Private Equity and COVID-19 Federal Support:

To Receive or Not To Receive?

While much attention has been paid in recent weeks to how the COVID-19-induced downturn will affect specific companies and workers across the US, considerably less attention has been focused on the dangers of any slowdown for private equity (PE) firms. PE firms collectively invest in hundreds of portfolio companies spread across every segment of the United States economy, and their investments directly employ almost nine million people. Ensuring that these firms continue to support companies and employ large numbers of workers should be of critical importance for policymakers.

For PE General Partners, it might be tempting to forestall plummeting portfolio valuations and potential liquidity concerns by asking portfolio companies to turn to federal assistance. This question is especially salient following the passage of the $2 trillion Coronavirus Aid, Relief, and Economic Security (CARES) Act, which set aside more than $375 billion in grants and loans to small businesses which will be administered by the Small Business Administration (SBA).

But what are the considerations that GP's and portfolio companies alike need to make as they navigate (often for the first time) the minefield that is the federal bureaucracy? And most importantly, would receiving such assistance be helpful for funds' long-term goals?

Our experts have compiled a few thoughts that PE-backed companies and their owners should consider when making that determination.

Navigating the Funding Process

To date, the U.S. Congress has passed three bills to support businesses, individuals, state and local governments as a result of the COVID-19 crisis: the Coronavirus Supplemental Funding Bill (March 6, 2020), the Families First Coronavirus Response Act (FFCRA) (March 18, 2020), and the Coronavirus Aid, Relief, and Economic Security Act (CARES) (March 27, 2020). The first

two bills were aimed at providing assistance to individuals and governments, while the third bill is commonly considered a "stimulus" bill for businesses.

Step One: Determine Eligibility

The first consideration for PE-backed companies in applying for federal assistance concerns eligibility. The CARES Act aid targeted at small businesses includes three programs:

1. The Paycheck Protection Program ($349 billion) to provide payroll relief by way of forgivable, federally guaranteed loans;
2. (B) Economic Injury Disaster Loans ($10 billion) to provide aid to businesses that suffer substantial economic injury as a result of the declared disaster; and
3. Relief ($17 billion) for borrowers with existing SBA loans.

The first eligibility hurdle is employee headcount. With limited exceptions, to qualify as a small business, a business must have fewer than 500 employees. While this might seem as though individual portfolio companies might qualify for SBA programs under this threshold, the second hurdle is the SBA's affiliation rule, which means that PE-owned companies are considered "affiliated" with all the PE firm's other portfolio companies. If a portfolio company has 300 employees but is owned by a PE firm whose portfolio companies employ a total of 1,000 people, the total number of employees across all portfolio companies is the relevant headcount.

An exception to this threshold applies to the "Accommodation and Food Services" sector, as defined by the North American Industry Classification System (NAICS). These businesses, such as hotels, motels, and restaurants, have a threshold of 500 employees for each physical location of the business. The only two other exceptions to the affiliation rules apply to SBA-approved franchise businesses and businesses that have received funds under the Small Business Investment Act.

Businesses that meet the eligibility standards to participate in the PPP may qualify for a loan up to $10 million determined by eight weeks of prior average payroll plus an additional 25% of that amount, with loan payments deferred for six months, and possible loan forgiveness options.

If a PE-backed portfolio company does not meet the eligibility standards for the PPP, they should consider other CARES Act programs that will be established by the Department of Treasury and announced in the coming days and weeks.

Step Two: Seek Out an SBA Lender

Eligible portfolio companies can participate in the PPP by applying through any existing SBA 7(a) lender or through any federally insured depository institution, federally insured credit union, and Farm Credit System institution that is participating. All loans will have the same terms regardless of lender or borrower. A list of participating lenders as well as additional information and full terms can be found at www.sba.gov.

Step Three: Consider What Makes The Business Unique

Businesses navigating the funding process should consider how to differentiate themselves from the rest of the pack. With some estimates saying there may be as many as several million grant applications for loans and grants tied to the CARES Act, communicating what differentiates a company from its peers and how a company is uniquely positioned to utilize those funds will be crucial for a successful application.

Step Four: Consider Loan Forgiveness Restrictions

In order to be eligible for loan forgiveness under the PPP, businesses must limit the use of the funds to specific financial obligations: for payroll costs (salary wages, commissions and tips capped at $100,000 for each employee), interest on mortgages, rent, and utilities. Due to likely high subscription, at least 75% of the forgiven amount must have been used for payroll. Forgiveness is based on the employer maintaining or quickly rehiring employees and maintaining salary levels. Forgiveness will be reduced

if full-time headcount declines, or if salaries and wages decrease.

Step Five: Assess Internal Risk Management Functions

In the long-term, companies must ask themselves how such assistance fits in with their strategic goals. Portfolio companies not eligible for PPP funds may consider pursuing funds made available in the near future under the Treasury Department loan programs. For oversight of these Treasury programs, the CARES Act also established a Special Inspector General for Pandemic Recovery (SIGPR) and a congressionally-appointed Oversight Commission. Both entities will conduct audits and investigations related to loans, loan guarantees, and other investments made by the Treasury Department, and companies receiving these Treasury funds should consider what impact such high-profile scrutiny will have on their business. Prior to applying for government assistance, a company should assess its ability to handle government investigations tied to the company's use of the funds. To prepare for this possibility, a company should coordinate its investor relations, legal, compliance, and communications teams to anticipate government interaction. Doing so will proactively prevent such challenges from arising and ensure that each team is prepared to handle incoming inquires.

Final Thoughts

Seeking and accepting federal assistance will prove to be a complicated process for PE-backed firms, and the restrictions on the use of those funds must be well-understood and followed in order to protect against investigations and litigation risks. However, even after these challenges are successfully navigated, there will be reputational backlash after the COVID-19 crisis passes, particularly for companies that accepted government assistance. The governmental investigations that occurred into the financial services and automotive sector after the financial crisis of the last decade may pale in comparison to what will transpire in the aftermath of this COVID-19 crisis.

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