



CARES Act Provides Relief to Small Businesses: Does that Include Portfolio Companies?

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Note: This article has been updated following Congress' and President Trump's approval on April 24, 2020 of additional funding for small businesses, as well as updated rules and guidelines from the Small Business Administration and the United States Treasury Departments since the Paycheck Protection Program loans were first made available on April 3, 2020.

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act), a sweeping third-wave relief package in response to the COVID-19 pandemic, became law March 27. To read the full overview of the bill, [click here](#).

The Coronavirus Aid, Relief, and Economic Security (CARES) Act (the "Act"), was signed into law on March 27, 2020. That was the third phase of federal legislative relief for the U.S. economy during the onset of the COVID-19 pandemic. That legislation, among other things, provides \$350 billion in relief to small businesses. Since the President signed the Act into law, the Small Business Administration (the "SBA") and United States Treasury Department have subsequently issued rules to clarify which small businesses may be available for such relief under the CARES Act.

The Act creates the Paycheck Protection Program ("PPP"), which makes significant changes to the SBA's current government guaranteed 7(a) Loan and Express Loan programs. The loans will be available through private lending institutions, but 100% guaranteed by the SBA through December 31, 2020, and thereafter reducing to 75% guarantees for loans exceeding \$150,000 and 85% guarantees for loans equal or less than \$150,000.

The SBA began making PPP loans on April 3, 2020, but by April 16, the SBA had run out of the \$349 billion that had been approved for PPP loans and was no longer able to process PPP loan applications. On April 24, in an effort to provide more funds to small businesses and other COVID-19 relief efforts, President Trump approved

Congress' \$484 billion relief spending bill, which allocated an additional \$310 billion to replenish the PPP loan program.

Additionally, with the announcement on April 16 that the PPP funds have been exhausted, borrowers and lenders are turning their attention to the Main Street Lending Program. More information on the Main Street Lending Program can be found [here](#).

We address the most common questions below. Contact us if you have further questions.

What businesses are eligible for PPP loans?

The SBA issued its "interim final rule" on April 2, 2020 to provide guidance on the eligibility requirements for PPP loans, which was updated on April 14, 2020. Further, on April 3, 2020, the Treasury Department clarified the affiliation rules for determining PPP loan eligibility. Additionally, in response to additional application questions, as well as public criticism directed at some notable large companies receiving PPP loans designed for small businesses, on April 24, 2020 the SBA again updated its "interim final rule" with additional explanations and answers to [frequently asked questions](#), and the Treasury Department soon followed on April 26 with additional [guidance and answers](#) to questions. All Treasury Department and SBA guidelines must be considered together in determining an applicant's eligibility under the Act.

In the update to its "interim final rule" effective April 24, the SBA expressly stated that hedge fund and private equity firms are ineligible for PPP loans because they are "primarily engaged in investment or speculation." Firms engaged in investment or speculation are generally deemed ineligible under the SBA's existing regulations for Section 7(a) loans, and the SBA and Treasury Department believes Congress did not intend for such firms to now be eligible under the PPP loans.^[1] As such, private equity firms themselves are generally ineligible for PPP loan under the Act.

However, though private equity firms are ineligible, their portfolio companies may still be eligible for PPP loans depending on whether it qualifies as a "small business". Whether a business entity is eligible for a PPP loan and qualifies as a "small business" varies by,

and depends on, the particular industry of such business.

The size standards are established by the North American Industry Classification System (the “NAICS”) codes assigned to all economic activity within twenty broad sectors, and sub-industries within those sectors.^[2] What constitutes a statutory “small business” is primarily determined by (a) its annual receipts in millions of dollars or (b) its number of employees, in each case, as established by the NAICS relative to that business’ industry standard. Please review the [NAICS](#) table for industry-specific annual receipts maximums or employee-based maximums.

Businesses whose size-standard is based on annual receipts in millions of dollars are generally in the agriculture, construction, retail and finance or insurance industries, among others. The maximum allowed dollars for businesses in these industries can vary widely depending on the industry, with the range being anywhere between \$1 million and \$41.5 million, though certain financial institutions are measured on the aggregate amount of their total assets.

