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So You Were Approved for a Paycheck Protection Program Loan—Now What?

The Paycheck Protection Program (the “PPP”) under the recently-enacted CARES Act was designed to protect jobs with “forgivable” loans to small businesses. While some guidance has already been issued by the Small Business Administration (the “SBA”) and the Department of the Treasury, the application of the rules governing the PPP remain unclear in many respects.

For those small businesses that have received a PPP loan, the next questions that may arise are:

1. given the negative publicity with respect to certain recipients of a PPP loan, is there anything I should do?
2. what are we permitted to use the proceeds of the PPP loan for?
3. how do we maximize the amount of the PPP loan that is forgiven?

The Eligibility Uncertainty

Applicants for PPP loans were required to certify that “Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” Last week, the SBA announced that:

This guidance is likely driven by the negative scrutiny in the media with respect to certain borrowers that have received PPP loans. The Secretary of the Treasury has

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indicated that a “full review” will be undertaken with respect to any PPP loan that exceeds \$2 million under the Paycheck Protection Program.

The SBA has published a deadline of May 7, 2020 for companies to return their PPP loans without risk of civil or criminal consequences for a breach of that certification that is ultimately found to have been untrue when made. It is not clear if repaying a PPP loan by May 7, 2020 would protect borrowers who violated any of the other requirements for the PPP loans, such as being an ineligible type of business or violating the affiliation rules or maximum employee requirement. *See: “NGE Client Alert: Requirements and Considerations for Paycheck Protection Program Loans.”* Nonetheless, borrowers who receive a PPP loan should re-confirm their eligibility for the PPP loan, and if they determine they were not eligible, prepay such loan prior to May 7, 2020.

Segregating and Budgeting the PPP Loan Proceeds

The proceeds of a PPP loan may only be used for certain “allowable uses.”^[1] Most significantly, *at least 75% of the PPP loan proceeds must be used for payroll costs*. And if you are intending to enjoy the benefit of loan forgiveness, you should note that only a subset of these allowable uses—*payroll costs, interest on a mortgage, rent and utilities*—will be taken into account in calculating the amount of any forgiveness of the PPP loan, and then only to the extent that these amounts were incurred and paid during the measuring eight-week period (the “Covered Period”) which commences on the date that the loan is disbursed to you. Since tracing the use of the PPP loan proceeds and the timing of the payments is so critical, recipients of PPP loan proceeds should consider using a segregated bank account for the loan proceeds, and be careful to document the use of these funds. In light of the eight-week clock that is running to determine the amount of forgiveness you may receive, it is prudent

to promptly and carefully budget and allocate these funds to payment of payroll costs, rent, utilities and mortgage interest incurred and paid in the Covered Period, taking care to allocate at least 75% to payroll costs. Your maximum possible forgiveness is the full amount of the PPP loan proceeds, together with accrued interest, capped at the amount loan proceeds that you spend on these allowable uses in the Covered Period, but this maximum forgiveness amount is subject to reduction as provided below.

The Employee Headcount Reduction

The maximum potential amount of forgiveness determined above is first reduced by the same percentage, if any, that the borrower's average full-time equivalents ("FTEs") per month during its Covered Period is less than its average FTEs per month during one of either of two base measuring periods (the borrower may choose the base measuring period in which it had the lower average FTEs per month). The alternative measuring periods are from February 15, 2019 to June 30, 2019, or from January 1, 2020 to February 29, 2020. While no clear guidance on the manner of making this calculation has yet been issued, it appears that for each month within each such period, the average number of FTEs per month is calculated by first taking the number of regular hours of work for all employees (disregarding any hours worked by any employee in excess of 40 within any week) on each payroll during such month. The average FTEs per month during the Covered Period, for example would be the average of these monthly averages for the months falling within the Covered Period. We then run the same math for each of the two alternative measuring periods, and choose the alternative measuring period with the lower average FTEs per month. If the borrower had, say, 8% fewer FTEs per month in the Covered Period relative to the chosen measuring period, then the forgiveness amount is reduced by 8%—UNLESS the borrower's reduction in FTEs

occurs prior to April 26, 2020 and by June 30, 2020 the borrower has restored its FTEs to the level in existence on February 15, 2020, in which case the borrower is deemed to have “eliminated” the reduction in FTEs and there is *no* reduction in the forgiveness amount attributable to employee headcount.

