



What's in the \$2 Trillion Stimulus Bill Responding to COVID-19 for Emerging Companies

April 2020

On Friday, March 27, 2020, the U.S. House of Representatives passed, and President Trump signed into law, House Resolution 748, known as the "Coronavirus Aid, Relief, and Economic Security Act" or the "CARES Act", which was previously passed by the U.S. Senate. The full text of the CARES Act is available [here](#).

The CARES Act authorizes up to \$2 trillion in government spending to address economic disruption caused by the COVID-19 pandemic. We published an alert on the CARES Act's impact on U.S. businesses adversely impacted by the COVID-19 pandemic generally [here](#). Title I of the CARES Act, the "Keeping American Workers Paid and Employed Act," provides a number of relief measures for emerging companies, including \$349 billion for Small Business Administration (the "SBA") loans, loan forgiveness, guarantees, and subsidies. The SBA and Treasury must still issue regulations, which are required by April 11, 2020 but may be available sooner. Title II of the CARES Act, which is titled the "Relief for Workers Affected by Coronavirus Act" (the "RWACA"), provides assistance for workers, their families and businesses in a variety of ways. This alert outlines some of the main provisions of the Keeping American Workers Paid and Employed Act and the RWACA that impact emerging companies.

Keeping American Workers Paid and Employed Act

The SBA administers several programs to support small businesses, including business loans and loan guaranty programs designed to encourage lenders to provide loans to small businesses "that might not otherwise obtain financing on reasonable terms and conditions." Section 7(a) of the Small Business Act of 1953 authorizes the SBA to provide business loans and loan guarantees to U.S. small businesses. The Keeping American Workers Paid and Employed Act will expand existing programs and provides additional protective measures, such as the Paycheck Protection Program (the "PPP"), Emergency EIDL Grants, subsidies for certain loan payments, and expanded bankruptcy protections described below.

SBA Express Loans

The SBA Express program features an accelerated turnaround time for SBA review of a loan application. The Keeping American Workers Paid and Employed Act increases the maximum loan for an SBA Express loan from \$350,000 to \$1 million through December 31, 2020.

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Paycheck Protection Program

The Keeping American Workers Paid and Employed Act also establishes the PPP, which helps small businesses obtain loans between February 15, 2020 and June 30, 2020 that are completely guaranteed by the federal government. These loans can be used to pay for payroll costs; group health care benefits during periods of paid sick, medical, or family leave; insurance premiums; employee salaries, commissions, or similar compensations; payments of interest on any mortgage obligation; rent; utilities; and interest on any other debt obligations incurred before the covered loan period.

Eligibility for SBA loans Expanded. The PPP temporarily amends the SBA loan program rules for the period beginning February 15, 2020 and ending June 30, 2020 and makes the following adjustments to the SBA eligibility standards:

- Expands the definition of “small business” eligibility to generally all businesses, including sole-proprietors, independent contractors, and other self-employed individuals, with not more than 500 employees (including those employed full-time, part-time or on another basis), or the applicable size standard for the industry as provided by the SBA, if higher.
- Allows businesses with more than one physical location that employs no more than 500 employees per physical location engaged in the hospitality and restaurant industries to be eligible.
- Waives affiliation rules for businesses in the hospitality and restaurant industries, franchises that are approved on the SBA’s Franchise Directory and small businesses that receive financing through the Small Business Investment Company program.

Maximum Loan Amount Increased. The maximum PPP loan is increased, now generally determined to be 250% of the business’ average monthly payroll up to \$10 million. The maximum interest rate for loans provided pursuant to the PPP is set at 4% and the maximum maturity is 10 years.

Standard SBA Requirements Waived. The PPP waives certain customary requirements to participate in the SBA loan program such as personal guarantees, borrower and lender fees, the credit elsewhere test (i.e., are the funds available to the small business from other sources), collateral requirements and prepayment penalties for any payments made on a covered loan.

