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SBA Loan Implications for Private Equity-backed Companies

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Private Equity / Government Contracts

The Coronavirus Aid, Relief, and Economic Security (CARES) Act opens up new Small Business Administration (SBA) loan opportunities to support many companies and nonprofit organizations with 500 or fewer employees. The CARES Act significantly expands the reach of traditional SBA 7(a) loans by providing $349 billion to guarantee private Paycheck Protection Loans (PPLs) that cover an average of 2.5 months of payroll costs for businesses in response to COVID-19 up to $10 million. The CARES Act also expands the Economic Injury Disaster Loan (EIDL) program to similarly increase eligibility. On March 27, Covington issued a client alert outlining the PPL terms and EIDL expansion.

The CARES Act expands the SBA's loan program to any business with 500 or fewer employees. Businesses in certain industries can be eligible with more than 500 employees if they meet applicable SBA employee-based size standards for those industries. However, other than as described below, the CARES Act does not appear to have overridden the general applicability of the SBA's existing affiliation rules which require that all employees of affiliates (for example, employees of a PE sponsor's other portfolio companies) be included in calculating the 500 employee limit. The Act contains an express waiver of the affiliation rules for only the following types of businesses:

- businesses with 500 or fewer employees per physical location that are assigned a North American Industry Classification System Code beginning with 72 (generally accommodations and food services businesses)
- franchises assigned an identifier code under the SBA
- businesses that receive financial assistance from a Small Business Investment Company

Under SBA rules, businesses/entities are considered to be affiliates of each other when one, directly or indirectly, controls (or has the power to control) the other or a third party controls (or has the power to control) both businesses/entities. In addition to owning a majority of the voting equity of the applicable business, control (and affiliation) can be found where a minority investor exercises negative control through contractual approval rights with respect to the business or through contractual or other economic dependence. In determining whether control/affiliation exists, the SBA considers the totality of the circumstances and may determine on a case-by-case basis that affiliation exists when there is clear and convincing evidence based on the totality of the circumstances even though there is no single factor that constitutes control/affiliation.

Although the express waivers described above may allow portfolio companies in those specific industries to access the SBA loan program, absent further amendment to the CARES Act or clarification from the SBA, the affiliate aggregation requirement would prevent most private equity portfolio companies from participating in the SBA loan program. The SBA is required to issue regulations to implement the program within 15 days of the enactment of the CARES Act. Covington is monitoring the situation and will provide an update following the adoption of the implementing regulations.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Private Equity and Government Contracts practices:

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