

IS YOUR BUSINESS ELIGIBLE FOR DISTRESSED INDUSTRY RELIEF UNDER THE CARES ACT?

Hodgson Russ Banking & Finance Alert
March 30, 2020

On March 27, 2020, President Trump signed into law H.R. 748, titled the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”), a \$2 trillion economic stimulus package that includes public health spending, immediate cash relief for individuals, and loans for businesses.

Title IV of the CARES Act, the “Coronavirus Economic Stabilization Act of 2020” (“Title IV”), provides up to \$500 billion in relief for states, municipalities, and severely distressed industries. Specifically, Title IV provides loans, loan guarantees and other investments in support of “eligible businesses,” which include air carriers and other United States businesses that have not otherwise received adequate economic relief in the form of loans or loan guarantees provided under the CARES Act. For information on CARES Act loan programs to be provided through the Small Business Administration, please see our companion alert [here](#).

Title IV loan programs are provided through two distinct programs: (1) loans and loan guarantees for air carriers and businesses critical to maintaining national security (the “Air Carrier and National Security Program”), and (2) loans, loan guarantees, and other investments administered through Federal Reserve programs and facilities to support financial institutions in lending to eligible businesses, states and municipalities (the “Federal Reserve Program”).

Further details on the programs and application procedures are required to be published by the Secretary of the Treasury (“Secretary”) by April 6, 2020. This alert summarizes the material eligibility criteria, terms, and restrictive covenants included in the CARES Act for any potential beneficiaries under each of these programs.

Air Carrier and National Security Program

Who is eligible?

Title IV allocates the following funds in loans and loan guarantees: (1) \$25 billion for air carriers, eligible businesses holding a Federal Aviation Administration Air Agency Certification (approved to perform inspection, repair, replace or overhaul services), and ticket agents; (2) \$4 billion for cargo air carriers; and (3) \$17 billion for businesses critical to maintaining national security.

Attorneys

Jessica Chue
Krystal Daniels
Christofer Fattey
Amy Fitch
Andrea Gervais
Valerie Stevens
Brianna Szopinski
James Thoman
Sujata Yalamanchili

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An applicant to this program must:

- be created or organized in or under the laws of the United States, and have significant operations in and a majority of its employees based in the United States;
- be an “eligible business”, as defined above, for which credit is not otherwise reasonably available at the time of the loan transaction;
- have incurred, or is expected to incur, losses directly or indirectly as a result of coronavirus such that the continued operations of the business are jeopardized.

Additionally, the Secretary must deem the intended obligation “prudently incurred”; in other words, some basic underwriting standards must apply.

What are the terms of the loans under this program?

Interest Rates. The Secretary will determine interest rates under the program based on the risk of the loan or loan guarantee, whether the loan is secured, comparable current average yield on marketable obligations of the United States of similar maturity, and market rates for comparable obligations prior to the COVID-19 outbreak.

Mandatory Warrants or Equity. A publicly-traded eligible business must issue a warrant or equity interest in that company to the Department of Treasury in support of any obligation under this program, provided that the Secretary may accept a senior debt instrument if a warrant or equity interest is not feasible. A non-publicly traded eligible business must issue either a warrant, equity interest, or senior debt instrument in support of its obligations.

Maturity. Loans and loan guarantees under this program must be as short as practicable and in any case not longer than five years.

Other Terms. The principal amounts of any obligation issued by an eligible business cannot be forgiven, and all loans made or guaranteed by the Department of Treasury will be treated as indebtedness for tax purposes.

What are the conditions and restrictive covenants under this program?

The loan or loan guarantee agreements must contain the following conditions and restrictive covenants:

No Buy-backs. Borrowers and their affiliates cannot purchase their own (or their parents’) publicly-traded stock while the loan is outstanding and for a period of 12 months thereafter, unless the borrower was bound by a contractual obligation to buy-back the equity on March 27, 2020;

No Dividends or Distributions. Borrowers may not pay dividends or make other capital distributions on common stock while the loan is outstanding and for a period of 12 months thereafter;

Employment Levels. Until September 30, 2020, the borrower must maintain employment levels of at least 90% of those in effect on March 24, 2020; and

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Executive Compensation. While the loan is outstanding, and for a period of 12 months thereafter (the “Restricted Period”), the total compensation of the borrower’s executives will be limited. Specifically, for employees with total compensation (including salary, stock, and bonuses) in calendar 2019 greater than:

- \$425,000 *per year*, during the Restricted Period such employee’s compensation in any consecutive 12 month period cannot exceed 2019 levels, and such employee cannot receive severance upon termination of more than two times 2019 total compensation;
- \$3,000,000 *per year*, during the Restricted Period such employee’s compensation in any consecutive 12 month period cannot exceed an amount equal to \$3,000,000 *plus* 50% of the excess of 2019 total compensation over \$3,000,000.

