



PPP Loan Program: Application and Affiliation Guidance¹

Key Takeaways:

- The final form of PPP loan application **removes the requirement for certifications directly by 20%+ owners** that had been included in an earlier version of the application.
- Applicants are still required to certify as to certain matters with respect to 20%+ owners.
- The SBA released guidance confirming that minority investors at any level of ownership may still be considered affiliated with the applicant if they hold certain control rights.
- Completing the PPP application will require cooperation among applicants and their investors to (1) determine who is a 20%+ owner, (2) assess and resolve any affiliation issues, and (3) provide applicants with enough information and reasonable assurance to complete the application.

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On April 2, 2020, the Small Business Administration (“SBA”) released its final form of application for Payroll Protection Program (“PPP”) loans under the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”). While this form addresses some of the problematic aspects of the earlier draft version of the application, it continues to contain several certifications that are causing certain applicants and their venture investors considerable confusion.

Additionally, on April 3, 2020, the SBA issued guidance on the affiliation rules applicable to the PPP,² and on April 4, 2020 the SBA released a letter from its General Counsel’s Office³ addressing these affiliation rules and the exemptions from affiliation created under the CARES Act. Based upon these releases, the affiliation rules applicable to the PPP are somewhat narrowed from the SBA’s most recent affiliation regulations applicable to the 7(a) business loan program more broadly, but the SBA’s guidance confirmed that a minority shareholder at any level (not just over 20%) may be an affiliate of the applicant if it has certain control rights.

¹ This article discusses the current status as of publication on April 6, 2020. We are actively monitoring developments, including with respect to SBA guidance on the application and implementation of the SBA’s rules in the context of the new CARES Act programs.

² Small Business Administration; Interim Final Rule (Business Loan Program Temporary Changes; Paycheck Protection Program); available at <https://home.treasury.gov/system/files/136/SBA%20IFR%202.pdf>.

³ Small Business Administration; April 6, 2020 Letter from John W. Klein (Associate General Counsel for Procurement Law) to William M. Manger (Associate Administrator for Capital Access) re Size Eligibility and Affiliation Under the CARES Act; available at <https://nvca.org/wp-content/uploads/2020/04/April-4-SBA-Guidance-on-Affiliation.pdf>.

This article attempts to provide a step-by-step approach to the PPP loan application, including assessing and responding to the affiliation question.

Threshold Matters:

- As a threshold matter, the applicant needs to determine whether any investor holds 20% or more of the applicant. **Each 20%+ owner must be scheduled in the “Applicant Ownership” section of the form.** The application does not make clear whether that section should list only record owners of 20% or more of the applicant’s equity or whether applicants should aggregate affiliated owners and report their aggregated ownership if it exceeds 20%. Applicants should consult their counsel.
- As a further threshold matter, the applicant should determine if any of its investors holds more than 50% of the applicant or if there is any other basis for affiliation, including impermissible negative or positive control rights, common management or the existence of an identity of interest⁴. If yes, the applicant will be deemed affiliated with the investor, and will have to aggregate employees for purposes of determining headcount. In many – if not most – cases, this will render the applicant ineligible.
 - If the applicant and a minority owner (regardless of whether such owner holds 20% or less) are affiliated due to control rights of the minority owner, be sure to work with legal counsel, the board and the applicable stockholders to determine if the provision(s) in the applicable governing documents or agreements that may raise questions regarding affiliation can be amended or waived before the application is submitted.
 - Note that affiliation based on an owner having greater than 50% ownership of the applicant’s voting equity, common management, or an identity of interests cannot be avoided in this manner.
- The applicant should also confirm that there are no other disqualifying conditions that would render the applicant ineligible, including those listed on 120.110, as amended by the CARES Act and confirm with its board that it can make each of the certifications set forth on page 2 of the application in good faith following a rigorous analysis of all relevant facts.
- If the applicant has received funding (either debt or equity) from an SBIC, the applicant is exempted from the affiliation rules discussed below. Likewise, exempt are applicants with a North American Industry Classification System (“NAICS”) code beginning with 72 (accommodations and food services), and that have received a franchise code from the SBA.

Step by Step Overview of PPP Loan Application for Questions that Implicate the Applicant’s Investors:

- Question 1 of the application requires the applicant to certify whether it or any of its owners (which is defined as 20%+ owners in the PPP Application instructions) is presently suspended, debarred, proposed for debarment, declared ineligible, voluntarily excluded from participation in this transaction by any Federal department or agency, or presently involved in any bankruptcy. A “yes” is disqualifying. Assuming the applicant can check “no” as to itself we recommend that:

⁴ Importantly, the SBA’s guidance does not include common investments, newly organized concerns, or the totality of the circumstances as potential additional bases of affiliation for purposes of the PPP loans program, which were summarized in our prior affiliation article. For purposes of the PPP loans program, the identity of interest test is based on close relatives/familial relationships that create identity of interest between owners.

