

A LEGAL PROFESSIONAL ASSOCIATION

BUCKLEY KING

1400 FIFTH THIRD CENTER

600 SUPERIOR AVENUE EAST • CLEVELAND, OHIO 44114-2652

T: 216.363.1400 • F: 216.579.1020

www.buckleyking.com

Writer's Email: nagorney@buckleyking.com

April 7, 2020

[This memorandum is not legal advice, and it is intended for general information purposes only]

To: Strategic Planning Group
From: Frank P. Nagorney

RE: Counting Employees of “Affiliates” to Determine Eligibility for PPP Loans

Some questions came up during the Friday session regarding the definition of a “small business” and SBA’s affiliation rules which require the aggregation of employees working for “affiliates”. This is particularly significant for food service and accommodation providers, and franchises where there are numerous affiliates operating at many locations.

The SBA issued an Interim Affiliation Rule regarding PPP on April 3. This rule waives affiliation for (1) any business concern with not more than 500 employees that has a NAICS code beginning with 72 (accommodation and food services); (2) any business concern operating as a franchise that is assigned a franchise identifier code by the SBA; and (3) any business concern that received financial assistance from a SBIC.

All other businesses must include employees of affiliates in determining whether they are a “small business” that is eligible for a PPP loan.

Affiliation Rule. SBA’s Interim Affiliation Rule for PPP sets up four tests to determine affiliations, which include persons controlling more than 50% control of voting equity; control by stock options, convertible debt and shareholder agreements, control by members of the board of directors, key management, and others; identity of interests such as between family members or persons will substantially identical business interests. These affiliation rules are waived for a business with not more than 500 employees that are assigned a NAICS code 72 (food and accommodations); a franchise; or financed by a SBIC. For all other businesses, these affiliation rules need to be taken into account in determining eligibility. A copy of the SBA affiliation rule is attached.

2410230v1

April 3, 2020

AFFILIATION RULES APPLICABLE TO U.S. SMALL BUSINESS ADMINISTRATION PAYCHECK PROTECTION PROGRAM

Four tests for affiliation based on control apply to participants in the Paycheck Protection Program.¹ For purposes of the determining the number of employees of an applicant to the Paycheck Protection Program, the applicant is considered together with its affiliates. Following is a summary of the applicable affiliation tests.

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.

(1) Affiliation based on ownership. For determining affiliation based on equity 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 Chief Executive Officer (CEO) (or other officers, managing members, or partners who control the management of the concern) to be in control of the concern. SBA will deem a minority shareholder to be in control, if that individual or entity has the ability, under the concern's charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders.

(2) Affiliation arising under stock options, convertible securities, and agreements to merge.

(a) In determining size, SBA considers stock options, convertible securities, and agreements to merge (including agreements in principle) to 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.

(b) 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" and are thus not given present effect.

(c) Options, convertible securities, and agreements that are subject to conditions precedent which are incapable of fulfillment, speculative, conjectural, or unenforceable under state or Federal law, or where the probability of the transaction (or exercise of the rights) occurring is shown to be extremely remote, are not given present effect.

(d) An individual, concern or other entity that controls one or more other concerns cannot use options, convertible securities, or agreements to appear to terminate such control before actually doing so. SBA will not give present effect to individuals', concerns', or other entities' ability to divest all or part of their ownership interest in order to avoid a

finding of affiliation.

(3) Affiliation based on management. Affiliation arises where the CEO or President of the applicant concern (or other officers, managing members, or partners who control the management of the concern) also controls the management of one or more other concerns. 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 one of more other concerns. Affiliation also arises where a single individual, concern or entity controls the management of the applicant concern through a management agreement.

(4) Affiliation based on identity of interest. Affiliation arises when there is an identity of interest between close relatives, as defined in 13 CFR 120.10, with identical or substantially, identical business or economic interests (such as 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.

Religious Exemption. The 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.

Waiver. The affiliation rules described above are waived for (1) any business concern with not more than 500 employees that, as of the date on which the loan is disbursed, is assigned a North American Industry Classification System code beginning with 72; (2) any business concern operating as a franchise that is assigned a franchise identifier code by the SBA; and (3) any business concern that receives financial assistance from a company licensed under section 301 of the Small Business Investment Act of 1958 (15 U.S.C. 681).