

**ALERTS**

# Paycheck Protection Program Update: Guidance on Affiliation, Clarification on Eligibility and New Forms

**April 6, 2020**

The Small Business Administration (“SBA”) and the U.S. Department of the Treasury (“Treasury”) have provided additional information and forms to borrowers and lenders on the SBA’s affiliation rules and necessary forms with respect to the Paycheck Protection Program (“PPP”) under the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”).

On April 3, 2020, the SBA promulgated a second Interim Final Rule<sup>[1]</sup> (“Supplemental Rule”) supplementing the Interim Final Rule issued by the SBA on April 2, 2020 (“Implementing Rule”), which implemented the PPP. The Supplemental Rule provides additional guidance on the application of certain affiliate rules applicable to the PPP. Further, on April 3, 2020, the Treasury issued guidance on the four affiliation tests that the SBA uses in determining whether an applicant, other than those specifically waived or exempted, should aggregate its employees or revenue (as applicable) with those of another business for purposes of determining an applicant’s eligibility under the PPP.

This *Alert* (i) provides an overview of the four affiliation tests and discusses the implications of such for fund managers and their portfolio companies;<sup>[2]</sup> (ii) addresses an inconsistency between the Supplemental Rule and Implementing Rule with regard to the eligibility criteria; and (iii) describes the application forms currently available on the Treasury’s website.

## I. New Guidance on Affiliation/Aggregation

The Treasury's recently issued guidance, together with the Supplemental Rule, further clarified the SBA's affiliation rules with respect to businesses seeking to apply for a PPP loan.

### *Affiliation Defined*

Under the SBA's affiliation rules, an applicant is deemed to be affiliated with another business when (i) one controls or has the power to control the other; or (ii) a third party or multiple third parties controls or has the power to control both. Affiliation is found when the power to control exists, and it does not matter whether such control is actually exercised.

### *Four Affiliation Tests*

Unless subject to a waiver or exemption (as described below), affiliation under any of the following four tests is sufficient to establish affiliation for applicants applying for a PPP loan.[3] Thus, applicants should consider whether its relationship (or relationship of any person that controls such applicant) with another individual or entity would be considered an affiliation under the SBA's affiliation rules and, thus, impacts the eligibility for a PPP loan.

## **1. Affiliation Based on Ownership**

If an individual or entity owns or otherwise has the power to control more than 50% of an entity's voting equity, affiliation between such persons will exist. Alternatively, if no individual or entity owns or otherwise has the power to control more than 50% of the voting equity of the entity, the SBA will deem such entity's board of directors, officers, managing members or partners that control the management of the entity to be in control for this purpose.

Minority shareholders may also trigger the SBA's affiliation rules under this test in such cases where a minority shareholder (whether an individual or an entity) has the ability, under the entity's charter or bylaws, or a shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders.

## **2. Affiliation Arising Under Stock Options, Convertible Securities and Agreements to**

# Merge

The SBA considers stock options, convertible securities and any merger or sale agreements (including agreements in principle) to have a present effect on the power to control a business, and thus, the SBA treats the foregoing as though the rights granted thereunder have already been exercised. The same should not be treated as having present effect when they are subject to conditions precedent that are incapable of fulfillment, speculative, conjectural or unenforceable under applicable law or where the exercise of such or the probability of a transaction is “extremely remote.” Further, any agreements to open or continue negotiations towards the possibility of a merger or sale are not given present effect.

Notably, an individual or entity that controls one or more entities cannot use options, convertible securities or other agreements to terminate such control before actually doing so. The SBA will not give present effect to such individual’s or entity’s ability to divest all or part of their ownership interest in order to avoid the finding of affiliation.

## **3. Affiliation Based on Management**

Affiliation may arise where an applicant’s management<sup>[4]</sup> shares common management with another entity or where an individual or other entity controls the board of directors or management of multiple entities. Affiliation can also be found where an individual or entity controls the management of the applicant through a management agreement.

