SULLIVAN & CROMWELL LLP

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Paycheck Protection Program

Key Changes Enacted in the Paycheck Protection Program Flexibility Act of 2020

SUMMARY

On Friday, June 5, 2020, President Trump signed into law the "Paycheck Protection Program Flexibility Act of 2020" (the "Act"). The U.S. Senate passed the measure by "unanimous consent" on Wednesday, June 3, following its passage in the U.S. House of Representatives on Thursday, May 29 by a vote of 417 to 1. The Act modifies the Paycheck Protection Program (the "PPP") established by the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"). In particular, the Act (1) establishes a minimum maturity of five years for all loans made after the enactment of the Act and permits an extension of the maturity of existing loans to five years if the borrower and lender agree; (2) extends the "covered period" (as described below) in Section 1102 of the CARES Act from June 30, 2020, to Dec. 31, 2020; (3) extends the eight-week "covered period" for expenditures that qualify for forgiveness to the earlier of (i) 24 weeks following loan origination and (ii) December 31, 2020; (4) extends the deferral period for payment of principal, interest and fees to the date on which the forgiveness amount is remitted to the lender by the Small Business Administration; (5) requires the borrower to use at least 60% (down from 75%) of the proceeds of the loan for payroll costs, and up to 40% (up from 25%), for other permitted purposes, as a condition to obtaining forgiveness of the loan; (6) delays from June 30, 2020 to December 31, 2020 the date by which employees must be rehired to avoid a reduction in the amount of forgiveness of a loan, and creates a "rehiring safe harbor" that allows businesses to remain eligible for loan forgiveness if they (i) make a good-faith attempt to rehire employees or hire similarly qualified employees, but are unable to do so, or (ii) are able to document an inability to return to pre-COVID-19 levels of business activity due to compliance with social distancing measures; and (7) allows borrowers to receive both loan forgiveness under the PPP and the payroll tax deferral permitted under the CARES Act, rather than having to choose which of the two would be more advantageous.

BACKGROUND

Among other actions taken in response to the COVID-19 pandemic, the CARES Act[1] established the PPP, a $349 billion lending program for eligible small businesses, administered by the Small Business Administration (the "SBA") under Section 7(a) of the Small Business Act. The SBA launched the PPP on April 3, 2020,[2] and, within two weeks, the initial $349 billion in funding authorized by the CARES Act had been depleted. In light of the unmet demand for PPP loans, and at the urging of the SBA and the U.S. Department of the Treasury, the "Paycheck Protection Program and Health Care Enhancement Act" became law on April 24, 2020, and increased by $310 billion the amount authorized for the SBA to commit for loans under the PPP, bringing the total to $659 billion.[3] PPP loans are fully guaranteed by the SBA and, before the passage of the Act, borrowers were permitted to apply for forgiveness of loan amounts representing up to eight weeks of payroll and other permitted expenses during the covered period, with the amount of forgiveness decreased in connection with certain workforce or salary reductions. For further information on the CARES Act and the PPP, please refer to our previous Memoranda to Clients on March 29, 2020, March 30, 2020 and April 23, 2020, and our COVID-19 Updates & Guidance web page.

KEY CHANGES TO THE CARES ACT

As noted above, the Act makes several significant changes to the PPP. First, the Act extends the minimum maturity of all new PPP loans from an SBA-mandated two years[4] to a minimum maturity of five years.[5] This provision of the Act applies only on a going-forward basis, and does not extend the maturity of loans previously issued under the PPP. However, the Act states that nothing in the Act, the CARES Act or the Paycheck Protection Program and Health Care Enhancement Act "shall be construed to prohibit lenders and borrowers from mutually agreeing to modify the maturity terms of a covered loan" in conformity with the requirements of the Act.[6]

Second, the Act extends the expiration date of the "covered period" in Section 1102 of the CARES Act from June 30, 2020 to December 31, 2020.[7] Although there may be some ambiguity as to the effect of the change to the definition of "covered period,"[8] a letter entered into the Congressional Record by the Act's lead sponsors (which was critical to securing the "unanimous consent" agreement in the Senate that allowed for expedited consideration of the House-passed bill) states that the "intention of the extension of the covered period in [the Act] is to allow borrowers who received PPP loans before June 30, 2020 to continue to make expenditures for allowable uses until December 31, 2020" and "should not be construed so as to permit the SBA to continue accepting applications for loans after June 30, 2020."[9] Notably, Section 1102(b) of the CARES Act, which authorizes commitments for PPP loans through June 30, 2020, remains unchanged by the Act.

