



This DIP Loan Brought To You By Someone Who CARES! (Or “I’m From The Government And I’m Here To Help You”)

PART ONE

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“No social stability without individual stability.”

*Aldous Huxley, **Brave New World***

Our world has undeniably changed, and will remain so for the foreseeable future. In an attempt to soften the inevitable economic blow that accompanies this global pandemic and its epic adverse impact on the U.S. economy, on March 27, 2020, Congress passed (and the President quickly signed) the “Coronavirus Aid, Relief, and Economic Security (CARES) Act” into law. The CARES Act is reported to be “twice as large as any relief ever signed”² and will provide \$2.2 trillion in relief to U.S. families, workers and businesses. This is the third piece of legislation³ passed to address this problem.

While bankruptcy lawyers are aware that CARES expanded the debt limitations for eligibility for the “Small Business Reorganization Act of 2019” (which became effective on Feb. 19, 2020) from a little over \$2.7 million to \$7.5 million (thereby opening up the streamlined restructuring capabilities for materially more financially distressed business),⁴ the authors believe that there could be another substantial implication for the brave new bankruptcy world: a new potential source of DIP financing.

There is something for almost everyone in the CARES Act. CARES has approximately \$377 billion allocated for financing “small businesses” (under 500 employees or the standard size established by the SBA for the businesses industry,

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² For a more in-depth and expanded analysis of the CARES Act, see Ebner, Weidner, Wheeler, Sheahan, Salerno, Simpson, Tews, Fenske, Araujo & Respeliers, “Coronavirus Aid, Relief, and Economic Security (CARES) Act Signed into Law: Overview of Key Provisions,” Stinson Client Alert (March 30, 2020).

³ The CARES Act is the “latest in a series of legislative packages addressing the COVID-19 pandemic. Two bills have already been enacted into law: the Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020 (P.L. 116-123) and the Families First Coronavirus Response Act (P.L. 116-127).” <https://crsreports.congress.gov/product/pdf/R/R46279>.

⁴ While not directly relevant to this article, the CARES Act also amended the Code to provide that debtors who have experienced a material financial hardship due to COVID-19 will be allowed to modify a plan under chapter 13, but only if the modified plan does not provide payments more than seven years after the first payment was due under the original chapter 13 plan (and the modification otherwise meets the requirements of §§ 1322(a)-(c) and 1325(a).

the “Small Business Provisions”⁵ and a program called Emergency Relief Direct Loans to Employers (the “Larger Business Provisions”), as well as a \$500 billion “Specified Industry Loan Program” (SILP)⁶. The Larger Business Provisions and SILP will be the subject of Part Two of this briefing.

We are all aware that Bankruptcy Code § 364 provides the vehicle to obtain post-petition financing on either a secured or unsecured basis (DIP financing). It is in this context that the CARES financing provisions become particularly interesting. Also of interest, the CARES Act does not expressly preclude application of some of these programs in a bankruptcy proceeding (and wisely so, since it is anticipated that the economic upheaval of COVID-19 will lead to more chapter 11 filings).

The authors recognize that there are established underwriting guidelines for Small Business Administration (SBA) loans. Moreover, there are new regulations (and undoubtedly future regulations as this plays out) that will come into play with these loans.⁷ As such, while there is no express prohibition for some of the loans referenced herein from being accessed in a chapter 11 proceeding,⁸ the *de facto* prohibition may come from underwriting guidelines.⁹

The foregoing notwithstanding, if the overarching purpose of the CARES Act is to assist businesses in weathering the economic storm while the COVID-19 virus ravages the economy, it is not unreasonable to suggest that such underwriting guidelines can and will be loosened in order to allow the application of some of these programs in a chapter 11 proceeding (whose aim will be to stabilize the business such that jobs can be retained, taxes paid in the future, etc.). In other words, the stimulus funds will be used where they can be most effectively deployed.¹⁰ The chapter 11 into which the funds are lent will not have as its purpose the goal of wiping out the SBA loans discussed herein.¹¹

Any prudent advisor to a financially distressed business enterprise¹² should consider the implications of the CARES Act and its financing provisions as part of a restructuring analysis. This briefing summarizes some of the major CARES Act provisions that could come into play in the bankruptcy/restructuring arena.

