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CORPORATE ALERT

March 2020

Cash Flow Assistance for Small Businesses: Potentially Forgivable Paycheck Protection Loans

On Wednesday, March 26, 2020, the United States Senate passed the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") aimed at providing extensive economic relief in response to COVID-19 and related financial problems. The United States House of Representatives passed the CARES Act on Friday, March 27, 2020 and it is expected to be signed by the President.

Of particular significance to small business owners, the CARES Act creates the Paycheck Protection Program providing cash-flow assistance to qualifying businesses with 500 or fewer employees through low interest, potentially forgivable loans ("Paycheck Protection Loans"). The key features of the Paycheck Protection Program are summarized below (subject to change pending final legislation).

Paycheck Protection Loans are available during the "covered period" which begins February 15, 2020 and ends June 30, 2020. They may be made directly by the U.S. Small Business Administration (the "SBA") or by lenders who are already authorized to make loans under the Small Business Act's current Business Loan Program. Other private sector lenders may be authorized by United States Treasury. The following terms would apply for each loan:

- Interest rate not to exceed 4% and a maximum maturity of 10 years.
- No collateral or personal guarantee would be required.
- No prepayment penalty.
- Payments of principal, interest and fees would be deferred for not less than 6 months and not more than 1 year.
- Loan recipients that maintain their payrolls, are eligible to have the portion of the loans used for qualifying payroll costs, interest on mortgage obligations, rent and utilities forgiven, as discussed more fully below.

Businesses (including nonprofits) are generally eligible to receive a Paycheck Protection Loan if they employ not more than 500 employees or such greater number as is established by the SBA as being standard for the industry in which the business operates, with full-time and part-time employees being counted as well as individuals employed on any "other basis". For certain business, such as hospitality and dining, the employee size generally will be determined on a per location basis. Individuals who operate under a sole proprietorship or as an independent contractor and

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certain self-employed individuals may also be eligible to receive a Paycheck Protection Loan if they provide certain documentation.

To qualify for a Paycheck Protection Loan, an eligible business must make a good faith certification that:

- The loan is necessary to support ongoing operation of the business as a result of the uncertainty of current economic conditions;
- Funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments;
- The business does not have an application pending or a loan under the Business Loan Program for the same purpose; and
- The business has not and will not receive other funds under the Business Loan Program between February 15, 2020 and December 31, 2020.

The amount of a Paycheck Protection Loan generally cannot exceed the lesser of (i) 2.5 times the average total monthly "payroll costs" (as defined below) incurred during the 1-year period before the date on which the loan is made; and (ii) $10 million. The calculation of average total monthly payroll costs is adjusted with respect to seasonal employers and employers that were not in business during the 1-year period before the date on which the Paycheck Protection Loan is made. In addition, the outstanding amounts of certain loans under the SBA's Disaster Loan Program are added to the calculation in subpart (i) above. However, in no event may the amount of a Paycheck Protection Loan exceed $10 million.

For these purposes, "payroll costs" consist of compensation paid to employees that is salary, wage, commission, or similar compensation; payment of cash tip or equivalent; payment for vacation, parental, family, medical, or sick leave; allowance for dismissal or separation; payment required for the provisions of group health care benefits, including insurance premiums; payment of any retirement benefit; payment of State or local tax assessed on the compensation of employees; and compensation to or income of a sole proprietor or independent contractor that is a wage, commission, income, net earnings from self-employment, and similar compensation and that is in an amount that is not more than $100,000 in 1 year, as prorated for the covered period. "Payroll costs" do not include individual employee compensation in excess of an annual salary of $100,000, as prorated for the covered period; payroll taxes; compensation of an employee whose principal place of residence is outside of the United States; or qualified sick or family leave wages for which a credit is allowed under section the Families First Coronavirus Response Act.

In keeping with the intent of the CARES Act, Paycheck Protection Loans may be used for payroll costs, payments of interest on a mortgage obligation (not including any prepayment of or payment of principal on a mortgage obligation), rent (including rent under a lease agreement), utilities, and interest on any other debt obligations that were incurred before the covered period. Loan amounts may also be used for any other purpose permissible under the Small Business Act's Business Loan Program.