## **4. Affiliation Based on Identity of Interest**

Affiliation rules may arise where there is an identity of interest between close relatives<sup>[5]</sup> with identical, or substantially identical, business or economic interests. For example, the SBA can find affiliation where such close relatives operate businesses in the same or similar industry in the same geographic area. However, in such case, the applicant can rebut the SBA’s determination by offering evidence to show that the interests or businesses are, in fact, separate.

### *Waived and Exempt Organizations*

As discussed in our initial March 30, 2020 *Alert*, the affiliation rules do not apply to the following small businesses applying for a PPP loan (i)

businesses in the “accommodation and food services” sector;[6] (ii) businesses operating as a franchise; or (iii) businesses receiving financial assistance from a small business investment company.[7]

The Supplemental Rule also exempts faith-based organizations from the affiliation rules where its relationship to another faith-based organization is based on a religious teaching or belief or otherwise constitutes part of the exercise of religion.

### *Implications for Fund Managers and Portfolio Companies*

Fund managers should carefully review their ownership interests in, and other agreements or relationships with, their portfolio companies to determine whether any of their portfolio companies would be considered affiliates of the manager, and each other, for purposes of determining eligibility for a PPP loan. Further, fund managers will also want to review their owners’ outside business interests (e.g., ownership interests, board positions, etc.) to determine whether any other business should be affiliated with the fund manager (and any affiliated portfolio companies) under the PPP, even if such business is unrelated to the fund manager.

## **II. Clarification On Eligibility Criteria**

The Supplemental Rule calls into question the Implementing Rule’s statement of the PPP eligibility test applicable to for-profit businesses. In the Implementing Rule, the SBA wrote, with regard to for-profit businesses:

You are eligible for a PPP loan if you have 500 or fewer employees whose principal place of residence is in the United States, or are a business that operates in a certain industry and meet the applicable SBA employee-based size standards for that industry, **and**

1. You are:

1. A small business concern as defined in section 3 of the Small Business Act (15 USC 632), and subject to SBA’s affiliation rules under 13 CFR 121.301(f) unless specifically waived in the [CARES] Act ... **(emphasis added)**.

However, in the Supplemental Rule, the SBA notes, with regard to for-profit businesses:

An entity generally is eligible for the PPP if it, combined with its affiliates, is a small business as defined in section 3 of the Small Business Act (15 U.S.C. 632), **or** (1) has 500 or fewer employees whose principal place of residence is in the United States or is a business that operates in a certain industry and meets applicable SBA employee-based size standards for that industry ... (**emphasis added**).

Accordingly, while the Implementing Rule explicitly indicates that an applicant must (1) have no more than 500 employees or the applicable SBA employee-based size standards for its industry; **and** (2) qualify as a small business concern under the Small Business Act, the Supplemental Rule seems to indicate that an applicant must only satisfy either of those requirements, but not both. This issue is important because it determines whether certain applicants could be excluded from the PPP based on a revenue test, even if they do not exceed the applicable employee size limit.

Because the Supplemental Rule is the SBA's most recent pronouncement on the PPP, it could be assumed that it supersedes the Implementing Rule and reflects the SBA's current intent. On the other hand, the purpose of the Supplemental Rule is to provide guidance on the application of the SBA's general affiliation rules to the PPP (as more fully described below) and only mentions the eligibility rules as a preface to doing so. In contrast, the Implementing Rule is the operative authority for implementation of the PPP, including eligibility.

However, a plain language reading of the CARES Act appears to support the interpretation in the Supplemental Rule. The relevant CARES Act provision states:

During the covered period, **in addition to small business concerns**, any business concern, nonprofit organization, veterans organization, or Tribal business concern described in section 31(b)(2)(C) shall be eligible to receive a covered loan if the business concern, nonprofit organization, veterans organization, or Tribal business concern employs not more than the greater of —

(I) 500 employees; or

(II) if applicable, the size standard in number of employees established by the Administration for the industry in which the business concern,

nonprofit organization, veterans organization, or Tribal business concern operates (**emphasis added**).

Therefore, consistent with the language in the Supplemental Rule, the CARES Act appears to permit another segment of businesses to qualify for PPP loans, in addition to those businesses that may qualify for such loans as small business concerns under the Small Business Act.

