

# Updated Business Affiliation Rules: Key Information for Paycheck Protection Program Borrowers

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**In the last few days, the Small Business Administration ('SBA') has published further guidance on the Paycheck Protection Program ('PPP') Business Affiliation Rules, which we attempt to summarize below.**

You can find all of the SBA's PPP related online postings [here](#) and read our previous coverage of the Business Affiliation Rules [here](#).

When a PPP loan applicant is calculating the number of employees it has, the applicant must consider the number of employees of any of its affiliates. There are **four tests** for affiliation based on control, which apply to applicants for PPP loans. "Concerns" and "Entities" are affiliates of each other when one controls or has the power to control the other, or where the same third party controls or has the power to control the other.

Affiliation depends on the actual facts involved. Every situation is different. Businesses should carefully review the regulation in its entirety and then review all relevant corporate documents and practices before deciding whether affiliation exists. **The examples below do not cover many situations and cannot be used as the rule for a particular situation.**

## **Test 1: Affiliation based upon Ownership**

Where an individual, concern, or business entity owns or has the power to control more than 50% of the concern's voting equity, affiliation exists.

For example if A owns 51% of Corporation X's voting rights and 51% of Corporation Y's voting rights, then Corporation Y is an affiliate of Corporation X, and the employees of both corporations must be counted in the total number of employees of either corporation's loan application.

The SBA will deem a minority shareholder to be in control (one who owns less than 20% of a concern) only if that shareholder has the ability under the organizational documents, shareholder's agreement, or other written documents, to prevent a quorum or otherwise block action by the Board of Directors or shareholders.

## **Test 2: Affiliation based on Options, Convertible Securities, or Agreements to Merge**

Stock options, convertible securities, and agreements to merge are considered by the SBA to have a present effect (i.e. they are treated as having been exercised for purposes of determining control, regardless of whether such rights have actually been exercised).

For example, if A owns 51% of Corporation X and has a stock option to purchase 51% of Corporation Y, the employees of Corporation X and Corporation Y must be counted in the total number of employees of either corporation's loan application, regardless of whether or not A has exercised its stock option to purchase 51% of Corporation Y, unless the stock option is subject to a condition precedent as outlined below:

If the stock option, convertible security, or agreement is subject to a condition precedent which is incapable of being fulfilled, is speculative, conjectural, or unenforceable under state or Federal law, or where the probability of the transaction occurring can be demonstrated to be extremely remote, it is not given present effect.

Additionally, agreements to negotiate towards the *possibility* of a merger or a sale of stock at some later date are not considered to have present effect.

Finally, the SBA will not give present effect to an individual's, concern's, or other entity's ability to divest all or part of its ownership interest at this time, in order to avoid a finding of affiliation (meaning, one cannot currently divest its ownership interest or control at this time in order to avoid a finding of affiliation).

### **Test 3: Affiliation based on Management**

Where a CEO, President, or other officer, managing member, or partner, controls the management of one or more entities or concerns, then affiliation exists. Additionally, where a single individual, concern, or entity controls a Board of Directors of a concern also controls the Board of Directors of one or more other concerns, affiliation exists. Finally, affiliation exists where a single individual, concern, or entity controls the management of a loan applicant through a management agreement.

For example, if XYZ corporation and ABC corporation share the same CEO, and majority of directors, the two corporations would be affiliates because of the common control over the executive and boards of directors and the employees of both corporations must be counted within the loan application of either corporation.

### **Test 4: Affiliation based on Identity of Interest**

Where relatives operate concerns or entities in the same or similar industries in the same geographic areas, the SBA determines that interests should be aggregated. Individuals and entities can rebut that determination with evidence showing that the interests deemed to be one are actually separate (i.e. two brothers who each own separate companies that grow and process hemp in NC could demonstrate that they do not have any shared ownership, input, management, or control of one another's businesses).

### **PPP Affiliation Rule Waivers**

For PPP only, the affiliation rules above are waived if:

- the business concern is assigned a North American Industry Classification System ("NAICS") code beginning with 72, as of the date on which the PPP loan is disbursed; or
- the business concern operating as a franchise is assigned a franchise identifier code by the SBA; or
- the business concern receives financial assistance from a company licensed under section 301 of the Small Business Investment Act of 1958 (15 U.S.C. 681).

## **Conclusion**

With this new clarification, our position remains unchanged. Remember that the affiliation rule applies even to companies not in the same line of business. Our advice continues to be, "Don't just wing it."

We hope this was helpful information. As always, we will continue to update you as we learn more from our borrower, lender, and legislative contacts.

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