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SBA Loan Guidance Doesn't Resolve Fate Of Venture Startups

By **Tom Zanki**

Law360 (April 6, 2020, 7:47 PM EDT) -- The Small Business Administration has provided guidance indicating that its affiliation rules will not bar religious organizations from seeking coronavirus relief loans, although its latest clarification does not address the status of venture-backed startups potentially stuck in limbo.

The SBA said Saturday that otherwise qualified faith-based organizations can apply for relief loans authorized under the Coronavirus Aid, Relief and Economic Security Act, or CARES, Act. The estimated $2 trillion relief package contains a $349 billion provision known as the Payroll Protection Program, or PPP, designed to save small business jobs during the pandemic.

The SBA's primary loan program is normally limited to for-profit small businesses, but the PPP specifies that not-for-profit organizations are eligible for relief subject to the SBA's affiliation rules. The SBA's latest guidance states that faith-based groups can seek loan relief exempt from affiliation rules that can limit eligibility.

The SBA cited the Religious Freedom and Restoration Act plus Supreme Court precedents that conclude the government should not "substantially burden" an organization's religious exercise unless there is a "compelling public interest" and no less restrictive ways to further that interest.

"The administrator has also concluded that she does not have a compelling interest in denying emergency assistance to faith-based organizations that are facing the same economic hardship to which the CARES Act responded and who would be eligible for PPP but for their faith-based organizational and associational decisions," the SBA said in an interim final rule posted online.

SBA Administrator Jovita Carranza said in a separate statement on Saturday said that "faith-based organizations have always provided critical social services for people in need, and SBA will make clear that these organizations may access this emergency capital."

While the SBA's latest action clarified the status of religious entities seeking CARES Act relief, it did not address whether certain venture-backed startups or private-equity backed small businesses may obtain relief from how the agency traditionally applies its affiliation rules. The uncertainty has raised questions about whether certain startups will miss out on PPP loans.

SBA affiliation rules consider a borrower together with its affiliates to determine eligibility for loans.

Such rules are in place to assure that large companies don't obtain aid intended for small companies. An entity must employ 500 or less workers to be eligible for relief aid under the PPP.

However, attorneys say some small businesses are backed by venture capital or private equity firms that own stakes in portfolio companies that combined employ more than 500, even though an individual startup seeking a loan may employ less. The SBA uses certain criteria to determine if a shareholder has sufficient control over a business before its affiliation rules kick in.

Attorneys said have sought clarity from the Treasury Department and SBA as to how affiliation rules will apply to venture or private-equity backed businesses that may fall into a gray area.

"There are still a lot of hard working people who are left out in the cold through no fault of their own," Manatt Phelps & Phillips LLP partner Brian Korn said, referring to employees of startups that are owned largely by several venture capital or private equity investors.

Messages to the Treasury Department and SBA were not immediately returned on Monday.

Loans under the CARES Act's PPP program can be forgiven fully if companies use proceeds on payroll costs, and most mortgage interest, rent, and utility costs over eight weeks after the loan is made. Companies can borrow up to $10 million at 1% interest and maturity of two years.

Politicians, including House Speaker Nancy Pelosi, D-Calif., and House Minority Leader Kevin McCarthy, R-Calif., are also lobbying the federal government to assure that venture-backed and private equity firms can participate in the PPP without being tripped by affiliation rules. The National Venture Capital Association is also pressuring the Treasury Department to clarify relief aid rules.

As of Monday afternoon, the SBA had not waived or relaxed its affiliation rules for PPP loan applicants with venture capital or private equity backing. The agency began accepting relief loan applications on Friday and will take requests through June 30.

"Companies are frantic and rushing through the application without a basic understanding of eligibility because the loans are available on a first-come, first-served basis," Crowell & Moring LLP partner Amy Laderberg O'Sullivan said. "This is virtually guaranteeing a wave of audits, investigations, and enforcement actions once we are through the current crisis."

Korn noted that venture-backed firms can seek aid under a separate provision of the CARES Act known as the Economic Injury Disaster Loans program, which provides cash advances for certain emergencies. Terms are considered less favorable than loans available under the PPP.

--Editing by Jay Jackson Jr.