Small Business Provisions¹³

There are at least three areas of the CARES Act totaling in excess of \$376.5 billion for small businesses that come into play here: the \$10.562 billion Emergency Economic Injury Disaster Loan and Grants (EIDL) Program, the \$349 billion Paycheck Protection Program (PPP) provisions, and the \$17 billion in Subsidies for Certain Other Small Business Loan Payments. *There is no express prohibition in the CARES Act that precludes these small business provisions' application in a chapter 11 bankruptcy proceeding.*¹⁴

1. EIDL Provisions

There are two CARES Act provisions that come into play here for smaller businesses.

5 While the CARES Act does not say anything about how the number of employees is calculated, Section 3 of the Small Business Act will likely apply. That provision says that size (based on employment) is measured by the average employment based on employment during each of the manufacturing concern's pay periods for the preceding 12 months. That would be consistent with the methodology for determining whether a reduction in the forgiveness is made due to a reduction in the workforce.

6 Yes, that is “billions.” To put this into historical perspective, 12 years ago the Emergency Economic Stabilization Act of 2008, which authorized the expenditure of economic stimulus federal money by the Troubled Asset Relief Program (known simply as TARP), created in reaction to the capital markets meltdown in 2008, was a quaint \$700 billion in its entirety. A few billion here, a few billion there; it starts to add up to real money eventually.

7 For example, the Treasury Department recently issued some guidance on payroll support to air carriers and contractors, and procedures and minimum requirements for loans to air carriers and eligible businesses and national security businesses. For anyone who may be interested, a link to the website where those are available is below. There does not yet appear to be any guidance on the PPP loans or other SBA relief. See: <https://home.treasury.gov/news/press-releases/sm960>.

8 CARES does have a certification requirement. The CARES loans discussed herein require a certification “acknowledging that funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments.” Accordingly, as long as the loan proceeds are used strictly for this purpose, it is a proper use of DIP financing monies and in compliance with the CARES Act. Attorneys' fees and other costs of administration would need to be paid from a different source of funds (not all that dissimilar to a restriction by a lender on the use of its cash collateral, for example).

9 The underwriting guidelines require that the owner have reasonable equity to invest and guarantee rates on regular Section 7 loans ranging from 50% to 90%, so the borrower would need to satisfy the lender's underwriting standards as the lender retains some risk of loss. The SBA maintains a Lender Guide, and there are some parts of the SBA website that can only be accessed by lenders with a password. The following materials on the SBA website generally discuss underwriting considerations and borrower requirements:

- <https://www.sba.gov/partners/lenders/7a-loan-program/terms-conditions-eligibility>;
- https://www.sba.gov/sites/default/files/articles/Chapter_4_Credit_Standards_Chart-1B.pdf;
- https://www.sba.gov/sites/default/files/SDOLoanFactSheet_Oct_2011.pdf; and
- <https://www.sba7a.loans/eligibility-and-qualifications-for-the-sba-7a-loan>.

10 Put another way, if the loans discussed herein are made before the chapter 11 filing of a distressed business, and because the loans are, in reality, more of a Band-Aid than a real overall cure for the existing economic malaise, then the loans will be subject to be altered, reduced or otherwise diminished in a subsequent chapter 11 proceeding. That benefits no one and indeed directly undermines the remedial goal of the CARES Act program.

11 As a practical matter, these loans, as DIP loans, will at a minimum have administrative expense priority such that, absent a meltdown of the entire case, they must be repaid as part of the confirmation of any chapter 11 plan.

12 At the risk of sounding callous, the new reality is that there are two kinds of business enterprises out there: those that are in financial distress, and those that are lying about being in financial distress. Such is the brave new world in which we currently live.

13 See *Small Business Owner's Guide to the CARES Act* (March 30, 2020), available at <https://www.sfnr.com/wp-content/uploads/2020/03/JTB-CARES-Act-SBA-Business-Owner-Guide.pdf>.

