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Updated March 30, 2020
Funds Available to Businesses under the Coronavirus Economic Stabilization Act (CARES ACT Title IV)

DISCLAIMER*: As you are aware, things are changing quickly and the aid measures and interpretations described here may change. This fact sheet represents our best understanding and interpretation based on where things currently stand as of March 30, 2020. We will be publishing a blog post summarizing our findings herein.

Major economic stabilization funds are made available to eligible businesses, states and municipalities under Title IV of the CARES Act. Title IV itself is titled the "Coronavirus Economic Stabilization Act of 2020" (referred to in this summary as "CESA"). This summary focuses on the funds available to businesses, with a particular emphasis on the $454 billion that is most broadly available to businesses.

The categories of available funds are:

- $25 billion to passenger air carriers and certain associated business such as those that perform, inspection, repair and replacement services of passenger airlines, and ticket agents
- $4 billion for cargo air carriers
- $17 billion for business important to maintaining national security
- $454 billion plus any excess from the above categories for direct loans, loan guarantees and investments to Eligible Businesses, states and municipalities.

We note that CESA does not specify how much of those funds must be available to businesses, states or municipalities (or how funds are to be allocated as between states or municipalities). The general structure is for the funds to be provided to financial institutions to support their lending to eligible businesses, states or municipalities. Loans, loan guarantees or other investments must be issued on or before December 31, 2020.[1] None of the loans, loan guarantees or other investments can be forgiven.

The basic definition of an Eligible Business[2] is either an air carrier or a US business that "has not otherwise received adequate economic relief in the form of loans or loan guarantees provided under [the CARES Act]."[3]

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[1] CESA Section 4029.

[2] CESA Section 4002.

[3] We note that the mere receipt of funds under another program does not make a business ineligible under Title IV; instead we believe there will be a measuring. Carriers and national security businesses will have a higher burden in this measuring because they have to show actual or expected losses that "jeopardize" their business under Section 4002(c)(2)(I). Other businesses will not have that added hurdles but still have to show that the funds they received under the other program did not provide "adequate relief."

Funds Available to Carriers & National Security Businesses

The Treasury Department will administer direct loans or loan guarantees to passenger or cargo carriers and national security businesses that meet the following criteria:[4]

- Credit is not reasonably available to the Eligible Business.
- The underlying obligation of the Eligible Business is "prudently incurred."
- The Eligible Business's continued operations must be jeopardized by losses related to the coronavirus pandemic.
- The loan must be sufficiently secured or the interest rate (which is determined by the Treasury Secretary) must reflect the risk of the loan or loan guarantee and, if possible, is not less than an interest rate based on market conditions for comparable obligations before the coronavirus outbreak.
- The loan or loan guarantee term shall be as short as possible but no more than 5 years.
- Until one year after the date of the loan or loan guarantee, the Eligible Business and its affiliates cannot engage in public company stock buybacks, unless contractually obligated as of the enactment date of the CARES Act, or pay dividends *on its common stock*. [our emphasis]
- The Eligible Business must, until September 30, 2020, maintain its employment levels as of March 24, 2020 to the extent practicable but is required to maintain no less than 90% of its workforce as of March 24, 2020.
- The Eligible Business must certify that it is a U.S.-domiciled business, and have significant operations, and a majority of its employees are based, in the U.S.
- The Eligible Business must either:
    - If it has publicly traded securities, issue a warrant or equity interest to the U.S. or
    - If it does not meet the above requirement, issue a warrant, equity interest or senior debt instrument to the U.S., as determined by the Treasury Secretary.[5]

  While the U.S. would not exercise voting power on common stock, the U.S. would have the freedom to sell or exercise the securities or debt instruments it receives.
- The Eligible Business must agree to the executive compensation limitations (described below).

The Treasury Secretary has 10 days to publish procedures for application and minimum requirements for making loans, loan guarantees or other investments for these loans.