Affiliation Rules Could Disqualify Smaller Venture-Backed Companies. Although not directly referenced in the PPP, SBA loans are subject to affiliation rules which include aggregating employees of all affiliated entities under common control, among other standards. The way the CARES Act is written, most emerging companies are considered affiliates of their VC or private equity firms. Therefore, the number of employees of a venture capital fund-controlled portfolio company could be aggregated with the venture capital fund’s other portfolio companies, leaving such companies unable to access loans under the PPP. Similarly, companies controlled by private equity firms could also be left out of the program.

Could Changes to the Affiliation Rules Allow Smaller Venture-Backed Companies to Access SBA Loans? Some recent press reports include speculation that these venture capital- or private equity-backed businesses could be brought back under the loan program by the Treasury Department or SBA. However, to date there has not been sufficient political interest to change the way it is written. Congress may be concerned about the optics of rescuing companies backed by venture capital and private equity firms, which are perceived as having nearly unlimited access to cash, fearing a backlash by voters against the

perception of Congress propping up enterprises owned by the wealthy before helping working people. This reflects a misperception of the role of venture capital and private equity in a crisis. These investors need to maximize returns for their limited partners and to do that, they are likely focused on keeping the business going and adapting to the market changes, not necessarily retaining jobs and payroll for employees. In fact, for the best interests of the business and its stockholders, investors may need to advise their companies to reduce expenses, which may include headcount and compensation. See further discussion in our alert “Considerations for Emerging Companies in the COVID-19 Era” [here](#). Industry groups such as the National Venture Capital Association are communicating with the Treasury Department and the SBA to persuade them to take further action to make changes to the current SBA rules on affiliation to allow smaller venture capital and private equity-backed companies to participate in the SBA loan program. We may see more on potential changes to the affiliation rules from the SBA and Treasury as they must still issue regulations under the CARES Act.

Larger Venture-Backed Companies Can Obtain Loans. The CARES Act separately provides for the possibility of additional loans for venture capital and private equity-controlled businesses under a program that does not include the SBA’s affiliation restrictions to address the needs of businesses with 500 to 10,000 employees. Any recipient of these loans must use the funds to retain at least 90% of its workforce, and must agree that they intend to restore at least 90% of its workforce that existed as of February 1, 2020 and restore all compensation and benefits to employees within four months after the termination of the COVID-19 public health emergency declaration. The timing, structure and availability for these funds is not likely to be known for several weeks. See “Economic Stabilization and Assistance to Severely Distressed Sectors of the U.S. Economy - Non-Profits and Mid-Sized Businesses” in our alert [here](#). These funds for companies in excess of 500 employees are in addition to any funds provided by the Federal Reserve under its newly announced Main Street Lending Program. See our summary of the Federal Reserve programs [here](#).

Requirements to Receive a Loan. In order to receive a loan under the PPP, eligible borrowers must certify that (i) the loan is necessary to support the ongoing operations of the business due to the uncertainty of current economic conditions; (ii) the funds will be used to retain workers and maintain payroll, mortgage, lease, or utility payments; and (iii) the eligible borrower does not have an application pending and has not received duplicative funds for the same uses from another SBA program. It is not currently known how the regulations implementing the PPP could restrict or slow the lending process for companies subject to ongoing layoffs, even if such companies can make the above good faith certification.

Loan Repayments are Deferred. The PPP allows for complete deferment of loan payments for at least six months and not more than a year.

Loans are Nonrecourse to Borrower. The PPP also provides that the SBA has no recourse against any individual shareholder, member or partner of a borrower for nonpayment of any covered loan, except to the extent that funds are used for an unauthorized purpose.

Authority Delegated to Lenders to Determine Borrower Eligibility Under More Lenient Criteria. The PPP provides for delegated authority to all SBA lenders who make these loans to small businesses, meaning that lenders will have the ability to make determinations on borrower eligibility and creditworthiness without going through all of SBA’s channels. It also requires lenders to determine, for eligibility purposes, whether a business was operational on February 15, 2020, had employees for whom it paid salaries and payroll taxes, or paid independent contractors, instead of determining repayment ability, which is not possible during this crisis.