14 As contrasted with the Larger Business Provisions, the subject of Part II of this series.

Emergency Economic Injury Disaster Loans (EIDLs):¹⁵ The Act appropriates an *additional \$562 million for Small Business Administration (SBA) disaster loans, including EIDLs*. For the covered period of *Jan. 31, 2020, through Dec. 31, 2020*, EIDL eligibility is expanded to include sole proprietors, independent contractors, cooperatives, ESOPs and tribal businesses with less than 500 employees.

For EIDLs of less than \$200,000, *the personal guaranty requirement is waived for the covered period*. Federally declared emergencies also now qualify as a trigger for the EIDL program, making *EIDLs available nationwide*.

During the covered period, the SBA can approve EIDLs based solely on the credit score of the applicant or an alternative method appropriate for determining creditworthiness; the “time in business” and “credit elsewhere” test requirements have been waived for the covered period.

Emergency Economic Injury Grants: The Act also includes *\$10 billion for emergency EIDL grants (EIDL Grants)*, to be provided by the SBA *through December 31, 2020*. Emergency EIDL grants are *\$10,000 advances to small businesses* applying for the EIDL program. The \$10,000 advance will be *provided within three days of the business applying for the EIDL*. Businesses *will not be required to pay back the advance*, even if they are ultimately denied the EIDL grant.

Subsidies for Certain Other Small Business Loan Payments: *\$17 billion is appropriated for the payment of certain other small business loans*. For loans in regular service, whether or not on deferment, made under 7(a) of the Small Business Act, Title V of the Small Business Investment Act, and loans under 7(m) of the Small Business Act made by an intermediary before enactment of the Act, the SBA will pay the principal, interest and fees owed for the six-month period commencing with the first payment due following the date of enactment (March 27, 2020) or, for loans on deferment, commencing with the next payment due after the deferment period. *The SBA shall also pay the first six months of principal, interest and fees owed on any such loans made during the period beginning on March 27, 2020, and ending on the date that is six months after the date of enactment (Sept. 27, 2020)*.

The Act waives the maximum loan maturity limits for those loans under deferment, and also extends the lender site visit requirement to within 60 days of a non-default adverse event and 90 days for a default adverse event.

State Trade Expansion Program: Federal grant funds appropriated for the State Trade Expansion Program (STEP) from fiscal years 2018 and 2019 will remain available to provide grants through the end of fiscal year 2021.

Entrepreneurial Development: The Act appropriates \$275 million toward funding and resources to small business development centers, women’s business centers and minority business centers. These centers must use the funds to provide education, training and advising on surviving the COVID-19 crisis to covered small businesses, especially those in impoverished or rural areas.

Resources and Services in Languages Other than English: Notably, the Act requires that SBA resources and services relating to the Act’s relief provisions be provided in the 10 most commonly spoken languages, other than English, in the U.S., including Mandarin, Cantonese, Japanese and Korean.

2. PPP Provisions

The CARES Act includes specific and detailed provisions expanding the authority of the Small Business Administration (SBA) to insure loans to help small businesses cope with the COVID-19 pandemic.¹⁶ The SBA currently provides partial guarantees of loans made under the SBA’s Section 7(a) loan program, including loans for disaster assistance. Under the CARES Act, the SBA is authorized to guarantee a new category of loans originated under the Act’s Paycheck Protection Program (PPP). PPP loans are intended to help small businesses fund certain payroll, loan interest, rent and utility expenses.

¹⁵ Emergency Injury Disaster Loans under Section 7(b)(2) of the Small Business Act. The CARES Act expanded the SBA’s authority under Section 7(b)(2).

¹⁶ The PPP loan rules are an addition to Section 7 of the Small Business Act. Those rules contain specific provisions relating to eligible borrowers, maximum loan amounts, how loan size is determined, maximum interest rate, maximum maturity, the criteria for qualifying for a loan, and the formula for calculating the amount of the loan to be forgiven. It is the statutory framework for the SBA to guarantee these loans. Despite these specifics, questions about the size, affiliation and number of employees are some of the areas where greater guidance would be useful.