For businesses whose size-standard is based on employees, generally the number of employees is capped at 500, but the NAICS lists a number of industries with a greater number of employees allowed. By way of example, a number of sub-sectors within the energy and manufacturing industries have a higher cap on the number of employees as established by the NAICS, including, without limitation: (i) Natural Gas Extraction and Petroleum Crude Extraction (each allowed up to 1,250 employees); (ii) Pipeline Transportation of Crude Oil (1,500 employees); (iii) Drilling Oil and Gas Wells (1,000 employees); (iv) Breweries, Wineries and Distilleries (each allowed up to 1,000 employees); (v) Farm Machinery and Equipment Manufacturing (1,250 employees); and (vi) Iron and Steel Mills and Ferroalloy Manufacturing (1,500 employees). A smaller subset of industries had their maximum number of employees capped at less than 500 by the NAICS (e.g., 250), but the CARES Act expands that cap to 500 for the entities in such industries for PPP loan purposes. The SBA considers “employees” to be all individuals employed on a full-time, part-time, or other basis, so long as that individual works a minimum of 40 hours per month.

Additionally, applicants for SBA loan programs, including PPP loans, typically must include their “affiliates” when applying the employee-based or revenue-based size standard, as the case may be. As mentioned, on April 3 the Treasury Department stated that borrowers of PPP loans are also subject to the affiliation rules contained in 13 CFR §121.301, which outlines a common control standard used to determine whether entities are affiliates of each other.^[3] Under 13 CFR §121.301, there are four circumstances reviewed to determine affiliation, and affiliation under any of such circumstances is sufficient to establish affiliation for applicants for PPP loans. The four circumstances are: (1) Affiliation based on ownership, (2) Affiliation arising under stock options, convertible securities, and agreements to merge, (3) Affiliation based on management, and (4) Affiliation based on identity of interest.^[4] Each of the four circumstances is summarized as follows:

- For affiliation based on ownership, an entity 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; *provided, however*, the SBA will deem a minority shareholder to be in control, if that individual or entity has the right or 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. However, if such minority shareholder irrevocably waives or relinquishes such right or ability, the minority shareholder would no longer be an affiliate of the business (assuming no other relationship that triggers the affiliation rules).
- For affiliation arising under stock options, convertible securities, and agreements to merge, the SBA treats such options, convertible securities, and agreements as though the rights granted have been exercised and considers them to have a present effect on the power to control a concern.
- For affiliation based on management, affiliation arises where:
 - (i) 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, (ii) 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, or (iii) a single individual, concern or entity controls the management of the applicant concern through a management agreement.

- For affiliation based on identity of interest, affiliation arises when “close relatives” share identical or substantially identical business or economic interests.

Ultimately, it is the entity seeking a PPP loan that must certify it meets criteria of a small business. As such, private equity sponsors and their portfolio companies will need to be mindful of these affiliation tests and carefully review their governing documents, financial statements, capitalization tables and management agreements, among other facts and circumstances, to determine whether affiliation exists. If affiliation is deemed under any of these four circumstances, the applicant portfolio company will need to total its revenues or employees, together with the private equity sponsor and the employees of the other portfolio companies controlled by the same sponsor. As such, under these affiliation rules, it may be difficult for private equity sponsored portfolio companies to meet the applicable size standards in order to qualify for PPP loans.

However, the CARES Act waives the affiliation requirement for the following applicants:

- Businesses within NAICS Code 72 (The Accommodation and Food Services sector comprising establishments providing customers with lodging and/or preparing meals, snacks, and beverages for immediate consumption.) with no more than 500 employees per physical location
- Franchises with codes assigned by the SBA, as reflected on the SBA franchise registry
- Businesses that receive financial assistance from one or more small business investment companies (SBIC)
- 501(c)(19) veteran organizations

- 501(c)(3) nonprofits (e.g., charitable, religious or educational organizations)
- Sole proprietors
- Independent contractors
- Other self-employed individuals

Additionally, an entity may be eligible under the PPP if, as of March 27, 2020, such entity meets both prongs of the SBA's "alternative size standard": (1) the maximum tangible net worth of such business is not more than \$15 million; and (2) the average net income after Federal income taxes (excluding any carry-over losses) of such business for the two full fiscal years before the date of the application is not more than \$5 million. Finally, the Treasury Department noted in its guidelines on April 26 that, in addition to existing statutory small business concerns, "a business is eligible for a PPP loan if the business has 500 or fewer employees whose principal place of residence is in the United States[.]" However, it is not clear from these guidelines whether a business who has employees with a principal residence outside of the United States contribute to the overall cap on number of employees.

