmative controls under organizational documents, previous relationships with or ties to another concern, and contractual relationships all factor into the SBA’s determination. The SBA considers the totality of the circumstances when determining affiliation and “even though no single factor is sufficient

³ eCFR Title 13, Chapter 1, §121.105.

⁴ Coronavirus Aid, Relief, and Economic Security Act, H.R. 748, 116th Con. (2020) § 1102(a)(2) amending 15 U.S.C. 636(a), new subsection (36)(D)(v).

⁵ *Id.* at new subsection (36)(D)(iii).

⁶ *Id.* at new subsection (36)(D)(ii).

⁷ A chart containing the sizing standards for each industry can be found here: https://www.sba.gov/sites/default/files/2019-08/SBA%20Table%20of%20Size%20Standards_Effective%20Aug%2019%2C%202019_Rev.pdf.

⁸ eCFR Title 13, Chapter 1, § 121.103(a)(6).

⁹ *Id.* at §121.301(f).

to constitute affiliation...may find affiliation on a case-by-case basis where there is clear and convincing evidence based on the totality of the circumstances.”¹⁰

Importantly, the CARES Act provides for an express waiver of the SBA affiliation rules during the Covered Period for any business concern that (a) is an Accommodation and Food Services Business, (b) operates as a franchise that is assigned a franchise identified code by the SBA or (c) receives financial assistance from a Small Business Investment Company.¹¹

Because the CARES Act does not expressly waive other affiliation rules that would typically apply, many portfolio companies of private equity funds will continue to be unable to qualify for the loans unless such portfolio companies can benefit from the waiver set forth above. The number of employees and revenues in a portfolio company would generally continue to be subject to the SBA affiliation rules when calculating the size of a business and would thus include employees and revenues of other portfolio companies controlled by the private equity fund.

The CARES Act can be read to include a potential ambiguity regarding whether the SBA affiliation rules apply to borrowers who now qualify for 7(a) Loans due to the expanded eligibility requirements in the CARES Act. The SBA must issue regulations regarding the new program within 15 days of enactment, which may address this potential ambiguity. The Firm will continue to monitor any new guidance from the SBA on affiliation.

- **Inability to Obtain Other Credit:** The CARES Act waives the typical 7(a) loan requirement that the business concern is unable to obtain credit elsewhere.¹²
- **Ineligible Businesses:** The CARES Act does not waive or override existing federal regulations related to ineligible business for 7(a) Loans. It should be noted that the SBA loans are not available to certain ineligible business, including:¹³
 - Firms involved in lending activities, such as banks, finance companies, factors, leasing companies, insurance companies (not agents), and any other firm whose stock in trade is money.
 - Real estate investment firms, when the real property is held for investment purposes as opposed to loans to otherwise eligible small business concerns for the purpose of occupying the real estate being acquired.

¹⁰ *Id.* at §121.301(f)(6). Because the SBA commonly receives question regarding affiliation, the SBA has provided a resource on navigating the affiliation rules which can be found here: https://www.sba.gov/sites/default/files/2018-09/2018-07-13%20AFFILIATION%20GUIDE_Updated%20%281%29.pdf.

Please note that updated federal regulations regarding affiliation were promulgated on February 20, 2020 and can be found at: <https://www.ecfr.gov/cgi-bin/text-idx?SID=off5f0839abff4eec707b4478ed733c6&mc=true&node=pt13.1.121&rgn=div5#sp13.1.121.a>.

¹¹ Coronavirus Aid, Relief, and Economic Security Act § 1102(a)(2) amending 15 U.S.C. 636(a), new subsection (36)(D)(iv).

¹² *Id.* at new subsection (36)(I).

¹³ eCFR Title 13, Chapter 1, §120.110.

SBA Resource: <https://www.sba.gov/partners/lenders/7a-loan-program/terms-conditions-eligibility#section-header-19>.

- Firms involved in speculative activities that develop profits from fluctuations in price rather than through the normal course of trade, such as wildcatting for oil and dealing in commodities futures, when not part of the regular activities of the business.
- Gambling activities, including any business whose principal activity is gambling. While this precludes loans to racetracks, casinos, and similar enterprises, the rule does not restrict loans to otherwise eligible businesses, which obtain less than one-third of their annual gross income from either the sale of official state lottery tickets under a state license, or legal gambling activities licensed and supervised by a state authority.

SBA 7(a) Loan Terms

An eligible business concern may receive one covered loan during the Covered Period. In addition to typical allowable uses under Section 7(a), the proceeds for the loans may be used for payroll costs¹⁴, group healthcare benefits during periods of paid sick, medical, or family leave, and insurance premiums, employee compensation, mortgage interest payments, rent, utilities and interest on debt that was incurred before the Covered Period.¹⁵ Generally, the maximum amount of the loan is the lesser of (a) \$10.0 million and (b) 2.5 times the average total monthly payments by the business for payroll costs incurred during the 1-year period before the date the Loan is made.¹⁶ It is important to note that the maximum amount formula only includes payroll costs and does not include other permitted uses of the loan.

Further specifics of the 7(a) Loans include:

- **Term:** Amounts outstanding after forgiveness (see below for eligible forgiveness amounts) is granted will have a maximum maturity of 10 years from the date the borrower applies for forgiveness.
- **Maximum Interest Rate:** Capped at 4% per annum.
- **Payment Deferrals:** The financial institution offering 7(a) Loans must provide for payment deferral (including, principal and interest and fees) for eligible loans for a period of not less than 6 months and not more than 1 year.
- **Collateral/Guaranty Requirements:** The loans are expressly non-recourse to any individual shareholder, member or partner of an eligible recipient of a covered loan for covered amounts used to pay payroll, employee benefits, rent, utilities and mortgage interest. No guarantee or collateral is required.

