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Special considerations for restaurants and franchised businesses under the CARES Act

By Keri A. McWilliams and Wesley Gangi

While few sectors are likely to be spared from the economic consequences of COVID-19, the leisure and hospitality segments have been among the hardest hit. For example, according to the March 2020 jobs report from the U.S. Department of Labor, more than 60% of March job losses came from restaurants and bars. In addition to being hardest hit, these segments are heavily franchised. Accordingly, the CARES Act (the Act) has special provisions designed to ensure that those affected will still have access to desperately needed rescue funds.

The Paycheck Protection Program

A key component of the relief offered through the CARES Act is the forgivable federal loans offered by the Paycheck Protection Program (PPP). The PPP, which is administered by the Small Business Administration (SBA), is designed to ensure that businesses with 500 or fewer employees can continue to meet their payroll demands. In determining the number of employees for the purposes of SBA loan eligibility, the SBA has traditionally taken into consideration the employees of all companies with which the applicant business is “affiliated.” Because of franchisor approval rights and transfer controls in franchise agreements, franchisees are often considered to be affiliated with franchisors, and are prevented from accessing SBA funds without special modifications to the franchise agreement. Without the relaxation or waiver of the traditional affiliation rules, small businesses that happen to be operating under a franchised brand may be prevented from accessing CARES Act funds.

Waiver of affiliation rules and locations-specific loans

To ensure that as many businesses as possible in the restaurant and hospitality sector—including franchised businesses—can still take advantage of CARES Act relief, the Act and the interim regulations released thereunder¹ contain three important modifications to traditional SBA lending rules. First, the Act waives the traditional affiliation rules for any business concern with not more than 500 employees that, as of the date on which the loan is disbursed, is assigned a North American Industry Classification System (“NAICS”) code beginning with 72 (the hotel and food

¹ See our alert, [“Review of the SBA’s interim final rule implementing the Paycheck Protection Program.”](#)

service industry). Second, the Act raises the employee cap for restaurants and hotels by allowing the employee count to be based on the number of employees at each physical location. For example, a restaurant franchisee with 1,000 employees across multiple physical locations could still be eligible for financial assistance under the PPP so long as none of the physical locations has more than 500 employees. Finally, the Act waives the traditional affiliation rules for any business concern operating as a franchise that is assigned an NAICS franchise identifier code. Franchisors that have already obtained a franchise identifier code are listed on the SBA's Franchise Directory (the Directory). The Directory lists all franchises reviewed by the SBA that are eligible for SBA assistance, as well as any further documentation that may be required to resolve eligibility or affiliation issues arising from the franchise relationship.² Essentially, if a franchisee is in a franchised system that has previously obtained a franchise identifier code from the SBA, then the SBA will not apply the affiliation analysis when a franchisee applies for a loan under Section 7(a), as amended by the Act. These franchisees may therefore be eligible for SBA assistance under the Act without taking the traditional route of having franchisors execute the SBA forms required to resolve any potential affiliation issues.

The application process for the PPP began on April 3, and SBA-certified lenders will be accepting applications through June 30. As a practical matter, however, businesses should apply as soon as possible, and should identify all possible bases for waiver of the affiliate rules. The dollar value of a loan under the PPP is based on 250% of the borrower's average monthly payroll cost for the year preceding the loan disbursement, and has an interest rate of 0.5% with a maturity of two years. The first payment under a PPP loan can be deferred for six months. PPP loans can be made by any participating SBA 7(a) lender, bank, or credit union, and the loans will be forgiven as long as at least 75% of the funds are used to keep employees on the payroll. The remaining portion of the loan may be used for rent, utilities, or mortgage interest. Based on our early experience, under the guidelines for the PPP, and because of the need to triage the massive demand for PPP loans, many small businesses may have an advantage in acquiring PPP funds from banks with which the business has a preexisting relationship.

Nixon Peabody's [Coronavirus Response Team](#) is tracking the development of the Paycheck Protection Program and regulations issued under the Act, and remains available to assist you with any questions you may have. For more information on the content of this alert, please contact your Nixon Peabody attorney or:

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² [The Directory and related forms can be found here.](#)