

COVID-19 Stimulus Loans: Are PE and VC Portfolio Companies Eligible?

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Economic Injury Disaster Loans (EIDLs) and the Paycheck Protection Program

- **EIDLs:** The Coronavirus Preparedness and Response Supplemental Appropriations Act, enacted on March 6th, provides for EIDLs to businesses that qualify as “small businesses” under existing Small Business Administration (SBA) rules.
 - Eligible businesses may receive up to \$2 million in loans to use for working capital and ordinary course expenditures, though the amount available to any business is tied to the actual economic injury sustained by that business resulting from the effects of COVID-19.
 - The loans may not be used for other purposes such as payment of dividends or payments on existing indebtedness. In addition, loans are only available to borrowers who can show that they are unable to meet their existing financial obligations or cannot pay ordinary course operating expenses; loss of anticipated profits or drops in sales are not sufficient economic injuries to qualify for a loan under this program. Recipients must also demonstrate that they have exhausted all reasonably available funds at their disposal and have been unsuccessful in obtaining other third-party funding (which may include additional equity investment from significant owners) on reasonable terms.
 - Pending legislation may alter these rules to permit businesses with fewer than 500 employees who may not otherwise meet SBA small business requirements to receive EIDLs and to waive the requirement that all other sources of funding be exhausted in some cases.
- **Paycheck Protection Loan Program:** Legislation currently pending includes a much publicized \$367 billion program that would make federally guaranteed, forgivable loans available to “small businesses” to cover eight weeks of payroll costs for U.S.-based employees.
 - Eligible businesses may receive up to \$10 million in loans, though the amount available to any business is based on the business’s prior payroll costs, typically in the one-year period prior to the loan commencement date (subject to adjustments for businesses that are seasonal or that were not in existence for that period).
 - Borrowers may have a portion of their loan principal forgiven in an amount equal to their payroll costs (not including costs for individuals compensated above \$100,000 annually), interest payments on mortgages, rent payments, and utility payments between February 15, 2020 and June 30, 2020. Any portions of loans used for other purposes are not eligible for forgiveness. In addition, eligibility for loan forgiveness is reduced if the business does not maintain its historical headcount.

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What is a “Small Business” for Purposes of Obtaining an Economic Injury Disaster Loan or a Paycheck Protection loan? Do Portfolio Companies of Private Equity and Venture Capital Funds Qualify?

- To be eligible to receive a loan under these programs, a business must be considered “small business” by SBA standards.
- The SBA currently uses a highly fact-dependent two-prong test.
 - **Prong 1:** The business’s size will be measured against a maximum value set by the SBA. The business’s size will typically be measured by its number of employees or annual receipts, depending on the business’ NAICS code for the industry in which the business is primarily engaged. The business’s size must not exceed the maximum value set by the SBA, though under the Paycheck Protection Program businesses may be considered “small” if they employ fewer than 500 people even if they do not meet an applicable receipts-based test.
 - **Prong 2:** The business is also aggregated with its “affiliates”. The size of the business combined with its affiliates must not exceed the size standard set by the SBA for either the primary industry of the business alone or the primary industry of the business and its affiliates, whichever is higher. For groups of affiliates that do not operate within the same industry (which is often the case with private equity and venture capital funds), the SBA historically has determined the primary industry code based on the primary income producing entity within the group.
- What is an “affiliate”?
 - Entities are “affiliates” when one controls or has the power to control the other, or a third party or parties controls or has the power to control both. It does not matter if control is actually exercised.
 - “Control” is defined expansively under the SBA regulations to include majority ownership of voting equity, contractual control-type rights, management control, identity of interest, economic dependence, and a number of other types of “control” that can exist in majority and minority ownership scenarios. In determining whether affiliation exists, the SBA may consider all connections between the business and a possible affiliate; even though no single factor is sufficient to constitute affiliation, the SBA may find affiliation on a case-by-case basis where there is clear and convincing evidence based on the totality of the circumstances.
 - Exceptions to the affiliation rules apply in limited scenarios. Additionally, in the case of loans under the Paycheck Protection Program, the aggregation rules are specifically waived for businesses in the accommodation and food services sector, franchises, and any business that receives financial assistance from a Small Business Investment Company.

The aggregation rules in the SBA’s “small business” size test may require a portfolio company’s size to be considered together with all other portfolio companies of its major investors (including, for private equity and venture capital funds, portfolio companies of earlier or later funds with common management). This makes eligibility difficult for such portfolio companies.

We encourage interested businesses to undertake this case-by-case factual analysis to determine eligibility. We are here to assist.

If you have questions regarding these developments, please contact a member of our Private Equity team.

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