In contrast, the section of the CARES Act that deals with the program for the Larger Business Provisions (to be discussed in Part Two of this briefing) merely says the Treasury will endeavor to seek the implementation of a loan program that provides financing for banks and other lenders to make loans to organizations with an annualized interest rate not higher than 2% per annum where no principal or interest will be payable for the first six months or such longer period as is determined by the Secretary. It then lists 10 certifications the borrowers are to make. The statute refers to eligible businesses, but does not define them other than by an employee size range.

Demand for PPP loans will be high, so time is of the essence when applying for PPP loans.

The Act requires the Treasury Secretary to implement regulations for administration of the PPP,¹⁷ which will include loan terms and conditions, interest rates, underwriting standards and the SBA guarantee percentage. While the PPP provisions suggest that the guarantee percentage will be 100% and the SBA will reimburse lenders for any forgiven loan amounts, the final guarantee percentage will be established by regulation. *Businesses should expect delays while the Treasury Secretary promulgates rules for PPP loans.* Borrowers who may be interested should immediately take steps to pull together their payroll and other financial information and seek out a lender participating in the PPP program to determine eligibility.

Key Takeaways: The Act commits \$349 billion to the (PPP), which will provide *loans of up to \$10 million to eligible small businesses to cover qualified costs. Loan amounts equal to up to eight weeks of payroll and other qualified costs may be forgiven if the business retains its employees and maintains compensation levels during the period covered by the Act.* All SBA loan fees also will be waived for PPP loans. All PPP loans will be nonrecourse to individual shareholders, members and partners of a borrower so long as the loan proceeds are used for permissible purposes. Moreover, PPP loan payments can be deferred for at least six months and up to one year.

Unlike traditional SBA loans, *applicants need not show that credit is unavailable elsewhere, nor will they have to provide personal guarantees or collateral to receive a PPP loan.*

Who Is Eligible for PPP Loans? Businesses that have already qualified as “small business concerns” under the Small Business Act, 501(c)(3) nonprofit entities, and businesses, veterans’ organizations and tribal businesses that employ no more than the greater of either (1) 500 employees or (2) the standard size established by the SBA for their industry are all eligible for PPP loans. *Sole proprietors, independent contractors and self-employed individuals are also eligible for PPP loans.* In addition, certain businesses with more than one physical location that have been assigned a North American Industry Classification System (NAICS) code beginning with 72 and that have 500 or fewer employees per location are eligible for PPP loans. The number of employees employed by a business’s affiliate(s) will be counted toward its total number of employees for small business size calculation in most cases. In addition, the borrower’s business *must have been in operation as of Feb. 15, 2020*, to be eligible to apply for and receive these loans. Lastly, businesses applying for a loan must also *certify that they have been negatively affected by the current economic conditions.*

As stated, the number of employees employed by a business’s affiliate(s) will be counted toward its total number of employees for small business size calculation in most cases. However, in determining eligibility for PPP loans, the Act waives the affiliation rules under 13 C.F.R. 121.103 for businesses of 500 employees or less that are in the accommodation and food services industry, franchises assigned a franchise-identified NAICS code, and businesses receiving financing through the Small Business Investment Company Act.

What Are PPP Loan Dollar Amounts and Payment Terms? The *maximum PPP loan amount* is the lesser of (1) \$10 million or (2) 2.5 times the average monthly payroll for the prior one-year period (or, for certain seasonal businesses, the average monthly payroll for certain periods specified in the Act).¹⁸ *The interest rate on PPP loans is not to exceed 4%.* Loan amounts not forgiven (as discussed below) will have a *loan maturity not to exceed 10 years.*

Payroll costs that may be covered by the loan include salaries, wages, commissions, payments for certain other benefits such as vacation, health insurance and retirement benefits, and state and local employment taxes. *Payroll costs can include certain compensation or other income to a sole proprietor or independent contractor.*

Payroll costs *excluded* from the loan are certain compensation in excess of \$100,000 per year, taxes under the Federal

¹⁷ Section (F)(iii) of Section 36 of the Small Business Act (as added by Section 1102) provides as follows: “The authority to make loans under this paragraph shall be extended to additional lenders determined by the Administrator and the Secretary of the Treasury to have the necessary qualifications to process, close, disburse and service loans made with the guarantee of the Administration.” Section 1109 of the Act provides for the establishment of guidance and rules and refers to the Secretary of the Treasury.