Here’s an example of this headcount forgiveness reduction calculation:

We are awaiting guidance as to how exactly the “elimination” of the reduction in FTEs is to be calculated. But it’s clear that a calculation of the borrower’s average FTEs per month for each of the two alternative base measuring periods, and a reasonable estimate of the borrower’s average FTEs per month for the Covered Period, will be a critical tool in the budgeting and allocation of PPP loan proceeds as described above, and in related decisions regarding if and when to furlough, terminate, bring back, or hire employees.

The Salary/Wages Reduction

Whatever potential forgiveness remains after performing the employee headcount reduction above is further reduced, dollar-for-dollar, for major reductions in compensation. This reduction is done on an employee-by-employee basis, but solely with regard to a subset of the employees. This subset consists of all employees who (i) were employed by the borrower during the eight-week Covered Period, (ii) were also employed by the borrower at any time during calendar year 2019, and (iii) “did not receive, during any single pay period during 2019, wages or salary at an annualized rate of pay in an amount more than \$100,000.” For each employee in this group, determine his or her total salary or wages for the first quarter of 2020. If the total salary or wages paid to the employee during the eight-week Covered Period is at least 75% of the employee’s total salary or wages

during the first quarter of 2020, then there is no reduction of the forgiveness due to that employee's compensation. But if the total salary or wages paid to the employee during the Covered Period declined more than 25% as compared to the employee's total salary or wages during the first quarter of 2020, then the forgiveness is reduced by the excess reduction (that is, beyond the first 25%) for that employee—*UNLESS* by June 30, 2020 the employee's compensation rate for the period from February 15, 2020 to April 26, 2020 has been restored to his or her compensation rate as at February 15, 2020, in which case the borrower is deemed to "have eliminated" the reduction in salary or wages as to that employee, and there is no reduction of forgiveness with respect to that employee. Again, further guidance on the manner of making these calculations is likely to be issued by the SBA. But the bottom line here is that it's wise to review the impact on the forgiveness of a PPP loan before making adjustments to salary and wages for employees who received salary or wages at an annualized rate of \$100,000 during any pay period in 2019.

The Documentation Requirements

A borrower that seeks forgiveness of its PPP loan obligations will be required to deliver very specific documentation to the lender that is servicing the PPP loan. This documentation consists of:

- (a) documentation verifying the number of FTEs on the borrower's payroll, and the related pay rates, for the Covered Period and the selected base measuring period as described above, including:
 - (i) payroll tax filings as reported to the Internal Revenue Service for such periods; and

- (ii) state income, payroll, and unemployment insurance filings for such periods;
- (b) documentation, including cancelled checks, payments receipts, transcripts of accounts, or other documents verifying payments on covered mortgage obligations, payments on covered lease obligations, and covered utility payments;
- (c) certification from a representative of the borrower authorized to make such certifications that:
 - (i) the documentation presented is true and correct; and
 - (ii) the amount for which forgiveness is requested was used to retain employees, make interest payments on a covered mortgage obligation, make payments on a covered rent obligation, or make covered utility payments; and
- (d) any other documentation which the SBA may determine to be necessary.

In summary, a recipient of a PPP loan intending to enjoy the benefit of loan forgiveness would do well to immediately segregate the PPP loan proceeds for ease of documenting the use of such funds, promptly develop a budget and plan assuring use of the PPP loan proceeds within the eight-week Covered Period solely for permitted uses as described above, preserve employee headcount and wage levels to the extent possible to minimize the reduction of the forgiveness amount, and prepare and maintain the required documentation with respect to the use of the loan proceeds.

This overview has been simplified for general clarity and should not be construed as legal advice. If you have



questions about this overview or any other matters related to the PPP program, please contact Bruce Fox, Chadwick Hoyt, Michael Gray, Robert Gerber, David Milligan, Tom Wolford or your Neal Gerber Eisenberg attorney.

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[1] The allowable uses include payroll costs for employees who are residents of the U.S. (which payroll costs are defined to include only (i) salary, wages, commissions or similar compensation (including cash tips) of an individual *up to a maximum rate of \$100,000 per year* without regard to payroll taxes imposed or withheld, (ii) payment for vacation, parental, family, medical or sick leave, (iii) severance, (iv) payments for retirement benefits, (v) payment of payroll taxes, and (vi) housing stipends and allowances), group health care benefits, health insurance premiums, rent under a lease in force before February 25, 2020, mortgage interest (but not principal) for mortgages incurred before February 15, 2020, electricity, gas, water, transportation, telephone or internet access for which service began before February 15, 2020, and interest on other indebtedness obligations incurred prior to February 15, 2020.