Accordingly, while the issue is not entirely free from doubt until the SBA issues further guidance, at this time we believe that an otherwise eligible applicant whose workforce does not exceed the applicable size limit should not refrain from applying solely because it does not qualify as a small business concern under the Small Business Act. However, it appears that applicants conducting a business normally ineligible for SBA business loans are still ineligible under the PPP (except for nonprofit organizations authorized under the CARES Act),<sup>[8]</sup> even if they have an eligibly-sized workforce.

### **III. New Forms Available for Borrowers and Lenders**

As we noted in our April 3, 2020 *Alert*, the SBA requires certain forms to be completed in connection with participating as either a borrower or lender in the PPP. Versions of three of those forms have now been made available on the Treasury's website.

Most notably still absent is the forthcoming application for nonbanks to become approved PPP lenders. As noted in our April 3, 2020 *Alert*, the SBA's Implementing Rule indicated that any non-depository financing provider would be eligible to become a PPP lender so long as such provider (i) originates, maintains and services business loans or other commercial financial receivables and participation interests; (ii) has a formalized compliance program; (iii) applies the requirements under the Bank Secrecy Act ("BSA") as a federally regulated financial institution, or the BSA requirements of an equivalent federally regulated financial institution; (iv) has been operating since at least Feb. 15, 2019; and (v) has originated, maintained and serviced more than \$50 million in business loans or other commercial financial receivables during a consecutive 12-month period in the past 36 months, or is a service provider to any insured depository institution that has a contract to support such institution's lending activities and is in good standing with the appropriate federal

banking agency. However, so far, no instructions have been given on how such institutions can apply.

## **1. CARES Act Section 1102 Lender Agreement**

As noted in our April 3, 2020 *Alert*, all previously approved lenders under the SBA's 7(a) program were automatically approved to make PPP loans. Previously unapproved entities within the following categories will automatically qualify upon submission of this agreement (SBA Form 3506) (i) federally insured depository institutions; (ii) federally insured credit unions; and (iii) Farm Credit System institutions (other than the Federal Agricultural Mortgage Corporation) that apply the requirements under the BSA and its implementing regulations as federally regulated financial institutions, or functionally equivalent requirements. As noted above, such entity cannot be (i) designated in Troubled Condition by its primary federal regulator; or (ii) subject to formal enforcement action by its primary federal regulator that addresses unsafe or unsound lending practices. Lenders will have to provide certain administrative information as well, such as indicating its primary federal regulator and any applicable lender identifiers.

The terms of the agreement govern only such applicable PPP lenders and will remain in effect even after the SBA repurchases such loans, but terminate such lender's authority to make a PPP loan on July 1, 2020. Under the agreement, lenders must process and approve PPP loans under the delegated authority of the SBA — without the SBA's prior review and approval — and must assume all obligations, responsibilities and requirements associated therewith. Notably, the agreement states that lenders will be responsible for all decisions concerning the eligibility of a borrower for a PPP loan. Such lenders must also ensure that all documentation held by such lenders which relate to the PPP loans are properly executed and otherwise fulfill the requirements of the PPP. However, as noted in our April 3, 2020 *Alert*, the Implementing Rule explicitly states that the SBA will allow PPP lenders to rely on borrower certifications and specified documents to determine PPP loan eligibility and to determine the amount of loan proceeds for which the borrower qualifies. Notably, the Interim Final Rule relieves lenders of any liability for providing a PPP loan to any borrower that factually does not meet the SBA's criteria, but fraudulently certifies that it does.

Under the agreement, lenders are to receive all principal and interest payments unless the SBA directs otherwise. Lenders must also service and liquidate all PPP loans and will bear all associated responsibility in doing so. Lenders may demand that the SBA repurchase PPP loans, and, in doing so, represent that all of such loans are in compliance with the PPP. The only fee permitted to be charged in connection with a PPP loan is the 1% interest rate. No other bonus, fee, prepayment penalty, commission or other payment or benefit from a borrower is permitted.

