



April 1, 2020

The Honorable Steven Mnuchin
Secretary of the Treasury
U.S. Department of Treasury
1500 Pennsylvania Avenue N.W.
Washington, D.C. 20220

The Honorable Jovita Carranza
Administrator
U.S. Small Business Administration
409 3rd Street S.W.
Washington, D.C. 20416

Dear Secretary Mnuchin and Administrator Carranza:

I write to express the views of the startup community regarding the rollout of the Paycheck Protection Program (PPP). With the first details issued yesterday, many startups are increasingly concerned that they will be either explicitly or *de facto* excluded from this program. I urge the agencies to modify the representation and certification requirements to accurately reflect the appropriate role of minority investors in corporate governance, and issue clear rules on affiliation so that banks can quickly and confidently process applications of small businesses with equity investors.

Startups are as vulnerable as other small businesses to this economic crisis. Because such a high percentage of their operating expenses are payroll, the questions raised in this letter are critical to protection of middle-class jobs during this crisis.

Affiliation Rules

The Small Business Administration's (SBA) affiliation rules are a fact dependent set of rules that look to the individual investor rights of minority investors in small businesses to determine whether those minority investors have rights that trigger affiliation. Given the unprecedented scale of PPP and the desperate need for distribution of funds to save jobs, it is doubtful that companies with ownership structures that are anything but completely clear of affiliation will have practical access to the loan programs. The significant amount of due diligence and legal review required for most VC-backed startups to determine affiliation status in their investor base will likely preclude them from even applying as a practical matter, needlessly putting at risk

potentially hundreds of thousands of jobs. Therefore, it is imperative that SBA and Treasury issue clear affiliation guidance that allows startups to access PPP.

Questions Regarding Application Representations and Certifications

Yesterday's release of the PPP application has caused significant confusion in the startup ecosystem. The questions, representations, and certification requirements for minority investors with more than 20 percent ownership included in the loan application do not accurately reflect the authority that minority investors have in a company ownership structure. Moreover, some of them are virtually impossible for companies to confirm with respect to their 20 percent owners, on the one hand, and 20 percent owners to confirm about their companies, on the other hand, at least in a timely way to permit loan applications to be submitted. Without changes, these application requirements will render many startups ineligible for the program as a practical matter.

We have five concerns on these issues for which we respectfully request immediate clarity:

Requirement that minority investors represent and certify actions of the company outside of investors' control

The *Representations and Authorizations* and *Certifications* sections of the PPP application include several commitments that must be made by the applicant and any 20 percent or greater owners. For instance, the application asks minority shareholders to certify—under criminal penalty—that “The funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments.” This representation asks a minority shareholder to make a representation about an action the *company* will take or not take in the future, when in fact minority investors do not have control of day-to-day operations. While minority investors commonly have seats on boards of directors and the ability periodically to monitor and vote on actions of the company, they have nothing remotely approaching the ability to control the actions of company management on a day-to-basis. The board can sanction the executive team for illegal or unethical behavior after the fact, but they cannot *prevent* such actions as they do not actually control the company. Asking that minority investors certify under the possibility of federal criminal prosecution certain actions that are not under their control places them in an impossible position: deny the company they believe in and support the funds they need to retain workers or risk criminal prosecution for actions outside of their control.

Requirement that companies certify information concerning its 20 percent owners

The PPP application also has a number of certifications that companies are required to make about their 20 percent owners. For example, Question 2 states, “Has the Business, any of its owners, or any business owned or controlled by any of them, ever obtained a direct or guaranteed loan from SBA or any other Federal agency that is currently delinquent or has defaulted in the last 7 years and caused a loss to the government?” Making this representation would require a VC-backed company to ascertain whether any other portfolio company of any VC that owns 20 percent of the company has defaulted on an SBA loan within the past 7 years. In many cases obtaining that kind of information will be a practical impossibility.

Confusion caused by application of the affiliation rules to minority investors

We are also concerned with the contradiction in the program that arises from the requirement that all investors in small businesses in excess of a 20 percent ownership certify that the company will comply with various requirements with the program, while at the same time current application of the SBA's affiliation rules may require that minority investors give up the very rights that allow them any oversight at all over these actions. For example, as stated above, the second requirement in the list of certifications requires minority investors to certify that "The funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments," followed by the potential for federal criminal charges for unauthorized use. However, current administration of the affiliation rules often finds that minority investor rights to block dividends and distributions, as well as other rights to have input on the use of funds, creates control and thus affiliation. This creates a contradiction where the SBA clearly wants minority investors to provide oversight of the funds distributed to the company, while at the same time also requiring that they relinquish the very controls that give them the ability to do so. It is important to note that the government and minority investors interests that the funds be used to save jobs and support the business are fully aligned.

Confusion regarding the purpose of the 20 percent threshold on the application

We are also concerned that the PPP application form creates the impression that minority owners between 20-50 percent of ownership may trigger the affiliation rules based upon percentage of ownership alone. Our understanding is that, for purposes of PPP loans, affiliation for investors with less than 50 percent ownership will be determined by the control rights of individual investors or specific funds, and not solely by percentage ownership. Whether this is the case or not, interpretation by banks or small businesses that such ownership automatically triggers affiliation could cause many to be denied or to forego application entirely, and resort to the very layoffs that PPP is intended to prevent. We request immediate clarity that the percentage threshold included in the application is only designed to create a clear exemption for those owners with less than the requisite percentage ownership from questions, representations, and certifications, and is not a potential test of affiliation based on ownership unto itself.

20 percent threshold is encouraging proposal but inadequate for startups

If the 20 percent threshold in the application truly does only relate to an exemption for all owners with less than 20 percent of ownership from the questions, representations and certifications, we request that the rule to be expanded to also exempt these investors from the SBA's affiliation rules. We are encouraged to see establishment of such a bright line test in the application and think that as a concept effective application could in fact improve the effectiveness of the PPP. However, the low percentage threshold would still leave most startups exposed, as many will have minority investors who have ownership stakes in excess of 20 percent. We strongly encourage the SBA to expand this bright line threshold to questions of affiliation, and utilize thresholds similar to the Small Business Innovation Research (SBIR) program, where ownership thresholds up to 40 percent are presumed exempt from affiliation, and only those owners between 40-50 percent ownership must provide information on their ownership rights..

Conclusion

It is imperative startups and the banks who will service the loans understand that these small businesses will be eligible for PPP. We request that you update the application before businesses can apply and include in guidance clear rules that take into account the real-world role of minority investors. Rather than requiring them to make representations and certifications on actions they do not control, we request instead that minority investors be empowered to support SBA's efforts for taxpayer protections by providing clear application of the affiliation rules that allows them to conduct *appropriate oversight* of the company, while avoiding requirements that these investors create criminal legal exposure for actions over which they have no control. Congress has created an incredibly powerful job retention program that, if effective, will save millions of jobs across America. Immediate clarity to the questions raised in this letter are critical to the ability of startups to preserve jobs through the economic crisis created by COVID-19.

On behalf of our members and American startups, I urge swift action to make clear to these companies that they will be able to access this program, which will provide them confidence that the broad layoffs under consideration may not be necessary.

Thank you for your prompt attention to this important matter.

Sincerely,

A handwritten signature in cursive script that reads "Bobby Franklin".

Bobby Franklin
President and CEO