In sum, while private equity firms themselves are not eligible to receive PPP loans, private equity sponsored portfolio companies may still be eligible if such portfolio companies: (A) (i) fall into the above-listed exceptions, (ii) together with their "affiliates", as determined under one of the four applicable tests outlined above, meet the statutory revenue-based or employee-based size standard as established the NAICS for the applicant's industry, or (iii) meet both prongs of the "alternative size standard", and (B) meet the other eligibility criteria as described in more detail below.

What other criteria must an entity meet to be eligible?

Applicants do not have to have a minimum credit score or show an ability to repay the PPP loans. However, applicants for PPP loans should carefully review the eligibility criteria under the Act and the guidelines issued by the SBA and the Treasury Department as each applicant must certify its eligibility on a [Borrower Application Form](#)

in order to be approved for a PPP loan. Applicants must meet the following criteria, among others, and must be to certify the same in the Borrower Application Form:

- The business must have been operational on February 15, 2020.
- The business had employees for whom they paid salaries and payroll taxes or paid independent contractors.
- Other applicant certifications include, without limitation: (i) current economic uncertainty makes the loan request necessary to support the ongoing operation of the business, (ii) it will use the loan proceeds to keep employees and make payroll and other permitted payment obligations, and (iii) such business is eligible to receive a PPP loan, which certification means that the business qualifies as a “small business concern”, after applying the affiliation rules (if applicable), or meets one of the permitted exceptions or exclusions.

All certifications in the Borrower Application Form must be made truthfully and in good faith, as the application states that “that knowingly making a false statement to obtain a guaranteed loan from SBA is punishable under the law,” which could result in civil, and possibly criminal, penalties for the applicants. In particular, the certification that “current economic uncertainty makes the loan request necessary to support the ongoing operation of the business” has been the subject of much discussion and scrutiny, as large publicly traded companies that have other means of raising capital have received PPP loans intended for small businesses. In its update to the “interim final rules” on April 24, the SBA reiterated this required certification for all applicants and noted in particular that private equity sponsored portfolio companies should carefully review that certification (along with the “affiliation” rules) to determine if they are eligible. The SBA’s updated interim final rule also advised that in making this required certification, the applicant makes this certification in its sole discretion and must be able to do so in good faith, taking into account its current business activity and its “ability to access other sources of liquidity to support their ongoing operations in a manner that is not significantly detrimental

to the business.” Additionally, Treasury Secretary Steven Mnuchin announced on April 28 that any business receiving more than \$2,000,000 in PPP loan proceeds will be subject to a full review by the SBA if there is loan forgiveness.

Accordingly, if applying for a PPP loan, each private equity sponsored portfolio company should carefully evaluate its (i) current business activity, (ii) its access to liquidity and other sources of capital, and (iii) whether a PPP loan is necessary to support its ongoing business. If an applicant does receive PPP loan proceeds, it should keep detailed records regarding the use of such proceeds and should be prepared to explain and justify their certification that the loan was necessary to support its business due to economic uncertainty at the time the application was submitted.

However, in the event an applicant believes it was or is ineligible, the SBA in its update on April 24 also stated that there would be a “safe harbor” for applicants who applied for a PPP loan prior to April 24 but who repay all loan proceeds received in full prior to May 7, 2020. The SBA further explained that this “safe harbor” is designed to encourage repayment of the loans by applicants who obtained loans based on “a misunderstanding or misapplication of the required certification standard.” As such, such applicants will be deemed to have made the required certifications in “good faith.”

What can the loans be used for?