¹⁴ “Payroll costs” includes salary or similar compensation, payment of cash tips, vacation, sick, parental, family, or medical leave, allowance for dismissal or separation, group health care, retirement payments, state or local taxes on the compensation of employees.

“Payroll costs” excludes compensation of an individual employee in excess of an annual salary of \$100k prorated for the Covered Period, withholding taxes, compensation of an employee with a principal place of residence outside of the US and qualified sick leave wages or family leave wages for which a credit is allowed under Section 7001 and 7003, respectively, of the Families First Coronavirus Response Act.

¹⁵ Coronavirus Aid, Relief, and Economic Security Act § 1102(a)(2) amending 15 U.S.C. 636(a), new subsection (36)(F).

¹⁶ *Id.* at new subsection (36)(E).

- **SBA Guarantee**: Up to 100% of 7(a) loans provided during the Covered Period are guaranteed by the SBA.
- **Fees**: Typical upfront and annual fees are waived.
- **Prepayment Penalties**: There are no prepayment penalties.¹⁷

SBA 7(a) Loan Forgiveness: A notable feature in the CARES Act is that it provides an eligible borrower loan forgiveness for covered loans in an amount equal to the sum of the following costs incurred and payments made during the 8-week period beginning on the date of origination of a covered loan (“Covered Forgiveness Period”): (a) payroll costs, (b) mortgage interest, (c) rent payments, and (d) utility payments. Any canceled indebtedness resulting from such loan forgiveness is expressly excluded from the borrower’s gross income for U.S. federal income tax purposes.¹⁸

The amount of loan forgiveness available to the borrower is reduced in proportion by both (i) any reduction in employees retained during the Covered Forgiveness Period compared to the prior year based on the specific formula set forth in the legislation and (ii) the amount of any reduction in total salary or wages of any employee during the Covered Forgiveness 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 Forgiveness Period. To encourage employers to rehire any employees who have been laid off due to COVID-19, there is no penalty if a borrower rehires an employee. The amount forgiven may not exceed the principal amount of the loan. In connection with a request for loan forgiveness, the borrower will be required to deliver supporting documentation.¹⁹

Application for 7(a) Loan: The CARES Act requires the SBA to issue regulations within 15 days of enactment that will explain specifics on how a borrower may apply for the expanded program. Once finalized those regulations will be posted on the SBA’s website. In evaluating the eligibility of a borrower for a 7(a) Loan the CARES Act states that a lender shall consider whether (a) the borrower was in operation on February 15, 2020 and (b) if the borrower either (i) had employees to whom it paid salaries and payroll taxes or (ii) paid independent contractors.²⁰

In connection with the application, the borrower is required to make a good faith certification (i) that the uncertainty of current economic conditions makes the loan request necessary, (ii) acknowledging the funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments and/or utility payments, (iii) that the borrower does not have an application pending for a loan under 7(a) for the same purpose and duplicative of amounts already applied, and (iv) during the period beginning on February 15, 2020 and ending on

¹⁷ Coronavirus Aid, Relief, and Economic Security Act § 1102(a)(1) amending 15 U.S.C. 636(a)(2), new subsection (F) [SBA guarantee]; id. at § 1102(a)(2) amending 15 U.S.C. 636(a), new subsections (36)(K) [term], (L) [maximum interest rate], (M) [payment deferral], (F)(v) and (J) [waiver of personal guarantee requirement and collateral requirement], (H) [fee waiver] and (R) [prepayment penalty].

¹⁸ *Id.* at § 1106(i).

¹⁹ *Id.* at § 1106(e).

²⁰ *Id.* at § 1102(a)(2), amending 15 U.S.C. 636(a), new subsection (36)(F)(ii)(II).

December 31, 2020 that the borrower has not received amounts under 7(a) for the same purpose and duplicative of amounts applied under a covered loan.²¹ Recipients of EIDL loans during the period beginning January 31, 2020 and ending on the date which covered loans are made available are not eligible for 7(a) loans offered under the CARES Act if the EIDL loan is used for payroll costs and other permitted uses as described under the CARES Act.²²

EIDL Loan Terms

In order to be eligible for a EIDL Loan, in addition to the general eligibility requirements for small businesses under the 7(a) Loan program, such loans are required to be made to eligible businesses who have incurred economic injury as a result of declared disaster and the borrower must show that they are not able to obtain credit elsewhere.²³ The CARES Act does not modify the ‘inability to obtain other credit requirement’ for EIDL Loans in the same manner as the 7(a) Loan Program. Borrowers are also required to have an acceptable credit rating and show an ability to repay loans.²⁴

Other terms of the EIDL loans also differ from the 7(a) Loans. The maximum loan amount is \$2.0 million, though for a business who is a major source of employment the SBA has authority to waive the \$2.0 million statutory limit (but the general eligibility requirements will continue to apply). The maximum term for EIDL loans is 30 years and the proceeds may be used broadly, including to pay fixed debts, for payroll, accounts payable and other bills. However, proceeds may not be used to refinance long-term debt. EIDL loans have an interest rate of 3.75% for for-profit entities.

²¹ *Id.* at new subsection (36)(R).

²² *Id.* at new subsection (36)(Q).

²³ The SBA takes into consideration the assistance available through business interruption policies and non-government sources, such as the business owner’s personal savings or credit that maybe available from banks.

²⁴ eCFR Title 13, Chapter 1, § 123.6.

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