



COVID-19

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**Coronavirus / COVID-19
Response Team**

MILLER 
JOHNSON
Attorneys

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MILLER 
JOHNSON
Attorneys

**SBA's Guidance on
Affiliation Rules in the
Paycheck Protection
Program**

» Erik Daly

MILLER 
JOHNSON
Attorneys

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Paycheck Protection Program (PPP)

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Executive Summary Overview

- Temporary form of Section 7(a) SBA loan
- Size of loans to equal 250% of borrower's average monthly payroll costs
 - Maximum loan size is \$10 million
- Personal guarantees and collateral not required
- No "credit elsewhere" testing
- No principal, interest or fee payments for six months
- No fee to apply or process; no pre-payment penalties
- May be used to refinance recent SBA EIDLs (disaster loans)
- PPP loans forgivable to the extent used for certain expenses during eight weeks post-loan, subject to employee retention and compensation conditions

Developments Since Last Week's Webinars

- SBA issued first interim final rule regarding PPP loans
 - Confirmed 25% cap on non-payroll costs for forgiveness and, on my reading, in general
 - Interest rate increased to 1.00% from 0.50% for non-forgiven portion of loan (if any)
 - Perpetuated confusion on "payroll cost" measurement period and \$100,000 per/employee "payroll cost" cap
 - Stated clearly that independent contractors do **not** count as employees for PPP loan calculations or loan forgiveness
 - Confirmed an eligible borrower may only receive one loan
 - Verified that funds will be allocated "**first-come, first-served**"
- Final loan application posted by SBA on eve of launch

Developments Since Last Week's Webinars (cont.)

- Banks and other financial institutions started accepting applications on Friday, April 3
 - Community banks and credit unions were up and running faster than large banks
 - Several large banks received criticism for moving slowly and imposing additional conditions
 - President, Congress, Treas. Sec., SBA Admin. take to Twitter
- Late on Friday, SBA issued second interim final rule regarding affiliation rules and published FAQs relating to faith-based organizations
 - PE and VC generally did not receive helpful treatment
 - Faith-based organizations received “affiliate” exemption

Developments Since Last Week's Webinars (cont.)

- On Monday, April 6, there were intermittent reports of SBA back-end system “crashes”
 - However, at the end of the day, SBA announced that the system was “up and running” and it “continued to process, approve, and guarantee billions of dollars of loans per hour”
- Federal Reserve released a statement that it would “establish a facility to provide term financing backed by PPP loans”
 - Federal Reserve statement indicated additional details of Fed “back-stop” would follow
- SBA issued FAQs answering certain key questions

Affiliation in General

- SBA confirmed that its “affiliation” concepts apply for purposes of determining eligibility for PPP loans, subject to statutory exceptions (e.g., food, hospitality, SBA-approved franchises, SBIC-financed)
 - “Concerns and entities are affiliates of each other 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 whether control is exercised, so long as the power to control exists.**”
 - “Affiliation under **any of the circumstances** described below is **sufficient** to establish affiliation for applicants for the Paycheck Protection Program...”
 - Affiliation may also be based on “**totality of the circumstances**”

1. Ownership

- A concern is an affiliate of an individual, concern or entity that **owns or has the power to control** more than **50 percent** of the concern's **voting equity**
 - If no individual, concern, or entity is found to control, SBA will deem the Board of Directors or President or CEO (or other officers, managing members, or partners who control the management of the concern) to be in control of the concern
 - Negative Control: A minority owner will be in control, if it has the ability, under the concern's governing documents, to **prevent a quorum** or otherwise **block action** by the board of directors or shareholders
 - However, such “negative control” may be irrevocably surrendered

2. Options, Convertible Securities and Agreements to Merge

- Options, convertible securities and agreements to merge (including agreements in principle) will have a present effect on the power to control a concern
 - SBA treats such options, convertible securities and agreements **as though the rights granted have been exercised**
- However, agreements to open or continue negotiations towards the possibility of a merger or a sale of stock at some later date are **not** considered “agreements in principle”
 - Unclear how detailed/committed a Letter of Intent (LOI) must be in order to be treated as an “agreement in principle”

2. Options, Convertible Securities and Agreements to Merge (cont.)

- Options, convertible securities and agreements that are subject to conditions precedent which are **incapable of fulfillment, speculative, conjectural or unenforceable** under law, or where the **probability** of the transaction (or exercise of the rights) occurring is shown to be **extremely remote**, are **not** given effect
- SBA will not permit gamesmanship or give present effect to the ability to divest all or part of one’s ownership interest in order to avoid a finding of affiliation (e.g., put rights)

3. Management

- Affiliation arises where the **CEO or President** of the applicant (or other officers, managing members or partners who control the management of the applicant) also controls the management of others
- Affiliation also arises where a single individual, concern or entity that controls the **Board of Directors or management** of one concern also controls the Board of Directors or management of others
- Affiliation will likely also result from a **management agreement** between parties

4. Identity of Interest

- Affiliation arises when there is an “identity of interest” between **close relatives with identical or substantially identical business or economic interests**
 - For example, where the close relatives operate concerns in the same or similar industry in the same geographic area
- Where SBA determines that interests should be aggregated, an individual or firm may rebut that determination with evidence showing that the interests deemed to be one are in fact separate

Affiliation in General (Revisited)