Loan Forgiveness under the PPP

The CARES Act provides that an eligible recipient of a covered loan under the PPP is eligible for loan forgiveness, up to the principal amount of the loan, for payroll costs, payments of interest on covered mortgages, payments on covered rent obligations, and covered utility payments between February 15, 2020 and June 30, 2020. Payroll costs include additional wages paid to tipped workers. Amounts to be forgiven will be reduced for borrowers who terminate employees or reduce salaries, with re-hire exemptions. Though amounts forgiven are considered canceled indebtedness, they will not be included in the borrower's taxable income.

How to Apply for Loan Forgiveness under the PPP. In order to receive loan forgiveness, an eligible recipient seeking loan forgiveness must submit to the lender the following documents:

- documentation verifying the number of full-time equivalent employees on payroll and pay rates;
- documentation verifying payments on covered mortgage obligations, payments on covered lease obligations, and covered utility payments;
- a certification from an authorized representative of the eligible recipient that the documentation presented is true and correct and that the amount for which forgiveness is requested was used only for authorized purposes; and
- any other documentation the Administrator of the SBA determines necessary.

Economic Injury Disaster Loans

The CARES Act provides \$10 billion for immediate advance payment for Economic Injury Disaster Loans ("EIDL") to eligible businesses to provide immediate financial resources to retain employees and meet other short-term expenses. Eligible businesses that apply for EIDL loans based on COVID-19 can request an advance payment of an amount up to \$10,000. The SBA must distribute the full amount of this advance payment within three days. Applicants are not be required to repay advance payments, even if subsequently denied for an EIDL loan. In addition, the CARES Act allows for waiver of personal guarantees on EIDL advances and loans relating to COVID-19 for loans of not more than \$200,000 while also streamlining the approval process and considerations for EIDL loans beyond the advance payments.

Permitted Uses. The EIDL advance payments may be used for any purpose allowed under the relevant sections of the Small Business Act, including providing paid sick leave to employees, maintaining payroll, meeting increased costs to obtain materials, making rent or mortgage payments, and repaying obligations that cannot be met due to revenue losses. Any advance payments will reduce loan forgiveness amounts otherwise available under the PPP.

Eligibility Verification. The SBA must determine eligibility prior to making the EIDL advance payment. Eligibility is determined via an applicant's sworn certifications, under penalty of perjury, that the applicant is qualified for the program.

Obtaining Loan Approval. The SBA is permitted to approve and offer EIDL loans, separate and apart from the EIDL advance payments, based solely on an applicant's credit score or use an appropriate alternative method to determine an applicant's ability to repay.

Subsidy for Certain Loan Payments

The CARES Act provides small businesses that are existing SBA borrowers with increased liquidity for a six-month period to continue day-to-day operations. The SBA will pay the principal, interest, and associated fees owed on existing covered loans for a six-month period starting on the next payment due date. SBA payments will be made no later than 30 days after the

date on which the first payment is due. In connection with these loan payments, the SBA is required to encourage lenders to provide payment deferments and to extend the maturity of covered loans.

Covered Loans: The following types of loans are covered under this program:

- existing SBA loans (including Community Advantage Pilot Program);
- 504 loans (long-term, fixed-rate loans used to acquire fixed assets for expansion or modernization); and
- other microloan products.

Loans sold in the secondary market that otherwise meet the standard remain "Covered Loans".

PPP loans are not included in the definition of covered loans due to the ability to defer payments on those loans for six to 12 months. Additionally, if a "Covered Loan" is already on deferment at time of enactment, it will be entitled to the subsidy payments for the six-month period beginning on the first payment due after the deferral period.

Eligibility Deadline: Covered loans existing at the time of enactment and those made prior to the six-month anniversary of enactment will be eligible to receive the full six months subsidy by the SBA.