Mandatory Continued Operation. The Secretary is authorized to require the continued operation of air carriers who receive loans under this program, and when considering whether to exercise this authority, will consider the air transportation needs of small and remote communities and the need to promote health care and pharmaceutical supply chains.

Federal Reserve Program

Who is eligible?

The Federal Reserve Program allocates \$454 billion, plus any unused funds under the Air Carrier and National Security Program, to support states, municipalities, and eligible businesses.

Unlike the Air Carrier and National Security Program, which is directly administered by Treasury, the Federal Reserve Program will establish programs and facilities for financial institutions to support lending to eligible businesses, states or municipalities. Through the program, the Federal Reserve may facilitate the (1) purchase of obligations or other interests directly from issuers, (2) purchase of obligations or other interests on the secondary market, or (3) making of loans, including loans or other advances secured by collateral.

Mid-Sized Companies. The Secretary is directed in the CARES Act specifically to implement a program or facility for direct loans to eligible businesses, including nonprofit organizations, that:

- have between 500 and 10,000 employees;
- certify in good faith that the uncertainty of economic conditions as of the date of its application makes the loan necessary for ongoing operations;
- are domiciled in the United States with significant operations and employees located in the United States; and
- certify in good faith that the business is not a debtor in a bankruptcy proceeding.

Small Companies. The CARES Act specifically states that some portion of the Federal Reserve Program may be reserved to small businesses, but no additional detail is available at this time.

What are the terms of the program?

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Like the loans and loan guarantees under the Air Carrier and National Security Program, loans under the Federal Reserve Program (including mid-size business loans) may generally be in such form and on the terms the Secretary deems appropriate. Similarly, the principal amounts of any obligation issued by an eligible business under the Federal Reserve Program cannot be forgiven, and all loans made or guaranteed by the Department of Treasury will be treated as indebtedness for tax purposes.

The mid-sized company program specifically caps the interest rate for loans at 2% per year, and requires no payments for at least first 6 months after a loan is made.

What are the conditions and restrictive covenants under the Federal Reserve Program?

Generally, eligible businesses receiving direct loans under the Federal Reserve Program, including the mid-size business loan program, must agree to the following conditions and restrictive covenants, unless the Secretary waives such requirements to protect the interests of the Federal Government:

No Buy-backs. Borrowers cannot purchase their own (or their parent company's) publicly-traded stock while the loan is outstanding and for a period of 12 months thereafter, unless the borrower was bound by a contractual obligation to buy-back the equity on March 27, 2020;

No Dividends or Distributions. Borrowers may not pay dividends or make other capital distributions on common stock while the loan is outstanding and for a period of 12 months thereafter;

Executive Compensation. During the Restricted Period (i.e. while the loan is outstanding, and for a period of 12 months thereafter), the total compensation of the borrower's executives will be limited. Specifically, for employees with total compensation (including salary, stock, and bonuses) in 2019 greater than:

- \$425,000 per year, during the Restricted Period such employee's compensation in any consecutive 12 month period cannot exceed 2019 levels, and such employee cannot receive severance upon termination of more than two times 2019 total compensation;
- \$3,000,000 per year, during the Restricted Period such employee's compensation in any consecutive 12 month period cannot exceed an amount equal to \$3,000,000 plus 50% of the excess of 2019 total compensation over \$3,000,000.

Mid-Size Business Certifications. Additionally, eligible businesses under the mid-size business loan program must certify in good faith that:

Employment Level Maintenance. Until September 30, 2020, the recipient will use the funds it receives to retain at least 90% of the recipient's workforce, at full compensation and benefits;

Employment Level Restoration. The recipient intends to restore not less than 90% of the workforce of the recipient that existed as of February 1, 2020, and to restore all compensation and benefits to the workers of the recipient no later than four months after the termination date of the COVID-19 public health emergency declared by HHS;

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No Offshore Labor. The recipient will not outsource or offshore jobs for the term of the loan and for 2 years thereafter; and

Unions. The recipient will not abrogate existing collective bargaining agreements for the term of loan and for 2 years thereafter, and will remain neutral in any union organization effort for the term of the loan.

Additional guidance from the Federal Reserve and financial institutions will be critical to understanding the scope and effect of these certifications. For example, the requirement to remain neutral in a union organization effort may be inconsistent with the free speech clause in the Taft-Harley Act, which amended the National Labor Relations Act, or even the First Amendment to the United States Constitution.

Hodgson Russ will continue to monitor this relief and will publish updates as we receive more information from the federal government and financial institutions implementing these programs. Please contact Christofer C. Fattey or Valerie E. Stevens for any questions you may have.

Please check our Coronavirus Resource Center to view many other alerts our attorneys in various practice areas have published on topics related to the pandemic.

If you received this alert from a third party or from visiting our website, and would like to be added to any of our mailing lists, please visit us at: <https://forms.hodgsonruss.net/sign-up-for-email-and-other-communications..html>.