¹⁸ The CARES Act specifically permits sole proprietors and self-employed businesses to participate. The benefits may not be as great when there are no employees. The maximum loan amount is determined by the average monthly payroll amount, which will be less for a sole proprietor. Note that payroll costs include “the sum of payments of any compensation to or income of a sole proprietor or independent contractor that is a wage, commission, income, net earnings from self-employment or similar compensation” (based on annual compensation of up to \$100,000 per year). In addition, the loan-forgiveness concept in the CARES Act calculates the loan-forgiveness amount to include payroll costs (as well as certain interest payments, rent and utility costs), so the forgiven amount would not be as great where there are no employees.

For some businesses with very few employees (including single-employee businesses), the EIDL grants, in conjunction with the PPA loans, will provide some relief. There is nothing that prohibits a single-employee business from applying for both an EIDL grant and a PPP loan; however, if both are given, the amount of loan forgiveness under the PPP loan will be reduced by the EIDL grant amount.

Insurance Contributions Act, Railroad Retirement Tax and Unemployment Taxes, compensation for employees residing outside the U.S., certain qualified sick leave wages, and certain qualified family leave wages.

Circumstances Under Which PPP Loans May Be Forgiven: *The SBA will forgive PPP loan amounts equal to up to eight weeks of qualified costs of the business, including payroll costs, interest payable on secured debt incurred before Feb. 15, 2020, rent due on leases in place before Feb. 15, 2020, and utility payments for service that began before Feb. 15, 2020. The amount of PPP loan forgiveness that a business is eligible for cannot exceed the loan principal. Additionally, the amount of loan forgiveness will be reduced proportionally by the reduction in number of employees compared to the prior year and by the reduction in pay of any employee beyond 25% of their compensation the year prior.*

A business that has already laid off employees or reduced salaries due to COVID-19 may still be eligible for PPP loan forgiveness if the business re-hires its employees and/or eliminates the salary reductions by June 30, 2020. PPP loan debt forgiveness will not be included in the borrower's taxable income; however, businesses that have PPP loan debt forgiven will not be eligible for the payroll tax deferral provided under Section 2303 of the Act. Any PPP loan balance not forgiven will have a maximum maturity date of 10 years.

Where Can Businesses Obtain PPP Loans? *In order to cut down on processing time, the Act eliminates the need to apply through the SBA and provides for delegating the authority to make and approve PPP loans to qualified lenders. For eligibility purposes, the Act limits a lender's consideration only to whether the business was in operation as of Feb. 15, 2020, and had employees to whom it paid salaries and payroll taxes, or paid independent contractors.*

Who Is a Qualified Lender? *All existing SBA lenders and other lenders approved by the SBA are eligible to issue PPP loans. Existing SBA loans (other than PPP loans) made between Jan. 31, 2020, and the date PPP loans become available under the CARES Act may be refinanced with PPP loan proceeds. The SBA will reimburse lenders for processing fees associated with issuing PPP loans (rates vary by loan amount).*

PPP loans are guaranteed by the SBA and may be sold in the secondary market. The SBA will reimburse lenders for any loan amount that is forgiven within 90 days of the date the amount of forgiveness is determined. The SBA may (and indeed is likely to) issue guidance requiring lenders to prioritize loans to businesses in underserved and rural markets.

Conclusion

As we embark on this journey into the great unknown together, as restructuring professionals we must continue to explore avenues of opportunity that open for our clients (existing and future). As they say, when one door closes, another opens.

Stay tuned for Part II: Larger Business Provisions and Specified Industry Loan Program provisions.