The Act focuses on amending the forgiveness provisions of the PPP,[10] and these provisions apply both to new loans and to loans already issued under the PPP. The covered period for expenses eligible for forgiveness, previously set at eight weeks beginning with the date of loan origination, now extends to the earlier of (i) the date that is 24 weeks after the date of loan origination and (ii) December 31, 2020.[11] Further, the deferral period for payments of principal, interest and fees is extended from the existing period of six months from the date of loan origination to the date on which the forgiveness amount relating to the loan is remitted to the lender.[12] If a borrower fails to apply for forgiveness, the borrower must make principal, interest and fee payments 10 months after the borrower's covered period ends, unless a lender agrees to extend the period of deferment.[13]

In addition, the Act amends the calculation of forgiveness in meaningful ways. The Interim Final Rule issued April 3, 2020 required both that (1) at least 75 percent of PPP loan proceeds must be used for payroll costs, and (2) at least 75 percent of the forgiveness amount must be attributable to payroll costs.[14] The Act does not include the use-of-proceeds requirement established by the Interim Final Rule, but does provide that forgiveness will be available only if at least 60 percent of loan proceeds are used for payroll costs; the remaining proceeds may be used for covered mortgage, rent or utility obligations.[15]

The safe harbor deadline relating to the rehiring of employees has also been extended. To be eligible for forgiveness of the full loan amount, the CARES Act requires that an employer maintain the same average number of full-time equivalent employees during the covered period as it had before such period, broadly speaking, and pay each employee at least 75 percent of the salary or wage amount previously paid, as compared to the most recent full quarter that the employee was employed prior to the covered period.[16] However, under the CARES Act, as amended by the Act, a borrower's loan forgiveness will not be reduced as a result of workforce or wage reductions if: (1) the borrower decreased the number of its full-time equivalent employees or reduced the compensation of any applicable employee between February 15, 2020 and April 26, 2020, as compared to its workforce or wages paid as of February 15, 2020, and (2) the borrower eliminated the reduction in the number of its full-time equivalent employees or employee compensation not later than December 31, 2020.[17] In other words, under the Act, any workforce reduction implemented between February 15, 2020 and April 26, 2020 that has been reversed by December 31, 2020 will not count against loan forgiveness.

In addition, the Act prevents a borrower's forgiveness amount from being reduced, notwithstanding a reduction in full-time employees, if the borrower is, in good faith, (a) able to document that it was unable to (i) rehire individuals who were employees of the borrower on February 15, 2020 or (ii) hire similarly qualified employees for unfilled positions on or before December 31, 2020, or (b) able to document an inability to return to the same level of business activity existing prior to February 15, 2020, due to compliance with COVID-19 related guidance from the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention, or the Occupational Safety and Health Administration.[18]

The changes that the Act makes to existing loans (both those that apply to all loans and the permitted change to the term of existing loans) raise a number of operational issues, with respect to both the logistics of implementing the new statutory provisions in over 4.5 million loans outstanding, and the procedures by which lenders will inform the SBA of modifications made to previously issued loans. The Act also raises operational issues with respect to the expanded safe harbors, including how borrowers certify to such events and how lenders should review such certifications.

Finally, the Act expands the availability of payroll tax deferments under the CARES Act. Section 2302 of the CARES Act allows employers to defer the payment of payroll taxes for the portion of the 2020 calendar year beginning with the date of enactment of the CARES Act until (i) December 31, 2021 for 50% of such taxes and (ii) December 31, 2022 for the remaining 50% of such taxes. As originally adopted, borrowers had to choose between this payroll tax deferral and obtaining forgiveness of the PPP loan. Under the Act, employers whose loans are forgiven under the PPP are now eligible for deferral of employer payroll taxes as well.[19]

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ENDNOTES

1 Pub. L. No. 116-136.

2 Over the period following April 3, 2020, the SBA, in consultation with Treasury, has issued extensive rules and guidance for lenders and borrowers participating in the PPP in a number of formats.

3 Pub. L. No. 116-139.

4 85 Fed. Reg. 20811, 20813.

5 The Paycheck Protection Program Flexibility Act (the "PPPFA") § 2(a).

6 *Id.* § 2(b).

7 *Id.* § 3(a).

8 Section 3(a) of the Act extends the "covered period" to December 31, 2020, which, when read in conjunction with Section 1102 of the CARES Act, would appear to permit the SBA to make PPP loans through the end of 2020. As a further indication that the SBA may retain the authority to guarantee PPP loans issued beyond June 30, 2020, the "covered period" for permitted expenses extends to the earlier of (i) the date that is 24 weeks after the date of loan origination and (ii) December 31, 2020. 24 weeks from June 30, 2020 is December 15, 2020.

9 *Congressional Record* 166:103 (June 3, 2020) at S2691.

10 *See* CARES Act § 1106.

11 PPPFA § 3(b). Under the Act, a borrower that received a covered loan before the date of enactment of the Act may alternatively elect for the covered period applicable to such covered loan to end on the date that is 8 weeks after the date of the origination of such covered loan. PPPFA § 3(b)(3).

12 *Id.* § 3(c).

13 *Id.*

14 85 Fed. Reg. at 20814, 20816.

15 PPPFA § 3(b)(2). It is not clear whether a borrower who has been unable to use 60 percent of the original loan proceeds will be precluded entirely from forgiveness, or whether the borrower could obtain forgiveness for the portion that was spent on eligible costs if it repays enough of the loan to bring the principal amount down to the level required to meet this 60/40 requirement.

16 CARES Act § 1106(d)(2), (d)(3).

17 PPPFA § 3(b)(2).

18 *Id.* § 3(b)(2).

19 *Id.* § 4. For a more in-depth discussion of the CARES Act's tax provisions, please refer to our Memorandum to Clients from March 30, 2020.

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