Under the CARES Act's loan forgiveness provisions, Paycheck Protection Loans may be forgiven under certain circumstances. The forgiven amounts will equal payment made for payroll costs (as defined above), interest on mortgages, rent obligations under a leasing agreement, and utilities during the 8-week period beginning on the date of the origination of the Paycheck Protection Loan. Such payments of interest, rent and utilities must be made pursuant to mortgages, leases and services, respectively, in effect before February 15, 2020. The forgiven amount cannot exceed the principal amount of the loan. Any amounts forgiven will not be included in the borrower's gross income.

The amounts forgiven will generally be reduced based upon a formula if the business (i) reduces its number of employees or (ii) reduces wages or salaries paid to employees who earned less than $100,000 in annualized salary by more than 25%. However, the forgiveness reductions won't apply with respect to employees discharged between

February 15, 2020 and thirty days after enactment of the CARES Act or wage reductions during that time period, if no later than June 30, 2020 the employer replaces such employees or, makes up for wage reductions, as applicable.

To apply for forgiveness of a Paycheck Protection Loan, borrowers must provide:

- Documentation verifying employees on payroll and their pay rates;
- Documentation on covered costs and payments (e.g., documents verifying mortgage, rent, and utility payments);
- Certification from an authorized representative of the borrower that the documentation is true and correct and that forgiveness amounts requested were used to retain employees and make other forgiveness-eligible payments; and
- Any other documentation that may be required.

Paycheck Protection Loans may provide small businesses with significant relief during these difficult economic times. Please reach out to us if you'd like assistance in evaluating how this very important program might apply to your business and to facilitate the new Paycheck Protection Loans.

Tax Credits for Employers Who Provide Coronavirus-Related Leave

The Families First Coronavirus Response Act (the "Act") provides federal tax credits for eligible employers who provide Coronavirus-related leave to their employees. Employers, including tax-exempt organizations, are eligible to claim these tax credits if they have fewer than 500 employees and provide qualifying Coronavirus-related paid sick leave or family and medical leave during the period between April 1, 2020 and December 31, 2020. Similar credits are available to self-employed individuals based on similar circumstances.

Tax Credit for Paid Sick Leave

Eligible employers may receive a refundable credit for sick leave paid to an employee who is unable to work because of Coronavirus quarantine (including a self-quarantine) or has Coronavirus symptoms and is seeking a medical diagnosis. This credit is equal to the employee's regular rate of pay, up to $511 per day and $5,110 in the aggregate, for a total of 10 days.

Eligible employers may also claim a credit for sick leave paid to an employee who is caring for someone with Coronavirus, or is caring for a child because the child's school or child care facility is closed, or the child care provider is unavailable due to the Coronavirus. This credit is equal to two-thirds of the employee's regular rate of pay, up to $200 per day and $2,000 in the aggregate, for up to 10 days.

In each case, eligible employers are entitled to an additional tax credit determined based on costs to maintain health insurance coverage for the eligible employee during the leave period.

Tax Credit for Paid Child Care Leave

In addition to the sick leave credit, for an employee who is unable to work because of a need to care for a child whose school or child care facility is closed or whose child care provider is unavailable due to the Coronavirus, eligible employers may receive a refundable child care leave credit equal to two-thirds of the employee's regular pay, capped at $200 per day or $10,000 in the aggregate. Up to 10 weeks of qualifying leave can be counted towards the child care leave credit. Eligible employers are entitled to an additional tax credit determined based on costs to maintain health insurance coverage for the eligible employee during the leave period.

Prompt Payment for the Cost of Providing Leave

Eligible employers who pay qualifying sick or child care leave will be able to retain an amount of the payroll taxes equal to the amount of qualifying sick and child care leave that they paid, rather than deposit them with the IRS. The payroll taxes that are available for retention include withheld federal income taxes, the employee share of Social Security and Medicare taxes, and the employer share of Social Security and Medicare taxes with respect to all employees. If there are not sufficient payroll taxes to cover the cost of qualified sick and child care leave paid, employers will be able file a request for an accelerated payment of the credit from the IRS. Self-employed individuals may claim their credits on their income tax returns and will reduce their estimated tax payments.