The following expenses incurred between February 15, 2020 through June 30, 2020:

- Payroll costs
 - excluding the costs of any individual employee annual salary in excess of \$100,000 in cash consideration and the compensation of employees whose principal residence is outside of the US
 - **It is important to note at least 75% of the loan must be used to pay payroll costs.**

- Costs related to the continuation of group health care benefits during periods of paid sick, medical or family leave, and insurance premiums
- Mortgage interest for a mortgage in place before February 15, 2020
- Rent for a lease in place before February 15, 2020
- Utility payments for service incurred before February 15, 2020
- Interest on other debt obligations entered into before February 15, 2020

What are the loan terms?

- Up to \$10,000,000, but will be based on a calculation of two and half times the business's average total monthly payroll costs during 2019, with certain restrictions as to what constitutes payroll costs^[5]
- Term of 2 years
- Interest rate of 1%
- SBA's standard fees are waived
- No personal guarantee from the business owner is required
- No collateral is required

Can the loan be forgiven?

Yes, part of the loan is eligible for forgiveness. The Act creates a system to determine how much may be forgiven. In general, the forgiveness program has the following aspects:

- Forgiveness is available in an amount equal to the amount spent by the borrower during an 8-week period after the loan closing date on payroll costs, mortgage interest, interest on other debt, rent obligations, and utility payments, that were in place before February 15, 2020. Only up to 25% of the loan amount will be forgiven for funds used to pay mortgage interest, rent obligations, utility payments and interest on other debt.

- There are caveats and statutory calculations governing forgiveness. For example, payroll expenses for employees earning above \$100,000 (prorated to the covered period) are not forgiven.
- The forgiven amount is reduced proportionally by any reduction in employees retained or in the pay of any employee (beyond 25% of prior compensation).
- Borrowers that re-hire workers previously laid off from February 15 through April 1, 2020 will not have those numbers counted against them during such period for loan forgiveness purposes, so long as they are rehired by June 30, 2020.
- The forgiven amount will not be included in the borrower's taxable income for this year.
- The SBA will purchase the forgiven amount of the loan from the lender.

Can loan payments be deferred?

Yes, lenders will be required to provide deferment relief for a period of six months.

How does the CARES Act impact the Economic Disaster Loan program?

The CARES Act formally waived certain existing provisions of the SBA's existing Economic Injury Disaster Loan ("EIDL") program and expanded its availability to certain eligible borrowers. Additionally, as part of the additional relief package on April 24, 2020, the EIDL program received additional funds totaling \$60 billion. If a business previously received an EIDL loan, the CARES Act allows it to be refinanced under the Paycheck Protection Program under certain conditions. The EIDL must be refinanced under the Paycheck Protection Program if it was used to pay payroll costs. Further, PPP funds and EDIL funds cannot be used for same purposes.[\[6\]](#)

Do you have an existing SBA 7(a), 504(b) or microloan?

The SBA will require lenders to provide payment deferments and will, to avoid balloon payments or other adverse consequences to borrowers, make the requisite payment on these loans to the lender for a six-month period.

What should you do next?

If you have any further questions, please contact [Austin Conner](#), [Dylan Grafe](#), [Eddy Moore](#) and [Becky Moore](#) or any attorney in Frost Brown Todd's [Financial Services](#) or [Private Equity](#) Industry Teams, or contact your bank about available options.

The impact of COVID-19 is impacting small businesses in different and unexpected ways. If you have any other coronavirus questions, please view Frost Brown Todd's [Coronavirus Response Team](#) page and review the numerous articles available.

To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a Coronavirus Response Team, including a special team focusing on SBA financial assistance under the CARES Act. Our attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.

[1] See 13 CFR § 120.110 for additional factors that make businesses ineligible for SBA business loans.

[2] See 13 CFR §121.201.

[3] 13 CFR §121.301(f): "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."

[4] See 13 CFR §121.301(f).

[5] For businesses that were not in operation during 2019 they may elect to use January 1, 2020 through February 29, 2020. Seasonal businesses may elect to use other dates, as well.

[6] Additional information on the Emergency Economic Injury Disaster Loan Program and a comparison to the Paycheck Protection Program can be found [here](#).

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