

> Covid-19 Client Alert

CARES Act Update - New PPP Guidance on Access to Liquidity Considerations, Private Equity Firms, Hedge Funds and ESOPs

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On April 24, 2020, the U.S. Department of the Treasury (the “Treasury Department”) issued [guidance](#) (the “Guidance”) for businesses intending to apply for a loan under the Payroll Protection Program (the “PPP”) established under the Coronavirus Aid, Relief, and Economic Security Act (the “Act”). In addition, yesterday, April 28, 2020, the Small Business Administration (the “SBA”) and the Treasury Department updated their [questions and answers](#) (the “Q&As”) with respect to the PPP. Our prior client alert on the Act is available [here](#). Below are key highlights from the Guidance and updates to the Q&As.

PPP Applicants Must Consider Current Business Activities and Access to Liquidity in Making Loan Certifications

The Guidance and most recent Q&As signaled that businesses owned by either private companies or large companies with adequate sources of liquidity to support their ongoing operations will need to be prepared to justify their certification that the PPP loan request is “necessary to support the ongoing operations of the Applicant.” The Q&As note that “it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith, and such a company should be prepared to demonstrate ... the basis for its certification.” The Guidance states that borrowers that previously applied for a PPP loan but do not believe they can meet the standard in light of the latest Guidance can rely on a limited safe harbor and avoid scrutiny by repaying the loan by May 7, 2020. It is not clear how the rationale underlying this guidance may effect smaller employers; whether, for example, the business needs be under an imminent existential threat to justify a PPP loan. The purpose of the Act would appear to be served if an employer takes a loan to avoid pending layoffs or salary cuts, even if the business is not threatened with immediate closure, absent the PPP loan. Should the SBA later decide that a smaller employer was not justified in taking the PPP loan, the likely consequence (apart from adverse publicity) would be having to repay the loan, rather than having it forgiven.

Private Equity Firms and Hedge Funds are Likely Ineligible for PPP Loans

The Guidance clarifies that hedge funds and private equity firms are primarily engaged in investment or speculation and are therefore ineligible to receive a PPP loan.

Private Equity Portfolio Companies are Required to Comply with Affiliation Rules and Required Certification

The Guidance states that the SBA's affiliation rules apply to private equity-owned businesses in the same manner as any other business. For purposes of these rules, the employees of a business's affiliates are included in its employee number, potentially tipping both that business and other businesses controlled by the same parties over the 500 employee loan-eligibility threshold. The SBA's affiliation rules define "control" more broadly than being a majority owner. For example, a minority owner that has blocking rights over a company's board or shareholder actions may be deemed to "control" that company. The Guidance notes that the Act waives the affiliation rules if the borrower receives financial assistance from an SBA-licensed Small Business Investment Company in any amount.

The Guidance also mentions that a private equity-owned business should "carefully review" the above-discussed required certification that "[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant."

ESOP Sponsors are not Affiliated with their ESOPs for PPP Loan Purposes

Finally, the Guidance states that a business sponsoring an employee stock ownership plan (ESOP) for its employees is not affiliated with its ESOP for purposes of PPP loan eligibility. So, ESOP sponsors do not need to consider the value of the assets held in the ESOP trust in determining their need for a PPP loan, including the required certification of necessity discussed above.

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Morrison Cohen LLP has created the [COVID-19 Resource Taskforce](#), a multidisciplinary taskforce comprised of attorneys with deep expertise in a broad range of legal areas, to assist clients navigating the challenging and uncertain business and legal environment caused by the COVID-19 pandemic. We encourage clients to utilize our capabilities by reaching out to their primary Morrison Cohen attorney contact, who will put you in touch with the appropriate Taskforce person. You may also reach out directly to Joe Moldovan and Alec Nealon, the Taskforce co-chairs:

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