



What every emerging growth company needs to know about newly released guidance from Treasury and SBA implementing rules under the CARES Act: a short primer on SBA loans and forgiveness

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On April 7, 2020, [United States Treasury issued further guidance](#) following on the [guidance issued by the U.S. Small Business Administration](#) on April 2, 2020 with instructions on how to apply for new loan programs contemplated by the The Coronavirus Aid, Relief, and Economic Security Act of 2020, or “CARES Act.” Adopted on March 27, 2020, the CARES Act legislation introduced the new Paycheck Protection Program, or PPP, with \$349 billion in funding, and expanded the already existing Economic Injury Disaster Loan Program, or EIDL, with \$10 billion of additional funding.

While both programs are generally aimed to help small businesses, some limitations may apply to bootstrapped and VC-backed startups.

Below we summarize key takeaways for emerging growth companies in assessing eligibility and access to these new forms of assistance, and how to mitigate against potentially disqualifying factors.

What is the difference between the EIDL and PPP?

When applying for either the EIDL or the PPP, it is important to understand that while both programs are aimed at helping small businesses, the funds that may be procured under these programs cannot be used for the same purpose.

EIDL conditions:

- EIDL loans are available for up to \$2 million, carry an interest rate of 3.75% and have a maximum term of 30 years.
- Only those loans for amounts of \$200,000 or greater must be guaranteed by any owner having a 20% or greater interest in the applicant (the CARES Act removed the requirement for personal guarantees on loans under \$200,000).
- The CARES Act also removed standard EIDL requirements that the borrower not be able to secure credit elsewhere or that the borrower have been in business for at least one year, as long as it was in operation on January 31, 2020.
- Applicants may request an expedited disbursement that is to be paid within three days of the request. The advance may not exceed \$10,000 and must be used for authorized costs but is otherwise not repayable if the EIDL loan is not approved.

PPP conditions:

- Covered loan period: Retroactive to February 15th, 2020, through June 30, 2020.
- Under the PPP, the funds can only be used for payroll, health care benefits, mortgage interest, rent, utility payments or interest on other debt obligations incurred prior to February 15th, 2020.
- The loan amount cannot exceed the lesser of (1) 2.5x average monthly payroll costs during the 1-year period before the date on which the loan is made; or (2) \$10 million.
- The legislation also temporarily increases the maximum amount for an SBA Express loan from \$350,000 to \$1 million through December 31, 2020.
- Borrower requirements include good faith certification that the loan is necessary because of economic uncertainty caused by COVID-19 and will be applied to maintain payroll and make required payments.
- Borrowers must also certify that they are not receiving this assistance and duplicative funds for the same uses from another SBA program.

- No collateral or personal guarantee are required.

“Small Business” Definition

In order to qualify for one of the CARES Act programs, a business must generally have:

- fewer than 500 employees; or
- fewer than the number of employees the SBA has designated as the size standard based on a company’s applicable 6-digit North American Industry Classification System (“NAICS”) Code, whichever is greater.

The number of employees of the company will be aggregated with the number of employees of all the company’s domestic and foreign “affiliates.”

Control Rights and Affiliation

The latest SBA guidance states that the definition of “affiliate” provided at 13 CFR section 121.103 will be waived, and that the SBA will instead apply 13 CFR section 121.301. Both sections contain similar definitions of control and affiliation, important differences have created confusion in the marketplace until now. The problem was that section 121.103(b)(5) excluded VC companies and Investment companies from the scope of affiliation, while section 121.301 does not. Following is a short summary of how to apply the affiliate test under 13 CFR section 121.301 to determine whether one company is affiliated with another:

1. **Ownership.** The general rule states that ownership of 50% or more of the company’s voting shares constitutes ownership-based control and triggers affiliation between entities.
2. **Common Management.** Affiliation based on common management may arise when two entities are deemed to be controlled by the same majority owner, President or CEO.
3. **Negative Control by a Minority Shareholder.** Even where a VC firm owns less than a majority of the voting securities of a business, determining VC affiliation with portfolio companies depends on the analysis of the positive or negative controls that the VC has over the company. For investors with a minority shareholding, affiliation with a company depends on the investor’s

ability to prevent a quorum or otherwise block action by the board of directors or shareholders.

4. **Stock Options, Convertible Securities.** Affiliation can also be based on ownership of convertible securities or options exercisable for securities. The SBA has clarified that control is calculated based on an as-converted and as-exercised basis, unless conversion or exercisability remains dependent on a condition precedent that cannot be fulfilled or is unenforceable under law.
5. **Identity of Interest.** Affiliation may arise where companies share identical or substantially identical business or economic interests, such where the businesses are controlled by nuclear family members.
6. **Totality of Circumstances.** Affiliation rules can also be triggered in various situations where the totality of circumstances indicates control. Businesses could be viewed as affiliated on a case-by-case basis even if no single factor standing alone would otherwise be sufficient.

Many practitioners expressed concerns that VC-backed companies would be ineligible under the CARES Act, due to the negative controls contained within NVCA standard protective provisions included within the charters and held by minority shareholders. In order to qualify for SBA assistance, companies should consider with their investors whether to amend their charters to remove or waive the offending protective provisions to qualify for PPP loans.

Alternatively, as the Treasury Department clarified in its April 7 FAQs, a minority shareholder can irrevocably waive an existing veto, thereby circumventing the affiliation rule. There is no clarification if such a waiver must be permanent or merely temporary for the period during which a loan is outstanding or assistance is being provided.

Another alternative solution to be considered would be to give all shareholders the same veto rights.

Loan Forgiveness

Under the PPP, loan recipients will be eligible for loan forgiveness for an 8-week period after the loan's origination date in the amount equal to the sum of the following costs incurred during that period:

- Payroll costs (compensation above \$100,000 excluded)
- Payment of interest on mortgage obligations

- Rent obligations
- Utility payments

The amount forgiven cannot exceed the amount borrowed. Loan forgiveness will be proportionally reduced if the average number of employees is reduced during the covered period as compared to the same period in 2019. The amount of loan forgiveness will be reduced by the amount of any reduction in total employee salary or wages during the covered period that is in excess of 25% of the total salary or wages.

Any remaining outstanding amounts (e.g., if not forgiven) will be repayable during a term not to exceed 10 years.

How and Where to Apply

The PPP application period for businesses opened on April 3, 2020 and will open for independent contractors and self-employed individuals on April 10, 2020. The CARES Act sets forth broad guidance on the overall application process, but no direct instructions. While the mechanics of submission remain uncertain, loan funds will be issued on a first come, first served basis. All applicants must submit their PPP application [forms](#) through [SBA Participating Lenders](#). The list of SBA Participating Lenders can be found [here](#).

EIDL application for a loan and loan advance of up to \$10,000 is relatively easy and can be [submitted online](#) directly through the SBA.

While every emerging growth company and startup can apply to both programs, we highly recommend considering if the funding is really needed. The PPP application form requires the person signing it to certify a number of statements including the one implying that current economic uncertainty makes a loan request necessary to support the ongoing operations. Making a false statement to obtain a guaranteed loan is punishable under the law, including imprisonment that can vary from 2 to 30 years and a fine varying from \$250,000 to \$1,000,000.

Please note that this article does not constitute legal advice, and you should seek advice of competent counsel before making a decision to seek or not to seek SBA assistance. With this disclaimer out of the way, we hope this provides useful

background on how to assess eligibility and access government assistance in these challenging times.



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