Both lenders and the SBA may terminate this agreement with 10 days' written notice by certified mail to the other party. In the event of termination, the SBA's guaranty will remain in effect and lenders must comply with PPP requirements for any loans made before termination. Importantly, lenders must comply with an SBA demand to purchase a guaranty or request to extend the maturity or the lender will automatically lose the SBA's guaranty. This agreement may also be assigned by any lender with the SBA's prior written consent, which the SBA may withhold in its sole discretion.

## **2. Borrower Application Form**

The SBA also published a modified application form (SBA Form 2483) for potential borrowers seeking a PPP loan.[9] The application largely remains the same as the form published on March 31, 2020 (see our prior *Alert*). This version does clarify that the borrower must provide the number of employees being counted for purposes of the PPP loan. In addition, the modified application adds certain questions aimed at determining a potential borrower's eligibility, which ask whether (i) all employees used to calculate the applicant's payroll calculation have a principal place of residence in the United States; and (ii) the applicant is a franchise listed in the SBA's Franchise Directory. The modified application also adds certain certifications, including (i) that the applicant will use PPP loans for business-related purposes as it specifies in the application; and (ii) that any Economic Injury Disaster Loan ("EIDL") it receives will be used for purposes other than those allowable under the PPP.

## **3. Lender Application Form — Paycheck Protection Program Loan Guaranty**

The PPP Loan Guaranty form (SBA Form 2484) is required to be submitted by any SBA-approved lender participating in the PPP and is the



means by which the SBA will repurchase PPP loans or loan pools. The form requires a lender to (i) submit administrative information on both the lender and the borrower (e.g., name, address, contact information, etc.); (ii) describe the structure of the PPP loan issued, including setting forth the amount of the loan, the borrower's average monthly payroll multiplied by 2.5 and the amount of any refinanced EIDL; (iii) attest to the borrower providing certain certifications to it; and (iv) make certain self-certifications, including (a) that it has complied with its obligations under the PPP; (b) that it has obtained and reviewed all required documents from the borrower and will retain such documents; and (c) that neither the authorized lender official signing the form, nor his or her spouse or children, have a financial interest in the borrower. The lender must also indicate whether it used an agent or other third party to assist in preparing the loan or loan application materials or to otherwise assist in services with respect to the loan.

*Authored by Joseph P. Vitale, Andrew J. Fadale, Stuart D. Freedman, Jessica Romano, David M. Rothenberg and Adam J. Barazani.*

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

---

[1] <https://home.treasury.gov/system/files/136/SBA%20IFR%202.pdf>.

[2] For additional information on loans available under the PPP, please see our April 3, 2020 *Alert*.

[3] *See also* 13 C.F.R. § 121.301(f).

[4] This can include the chief executive officer, President or other officers, managing members or partners that have the power to control the business.

[5] A "close relative" is a spouse, parent, child or sibling, or the spouse of any such person. 13 C.F.R. § 120.10.

[6] As determined under NAICS.

[7] A small business investment company is any licensed under section 301 of the Small Business Investment Act of 1958 for purposes of providing "private equity capital and long-term loan funds" to small businesses for small-business-related concerns.

[8] A list of such ineligible businesses appears at 13 CFR § 120.110 and is further discussed in SBA Standard Operating Procedure 5010, Subpart B, Chapter 2. For more information, please see our April 3, 2020 *Alert*.

[9] This form has been included in previous *SRZ Alerts*, but note that the form has been updated multiple times in the past several days.

---

*This is a fast-moving topic and the information contained in this Alert is current as of the date it was published.*

*This communication is issued by Schulte Roth & Zabel LLP for informational purposes only and does not constitute legal advice or establish an attorney-client relationship. In some jurisdictions, this publication may be considered attorney advertising. ©2020 Schulte Roth & Zabel LLP. All rights reserved. SCHULTE ROTH & ZABEL is the registered trademark of Schulte Roth & Zabel LLP.*

---

## Related People



**Stuart  
Freedman**

Of Counsel  
New York



**Jessica  
Romano**

Special Counsel  
New York



**Adam  
Barazani**

Special Counsel  
New York

---

## Practices

**BANK REGULATORY**

**FINANCE**

**MERGERS AND ACQUISITIONS**

**EMPLOYMENT AND EMPLOYEE BENEFITS**

---

## Attachments

⬇ Download Alert