- The applicant ask each 20%+ owner to confirm whether, as to such 20%+ owner, the answer to this question is “no;” and
- Each 20%+ owner confirm back appropriately (yes or no), and the 20%+ owner and the applicant would retain this record.
- Question 2 of the application requires the applicant to certify whether it, any owner (which is defined as a 20%+ owner in the PPP Application instructions), or any “business owned or controlled by any of them,” has obtained a direct/guaranteed loan from the SBA or any Federal Agency that is delinquent or has defaulted in the last 7 years. A “yes” is disqualifying. Assuming the applicant can check “no” as to itself, we recommend that:
 - The applicant ask each 20%+ owner to confirm whether, as to itself and businesses owned or controlled by them, the answer to this question is “no;” and
 - Each 20%+ owner confirm back as to itself and, to its knowledge, the other companies in which it owns 20% or more or are otherwise affiliated with it:
 - As a practical matter, the 20%+ owner should ask its managers (for example, a fund’s MDs) by email whether any of their portfolio companies, to the manager’s knowledge, would not be able to make this certification; and
 - Managers respond to the internal inquiry, and the fund retain this record.
 - It is understood by NVCA that as drafted the question is very hard to answer, and our general recommendation is to do reasonable, good faith diligence to determine the answer and keep a record of the same.
- Question 3 of the application requires the applicant to certify whether it, or any of its 20%+ owners, is “an owner of any other business” or has “common management with any other business”, and provides for attaching as addendum A a list of all such businesses with a description of the relationships.
 - If the applicant has no 20%+ owners and can answer “no” as to itself, the applicant should check “no.”
 - If the applicant is “an owner of any other business” or has “common management with any other business”, the applicant should check “yes” and the applicant should answer the question completely, including as to addendum A, as to itself.
 - If the applicant has any affiliates (including less than 20% owners) or 20%+ owners, the applicant should inquire of each affiliate or 20%+ owner whether it “owns” any other businesses or has “common management with any other business”– we suspect for substantially all VCs/PEs, the answer is yes.
 - We expect that each affiliate (whether 20%+ owner or otherwise) will need to list each applicable business “owned” or “in common management” with such affiliate.
 - For 20%+ owners who are not affiliates, we believe it is not necessary for the application to list other businesses owned or under common management with such unaffiliated owner. However, in the interest of transparency some applicants may choose either to list in addendum A all of the entities and businesses provided by such owner or (if accurate) indicate that applicant was not able to obtain such information from such owner, and to the extent true,

indicate that the applicant is aware that such owner may own other businesses or have common management with other businesses. In any event, the applicant should indicate that such the 20% holder of the applicant is not an affiliate of the applicant and no other information will be provided. A sample of such a statement is attached hereto as Attachment 1. **Additional note (April 8, 2020):** We have become aware that some lenders are rejecting and/or requiring more information from applicants that have declined to provide a list of the companies owned by or under common management with the applicant's 20% holders and delaying processing of the application. We therefore recommend that applicants discuss the pros and cons of this approach prior to submitting the application.

- Question 5 requires the applicant to certify whether it or any "individual owning 20% or more" of the applicant's equity is subject to an indictment, criminal information, arraignment, or other means by which formal criminal charges are brought in any jurisdiction, or presently incarcerated, or on probation or parole. A "yes" is disqualifying. Assuming the applicant can check "no" as to itself, we recommend that the applicant follow the approach for Question 1 in addressing individuals owning 20%+ of the applicant's equity.
- Question 6 requires the applicant to certify whether it (if an individual) or any 20%+ owner has been convicted, pleaded guilty, pleaded nolo contendere, placed on pretrial diversion, or placed on any form of parole or probation (including probation before judgment). A "yes" is disqualifying. Assuming the applicant can check "no" as to itself, we recommend that the applicant follow the approach for Question 1 in addressing owners of 20%+ of the applicant's equity.

Reminder Guide for Analyzing Affiliation based on Stock Ownership:

In looking at affiliate status, an investor **will be deemed an affiliate if:**

- The investor holds more than 50% of the voting stock **or**
- The investor holds **any** voting stock, but less than 50%, and can "control" (veto) "ordinary" (operational) decisions, detailed in our prior article:
 - Non-exhaustive list of examples of blocking rights creating affiliation:
 - The investor hold sufficient shares to block the vote, based on the voting threshold (example, threshold is 50% of preferred and the investor holds 55% of preferred)
 - The specific investor's affirmative vote is required to approve an action, together with any general percentage approval as may be required
 - Item in question requires "both" preferred directors (such that either can block)
 - Board consists of only two members, one of which is controlled by the investor, such that the investor's board member can block.
 - Non-exhaustive list of examples of "ok" scenarios that **do not result in affiliation:**
 - Threshold to approve item is majority, and no investor has a majority or can block

- Item in question requires “one of the preferred directors” and there are two or more preferred directors designated by different unaffiliated investors in office (such that none can block)
- Board consists of 5 seated members, quorum is majority of seated directors, no investor controls more than 2 seats

As noted previously, if no investor has “impermissible” control as outlined above, include a statement in the addendum along the lines outlined above for the answer to question 3. If any investor will be considered an affiliate based on the above analysis, work with legal counsel to consider necessary changes **before** applying for PPP.

NVCA continues to monitor whether additional guidance on affiliation may be provided; however, we do not know when or whether such guidance will be forthcoming and if any such guidance will obviate the more detailed analysis outlined above. We expect to update our membership with new developments.

Attachment 1

As indicated under “Applicant Ownership,” certain stockholder (“Stockholder”) owns, as of the date of the Application, a greater than 20%+ ownership stake in the applicant. However, as of the date of the Application:

- Stockholder does not own 50% or more of the applicant’s voting securities; and
- Stockholder, alone, does not have the right to prevent a quorum or otherwise block action by the board of directors or shareholders under the applicant’s charter or bylaws or pursuant to a shareholders agreement, as determined pursuant to 13 CFR § 121.301 (the “**Applicable Affiliation Rules**”).

[IF APPLICABLE: In the interest of transparency, and notwithstanding the foregoing, the applicant advises that Stockholder provided the following list of companies it owns: [list].]

The Applicant has further determined that Stockholder is not an affiliate of the applicant under the Applicable Affiliation Rules. Because the applicant is not an affiliate of Stockholder under the applicable Affiliation Rules, and because Section 1102 of the CARES Act specifically applies SBA’s affiliation rules to the PPP program, Sec. 36(D)(vi), no further information regarding the Stockholder or the relationship between Stockholder and the applicant, or other businesses in which the Stockholder has invested or with which it has common management, is being provided with the Application.