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IMPACT OF SBA AFFILIATION RULES ON ELIGIBILTY FOR PAYCHECK PROTECTION LOANS AND EIDLS UNDER THE CARES ACT

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In response to the COVID-19 crisis, the President signed the Coronavirus Aid, Relief, and Economic Security Act (the "Act") (P.L. 116-136) on March 27, 2020, to provide – among many other things - emergency financial relief for eligible small businesses (and certain not-for-profit and veterans organizations) disrupted by the coronavirus pandemic. The Small Business Administration (SBA) received funding and authority through the Act to establish a new Economic Injury Disaster Loan ("EIDL") program, and the Act created and enabled significant funding for a second new loan program called the Paycheck Protection Program (the "PPP"), in both cases to assist small businesses (and certain not-for-profit and veterans organizations) nationwide adversely impacted by the COVID-19 emergency.

In general, a small business adversely affected by the COVID-19 crisis is eligible to apply for either a PPP loan or an EIDL if (i) the business concern has 500 or fewer employees; or (ii) is a business that operates in a certain industry and qualifies as a "small business concern" under existing SBA rules applicable to that industry. In both cases, the Act and interim final rules released under the Act by Treasury on April 4, 2020 (the "Interim Guidance") together provide that a small business concern's eligibility to apply for a loan is affected by the SBA's 'affiliation rules' promulgated under 13 CFR 121.301(f) unless specifically waived in the Act (the "SBA Affiliation Rules").[1]

For purposes of the determining the number of employees of a small business seeking eligibility to apply for either a PPP loan or an EIDL, the SBA Affiliation Rules require employees of both the small business concern filing the loan application and any 'affiliated' business concerns to be aggregated. For example, if company A is the prospective borrower and has 70 employees, and if company B has 30 employees and is 'affiliated' with company A, then company A is deemed to have 100 employees in making the eligibility determination.

Pursuant to the Interim Guidance, small businesses and other entities are 'affiliates' of each other under the SBA Affiliation Rules when there is common control or one business has the power to control the other, or a third party or parties controls or has the power to control both. The SBA Affiliation Rules apply regardless of whether control is actually exercised, and control is analyzed both in the affirmative and in the negative, such as through veto rights, and may be found to exist indirectly by control powers instilled in third parties.

Some additional factors described in the Interim Guidance are used as a touchstone to determine whether business concerns are affiliates of each other under the SBA Affiliation Rules including without limitation quantum of equity ownership and identity of interest. Prospective borrowers should consult with their trusted advisors for a more detailed analysis of how these additional factors might apply to their particular facts and circumstances.

As previously indicated, an eligible borrower also includes any business that already qualifies as a "small business concern" under existing SBA rules. If the applicable SBA size standard is 'receipts based' (as opposed to 'employee based'), then the annual receipts of both the small business concern filing the loan

application and any ‘affiliated’ business concerns would be aggregated.

The description of the SBA Affiliation Rules contained in this note is intended to be a very brief and non-exhaustive summary. Prospective borrowers seeking to determine eligibility for either a PPP loan or an EIDL should consult with their trusted advisors as to the application of the SBA Affiliate Rules to their particular facts and circumstances.

It is important to note that the terms and conditions of the loans enabled by the Act under the PPP and EIDL loan programs continue to evolve and change with great rapidity, and there is still a good deal of ambiguity surrounding the application process and how the different criteria that affect eligibility may ultimately apply.

[1] We note in passing the Act together with the Interim Guidance appear to make the SBA Affiliate Rules applicable to prospective borrowers that are nonprofit organizations and veterans organizations (except for certain ‘faith based’ organizations) in the same manner as with respect to ‘for profit’ small business concerns. Those organizations are otherwise beyond the scope of this note.

The COVID-19 pandemic is creating rapidly-changing issues for businesses, and government aid processes and measures designed to assist businesses may also change materially from when this post is issued. We therefore encourage you to monitor our website, review our future posts and generally remain alert for additional updates or modifications to laws and regulations.

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