

LOAN FRUSTRATION CONTINUES FOR PE AND VC COMPANIES

Many companies controlled by private-equity firms and venture-capital firms still have not received clearance to apply for emergency loans through the Small Business Administration.

Despite bi-partisan support and lobbying efforts by PE and VC firms late last week, there has been no waiver of the Small Business Administration's affiliation rules, which jeopardizes the ability of companies controlled by PE and VC firms to apply for Paycheck Protection Program loans and other SBA Section 7(a) business loans, including Economic Injury Disaster loans. We previously wrote about these efforts [here](#).

The SBA issued guidelines late Friday excluding faith-based and non-profit organizations from the affiliation rules for PPP loans, but leaving intact the affiliation rules for PE and VC companies. Even if a waiver is eventually issued, it may be too little, too late for PE and VC companies because some SBA-authorized lenders have been accepting PPP loan applications since Friday and have already approved PPP loans.

SBA Affiliation Rules

Under the SBA's affiliation rules, the employees of portfolio companies controlled by a PE or VC firm are combined for purposes of determining whether each company has no more than 500 employees. Companies with more than 500 employees are ineligible for PPP and EID loans, with some limited exceptions. The SBA affiliation rules also do not apply to companies with North American Industry Classification System codes beginning with 72 (the hospitality industry).

It is important to note, though, that being owned by a PE or VC firm does not automatically make a company ineligible for a PPP or EID loan. First, the companies must actually be controlled by the PE or VC firm. Accordingly, mere ownership of less than 50% of the voting interests by a PE or VC firm, without additional rights allowing the PE or VC firm to control the company, would not prevent the company from applying for a loan. Second, a PE or VC firm must actually have more than 500 across its controlled companies.

Control by a PE or VC Firm

The first issue is whether the PE or VC firm controls the company. The SBA clarified Friday night that the applicable affiliation rules are under [13 CFR 121.301](#). These affiliation rules are not as strict as the affiliation rules under 13 CFR 121.103.

Under 13 CFR 121.301(f), a PE or VC firm may exert control over a company in several ways, including: (i) owning more than 50% of the voting stock or other voting equity interest of the company, (ii) controlling a majority of the board of directors or managers, or (iii) having veto rights or other protective rights allowing the PE or VC firm to block action by the board or owners of the company.

Combination of Employees

The CARES Act relaxed the eligibility requirements of prospective borrowers by allowing companies with no more than 500 employees to apply for PPP and EID loans, even if they would not have previously satisfied the SBA's size limitations, based, for example, on annual revenues. The SBA, however, combines the employees of all affiliates in determining eligibility. Each part-time employee is counted as one employee.

A company controlled by a PE or VC firm is still eligible for a loan if the combined employees of that company and any other companies controlled by the PE or VC firm are not more than 500.

For example, if a PE firm controls five portfolio companies, and each portfolio company has 75 employees, all of the portfolio companies are eligible for a PPP or EID loan because the combined number of 375 employees does not exceed the SBA's 500-employee limit.

Amendment of Organizational Documents

PE and VC firms frustrated by the lack of an SBA affiliation waiver could consider amending the organizational documents of one or more portfolio companies to waive or remove provisions that grant the PE and VC firms effective control over the company (e.g., veto powers) when the PE and VC firms do not own a majority of the voting interests of the company.

There is no guarantee that the SBA would accept an applicant's last-minute changes to its organizational documents, but to increase the chances of acceptance and to protect the applicant from claims of misleading the SBA, any amendment to the organizational documents should be: (i) fully disclosed to the SBA, (ii) effective prior to the date of application and effective through at least the term of the loan (perhaps longer), (iii) in accordance with general contract principles required for enforceable contracts, and (iv) strictly adhered to by all parties, particularly the PE and VC firms.

O'Neil, Cannon, Hollman, DeJong & Laing remains open and ready to help you. For questions

or further information relating to the Paycheck Protection Program and Economic Injury Disaster loans, please speak to your regular OCHDL contact, or the author of this article, attorney [Pete Faust](#).