Force Majeure Clauses and COVID-19

As the global spread of COVID-19 continues, businesses are experiencing disruptions to their operations. These disruptions include quarantines, mandatory closings, travel restrictions, border closings, shipping cancellations, supply chain delays and employee absences. Many businesses are questioning whether they can continue to meet their contractual obligations. However, failing to meet contractual obligations can expose businesses to significant liability. One key step to assess (a) potential liability for failure to meet contractual obligations, or (b) their contractual counterpart's liability for not meeting its obligations, is to determine whether the applicable contract has a *force majeure* clause and, if it has one, review its language.

In the United States, contract law matters are governed by state law. Therefore, the ability to claim *force majeure* depends upon the existence of an express *force majeure* provision in the contract and the applicable state law. If the contract does not contain a *force majeure* clause, the parties must rely on state law doctrines to allocate liability for non-performance.

What is a *force majeure* clause?

Literally translated, *force majeure* means a "superior force" and a *force majeure* clause is "a contractual provision allocating the risk of loss if performance becomes impossible or impracticable, especially as a result of an event or effect that the parties could not have anticipated or controlled." (Black's Law Dictionary, 11th Ed. 2019). In layman's terms, this provision allocates risk between two contracting parties if one party must suspend or terminate performance due to unforeseen circumstances. What constitutes a *force majeure* event depends upon the terms of the relevant contract and applicable law.

Most *force majeure* provisions include a list of specific events that are not reasonably foreseeable and beyond the parties' control. These typically include earthquakes, tornados, floods and war. Many *force majeure* clauses also contain a catch-all phrase to try to capture events not specifically listed such as "acts of God," "government regulations," "national emergencies," or "acts beyond the control of the parties."

Are courts likely to view COVID-19 as a *force majeure* event?

This depends on the language of the specific contract. Courts generally look to whether (i) the event qualifies as *force majeure* under the contract; (ii) the event was foreseeable; and (iii) performance is still possible. Courts put most weight on whether the event is specifically described as a *force majeure* event. COVID-19 will likely qualify as a *force majeure* event if the contract provision specifically includes references to a "pandemic," "epidemic", "disease" or "government declared emergency". If the *force majeure* provision does not contain such specific references, parties may claim COVID-19 is covered under the *force majeure* clause's catch-all provision. However, court's strictly construe catch-all *force majeure* clauses making it more difficult to argue that they apply.

In some jurisdictions, such as New York, even if "pandemic" is listed as a *force majeure* event in the contract, to successfully invoke the clause for COVID-19 a party must establish: (i) the event was not reasonably foreseeable, and (ii) performance is impossible rather than merely impracticable or economically difficult. (*In re Cablevision Consumer Litig.*, 864 F. Supp. 2d 258, 264 (E.D.N.Y. 2012)).

In New Jersey, this is not the case. If the parties unambiguously allocate the risk of the specified event in the *force majeure* clause, the court will not inquire into the foreseeability of the event. (*Facto v. Pantagis*, 390 N.J. Super. 227, 233 (App. Div. 2007)). However, if the event is not specifically listed in the *force majeure* clause, courts must determine what unforeseeable events the parties intended to include that might excuse performance. (*Union Cnty. Utilities Auth. v. Bergen Cnty. Utilities Auth.*, 995 F. Supp. 506, 518 (D.N.J. 1998)). Either way, the party invoking a *force majeure* clause must still prove the event was serious enough to materially interfere with performance. *Facto* at 231-32.

What about contracts without a *force majeure* clause?

Even if a contract does not contain *force majeure* language, a non-performing party may still be excused under common law doctrines of excuse, impossibility or impracticability. Similarly, in the sale of goods, the Uniform Commercial Code excuses a seller from timely delivery or for non-delivery of goods where its performance has become impracticable because of either (i) the unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting or (ii) compliance in good faith with an applicable foreign or domestic government regulation or order. (N.J.S.A. 12A:2-615(a)).

Notice Requirement

To avoid liability, a party unable to perform under a contract, whether relying on a *force majeure* clause or a common law doctrine, must provide timely notice to its counterparty. The notice period and form of notice may be specified in the contract and otherwise should be reasonable. A party considering whether to delay or terminate performance should carefully consider when and how to provide such notice. Communication between the parties is usually a key factor reviewed by courts in breach of contract actions.

If you have any questions about this Alert:

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