- SBA notes that the PPP application form is written to elicit information about potential affiliates and that **borrowers should use that information to assess whether they have affiliate relationships** that should be considered in the number of employees reported on the application
- Affiliation concepts will also generally apply to **not-for-profit borrowers** in the same manner as with respect to small businesses, subject to a **broad exception for “faith-based organizations”...**

Faith-Based Organizations

Faith-Based Organizations

- Bottom line: The relationship of a faith-based organization (FBO) to another organization is **not** considered an “affiliation” with the other organization **if the relationship is based on a religious teaching or belief or otherwise constitutes a part of the exercise of religion**
 - SBA’s analysis and conclusion are rooted in the First Amendment and the Religious Freedom Restoration Act
 - Per the SBA, because affiliation among FBOs is often intertwined with the exercise of religion or an expression of religious belief, it would be impermissible to condition receipt of PPP loans on affiliation in this context

Faith-Based Organizations (cont.)

- SBA determined that it has no “compelling interest” in denying PPP loans to FBOs based on affiliation
 - “SBA accordingly must exempt faith-based organizations that would otherwise be disqualified from the PPP based on features of those organizations’ affiliations that are a matter of **sincere religious exercise.**”
- Also, because the SBA’s affiliation rules were written to apply to for-profit entities, applying those rules to FBOs would likely present administrative difficulties and present significant risks that SBA would mischaracterize relationships among FBOs

Deference to FBO Good-Faith Determinations

- SBA will defer to FBOs regarding these affiliation determinations
 - “A faith-based organization seeking [a PPP loan] may rely on a **reasonable, good faith interpretation** in determining whether its relationship to any other person, group, organization, or entity is exempt from the affiliation rules under this provision, and **SBA will not assess, and will not require participating lenders to assess, the reasonableness of the faith-based organization’s determination.**”
- SBA regulations revised to memorialize this exemption and provide application guidance

Deference to FBO Good-Faith Determinations (cont.)

- FBO applicant that seeks to rely on this exception should attach an Addendum to its PPP loan application stating that:
 - “The Applicant claims an exemption from all SBA affiliation rules applicable to Paycheck Protection Program loan eligibility because the Applicant has made a reasonable, good faith determination that the Applicant qualifies for a religious exemption under 13 C.F.R. 121.103(b)(10), which says that “[t]he relationship of a faith-based organization to another organization is not considered an affiliation with the other organization . . . if the relationship is based on a religious teaching or belief or otherwise constitutes a part of the exercise of religion.”

FBO Affiliation Examples

- If your FBO affiliates with another organization because of its **religious beliefs** about church authority or internal constitution, or because the legal, financial, or other structural relationships between your organization and other organizations reflect an **expression of such beliefs**, your organization would qualify for the exemption
- If, however, your FBO is affiliated with other organizations **solely for non-religious reasons, such as administrative convenience**, then your organization would be subject to the affiliation rules

Other FBO-Related Guidance

- SBA confirmed that “houses of worship” are eligible to receive PPP and EIDL loans
 - Need not provide any secular services to be eligible
- No additional limitations on use of loan proceeds beyond those that apply to non-FBOs
 - Confirmed that loan proceeds can be used to pay salaries of ministers and staff engaged in the religious mission of the FBO

Other FBO-Related Guidance (cont.)

- Churches (including temples, mosques, synagogues, and other houses of worship), integrated auxiliaries of churches, and conventions or associations of churches qualify for PPP loans as long as they meet the requirements of **Section 501(c)(3)** of the IRC ... **even if they have not actually been notified of their tax-exempt status by the IRS**
 - Many such organizations are not required to formally obtain 501(c)(3) notification from IRS

Other FBO-Related Guidance (cont.)

- Generally speaking, an FBO loan recipient will retain its independence, autonomy, right of expression, religious character and authority over its governance
 - However, certain federal non-discrimination obligations will apply during while the loan is outstanding
 - SBA regulations provide that the recipient may not discriminate on the basis of **race, color, religion, sex, handicap, age, or national origin** with regard to **goods, services, or accommodations offered**
 - SBA will apply these obligations to **public-facing** goods, services, and accommodations, but **not to an FBO's "ministry activities within its own faith community"**

Other FBO-Related Guidance (cont.)

- For example, SBA regulations require a faith-based organization that operates a restaurant or thrift store open to the public to serve the public without regard to protected traits
- However, SBA regulations will **not** apply to limit an FBO's ability to distribute food or clothing exclusively to its own members or co-religionists
 - SBA generally will not apply its nondiscrimination regulations in a way that imposes **substantial burdens** on the religious exercise of FBOs, such as by applying those regulations to the performance of church ordinances, sacraments or religious practices

PPP: Enforcement and FOIA Reminders

- Sample application is very clear that if PPP funds are procured or utilized impermissibly, then the government retains the ability to pursue hefty fines, civil and/or criminal charges
- False Claims Act will also incentivize enforcement
- Fine print of application states the following information may need to be provided in response to a FOIA request:
“other information such as the names of the borrowers (and their officers, directors, stockholders or partners), the collateral pledged to secure the loan, the amount of the loan, its purpose in general terms and the maturity”

MILLER JOHNSON
Attorneys



Erik Daly

616.831.1723

dalye@millerjohnson.com

millerjohnson.com

45 Ottawa Ave SW
Suite 1100
Grand Rapids, MI 49503

100 W Michigan Ave
Suite 200
Kalamazoo, MI 49007

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