

Publications

COVID-19, Private Investors and the CARES Act: *Do Investor Backed Companies Get Left Out in the Cold?*

Related Services

Corporate and Business
Organizations

Finance

Related Industries

Private Equity

CLIENT ALERT | 3.30.2020

Phase III of the federal COVID-19 relief legislation – the CARES Act, which President Trump signed into law on March 27, 2020 and is summarized in a [previous alert](#) – amends Section 7(a) of the Small Business Act (SBA) to create the Paycheck Protection Program (PPP). Under this expansion of the SBA's traditional loan program, the government will provide or 100% guarantee loans made to eligible persons or entities over the next several months in an effort to help small businesses impacted by COVID-19. The CARES Act also creates a loan forgiveness program for certain payments made with the PPP loans. You can find more information about the PPP [here](#). This alert provides answers to some of the preliminary questions private equity, family office, fundless sponsor and venture capital firms, along with their portfolio companies, might be asking as they consider applying for a loan under the PPP.

We invest in several small businesses, can those companies get access loans under the PPP?

If the business is already considered an SBA “small business,” then yes.

The CARES Act expands the definition of “small business” to include the following categories of businesses.

If the business does not have more than the greater of (i) 500 employees; or (ii) if applicable, the size standard in number of employees for the business's NAICS coded industry, then yes.*

*In these instances, the CARES Act amends the SBA's typical eligibility requirements for a “small business” – removing the annual revenue threshold but still applying the “affiliation” rule.

If the business is:

- assigned a NAICS code beginning with 72 (generally the hospitality and food service industry) - so long as they employ not more than

500 employees per physical location;

- operating as a franchise that is assigned a franchise identifier code by the SBA; or
- already receiving financial assistance from a “small business investment company” under the SBA, then yes. **

**In these instances, the CARES Act amends the SBA’s typical eligibility requirements for a “small business” and removes the “affiliation” rule.

What if we have to rely on the SBA’s traditional definition of “small definition” because our business does not fall into any of the expanded categories?

To be eligible for an SBA loan, a business must be considered a “small business” by the SBA. The SBA measures a business’ size by its number of employees (a maximum ranging from 500 – 1,500) **or** its annual receipts (a maximum ranging from \$1 million to \$41.5 million) and compares those metrics to the maximums allowed under a rubric keyed to the business’ NAICS coded industry. However, in a potential pitfall for investors, these measures will include “affiliate” entities (see below).

We invest in several business, how do I know if those businesses are “affiliates” under the SBA?

The SBA will count all of the employees and annual receipts for any “affiliate” of the business when determining eligibility – and this is where investors and their companies can get hung up. Under the SBA, an “affiliate” entity is one under control of, or common control of a third party, and “control” is thought of broadly - even shared management, boards of directors or minority owners can be considered common “control” and create an “affiliate” relationship between entities. Further, the SBA makes it clear that there is no one controlling factor when determining “control” and “affiliation.” The SBA even provides **some examples** of “control” and “affiliation.”

If an “affiliate” relationship is established, the SBA will then aggregate the total number of employees and annual receipts of all of the “affiliate” entities and compare them to the maximums allowed under the NAICS coded industry of the predominate “affiliate” in a group.

Are our foreign businesses, counted as “affiliates” under the SBA?

Yes, employees and annual receipts for domestic or foreign “affiliates” are aggregated together in order to determine small business eligibility.

Are more rules forthcoming?

Yes, the CARES Act provides that over the next 30 days the SBA will issue rules and regulations to further implement the PPP.

In short, while the CARES Act provides much need relief for American businesses many may not be able to access the loans because of the SBA’s affiliation rules. Determining “affiliation” and “control” is a fact and circumstance driven exercise.

If you have questions about the CARES Act and how it applies to your business or investment, please contact your Vorys attorney.