Bankruptcy Relief for Small Businesses

Easier for Emerging Companies to Reorganize. The expense and complexity of Chapter 11 historically made a Chapter 11 reorganization not a viable option for many small businesses. Congress recently enacted the Small Business Reorganization Act ("SBRA") in February 2020 to relax many of the hurdles in Chapter 11 for small businesses to successfully reorganize. The changes were implemented in a new Subchapter 5 of Chapter 11 ("Small Business Chapter 11"). But only businesses with debts in the amount of \$2,725,625 or less could access the new Small Business Chapter 11. The CARES Act increased the debt limit of SBRA to \$7.5 million, thereby permitting many more small businesses to access the new, streamlined Small Business Chapter 11. However, the Small Business Chapter 11 eligibility threshold of \$2,725,625 will return after one year.

Assistance for American Workers, Families and Businesses

The RWACA provides assistance for emerging companies in a number of ways. It makes revisions to the income tax code, including the following relevant to emerging companies:

Employee Retention Credit For Employers Subject To Closure or Significant Decline in Revenue Due To COVID-19

50% Payroll Tax Credit for Retaining Employees. The CARES Act provides a refundable payroll tax credit for 50% of "qualified wages" paid by any "eligible" employer to employees during the COVID-19 crisis. The credit may be claimed against the employer's share of all Social Security taxes owed by the employer (as reduced by credits against such taxes for qualified sick leave and family leave claimed under applicable provisions of the Family First Coronavirus Relief Act ("FFCRA")). The employer may obtain a refund to the extent the credits exceed the employer's social security tax obligations.

Eligibility for Payroll Tax Credit

An employer generally is treated as an "eligible employer" (i) during any calendar quarter for which the employer's operations were fully or partially suspended due to orders from a governmental authority limiting commerce, travel or group meetings

due to COVID-19 or (ii) beginning with the first calendar quarter after December 31, 2019 for which the employer's gross receipts are less than 50% of the employer's gross receipts for the same calendar quarter in the prior year and ending with the calendar quarter following the first calendar quarter for which the employer's gross receipts are greater than 80% of the employer's gross receipts for the same quarter in the prior year.

For eligible employers with greater than 100 full-time employees during 2019, "qualified wages" generally include wages paid to employees during period in which they are not providing services due to the COVID-19-related circumstances described above. For eligible employers with 100 or fewer full-time employees during 2019, all employee wages generally qualify for the credit, regardless of whether the wages are paid to an employee who is providing services during the period of the COVID-19 related circumstances described above. There are several limitations, however.

- The credit is limited to the first \$10,000 of compensation, including health benefits, paid to any eligible employee for all quarters.
- For employers with 100 or fewer employees, no credit is allowed for wages taken into account under the family leave and sick leave provisions of the FFCRA.
- For employers with more than 100 employees, the maximum amount of wages taken into account with respect to an employee during a period in which the employee is not providing services due to the COVID-19-related circumstances described above may not exceed the amount such employee would have been paid for working an equivalent duration during the 30 days immediately preceding such period.
- No credit is allowed to employers who receive small business interruption loans under Section 7(a)(36) of the Small Business Act.
- The credit is not allowed for wages paid to any employee for whom the employer is claiming the work opportunity credit.

For purposes of applying the foregoing rules, all persons treated as a single employer under the relevant sections of the Internal Revenue Code are treated as a single employer. The credit is available for wages paid or incurred from March 13, 2020 through December 31, 2020.

Deferral of Payment of Employer Payroll Taxes

Defer Payment of 6.2% Employer Payroll Tax. Employers generally are responsible for paying a 6.2% Social Security tax on employee wages, up to a specified wage cap (\$137,700 of wages for 2020). Self-employed persons are subject to a corresponding Social Security component of self-employment tax. The CARES Act generally allows employers to defer payment of the employer's share of Social Security tax which the employer otherwise is required to pay after March 25, 2020 and before January 1, 2021 and, instead, pay such deferred social security tax (without interest or penalty) over the following two years, with half of the amount required to be paid by December 31, 2021 and the other half by December 31, 2022. A similar deferral applies to 50% of the social security portion of the self-employment tax otherwise required to be paid by self-employed individuals after March 25, 2020 and before January 1, 2021. The foregoing deferrals do not apply, however, to taxpayers who have indebtedness forgiven under certain other provisions of the CARES Act.

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