Funds Available to Other Businesses

CESA authorizes the Treasury Department to provide loans, loan guarantees and other investments to Eligible Businesses that are not passenger or cargo carriers or national security businesses. This authorization falls into two categories that leave considerable room open for further definition and structure:

- Treasury is authorized to participate in loans and loan programs designed by the Federal Reserve for the primary loan markets, secondary loan markets, and direct lending but Treasury's participation would be subject to certain rules. CESA expressly contemplates that one of the direct lending programs would be the Main Street Lending Program (that the Federal Reserve announced on around Monday, March 23, 2020 as being targeted towards small and mid-sized

[4] CESA Section 4003(c)(2), 4003(d).

[5] We read CESA Section 4003(d)(1) as giving publicly traded companies the option to issue a warrant/ equity interest or senior debt instrument to the U.S.

businesses). It is important to recognize that CESA does not authorize the Main Street Lending Program—it merely provides rules that would apply to Treasury's participation in that or any other programs established by the Federal Reserve.

- Treasury is instructed to endeavor to create a program for mid-sized businesses with 500-10,000 employees.

It is worth reiterating that there are no pre-designated amounts for either of these categories and that amounts funded to states and municipalities (which also is not pre-designated) will be deducted from the broadly allocated $454 billion amount under CESA. Therefore, we will have to await the Treasury Department's direction on how it intends to allocate the $454 billion.

General Rules Applicable to Treasury's Participation in Federal Reserve Loan Programs

CESA authorizes the Treasury Department to participate in loan programs or facilities that are established and administered by the Federal Reserve in any of the following three capacities:

- By purchasing existing obligations in the primary loan market;
- By purchasing existing obligations in the secondary loan market; or
- By making new secured loans, loan guarantees or other investments directly with the Eligible Business as the borrower.[6]

The Treasury's participation in new lending programs to be established by the Federal Reserve (such as the Main Street Lending Program) would fit under this last "direct loans" category. But in addition to any Federal Reserve program requirements, the following criteria would apply any direct loans, loan guarantees or other investments made by the Treasury under those programs[7]:

- The loan must not be part of a syndicated loan facility, and must not be an ordinary course loan by a financial institution or a securities or capital markets transaction.
- The loan must be collateralized as required under Section 13(3) of the Federal Reserve Act.
- The loan or loan guarantee term shall be as short as possible but no more than 5 years.
- Until one year after the date of the loan or loan guarantee, the Eligible Business and its affiliates cannot engage in public company stock buybacks, unless contractually obligated as of the enactment date of the CARES Act, or pay dividends *on its common stock*. [our emphasis]
- The Eligible Business must be a U.S.-domiciled business, have "significant operations in the U.S." and have a majority of its employees based in the U.S.
- The Eligible Business must agree to the executive compensation limitations (discussed below).[8]

The Treasury Secretary can waive these requirements if "necessary to protect the interests of the Federal Government" but must make himself available to testify before Congress about his reasons.

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[6] CESA Section 4003(b)(4), 4003(c).

[7] CESA Section 4003(c)(2), (3).

[8] While the compensation limitations in CESA Section 4004 only refer to carriers and national security businesses, Section 4004(c)(3)(A)(ii)(III) explicitly applies them to other businesses. We believe that this explicit reference overrides the more limiting language. An alternative reading could provide an avenue for the carriers and national security business to circumvent the compensation limitations altogether which in our view is clearly not the Congressional intent.

Special provisions for Mid-sized Businesses & Non-profits (500-10,000 employees)

CESA requires the Treasury Secretary to endeavor to implement financing arrangements that are made directly to Eligible Businesses and nonprofit organizations with 500-10,000 employees.[9] The mandatory loan terms are:

- an interest rate that does not exceed 2% per year.
- no principal or interest payments shall be required during the first 6 months or a longer period as the Treasury Secretary determines.

The following criteria apply to the loans and loan guarantees under this mid-sized business program:[10]

- The Eligible Business must certify that it needs the loan to support ongoing operations which are affected by uncertainty or economic conditions at the time of the loan application.
- The funds will be used to retain at least 90% of its workforce (presumably measured as of March 24, 2020) at full compensation and benefits until September 30, 2020.
- The Eligible Business intends to restore not less than 90% of its workforce as of February 1, 2020 at full compensation and benefits within 4 months after the HHS Secretary terminates the emergency declaration.
- The Eligible Business must be domiciled in the US and have “significant operations and employees located in the U.S.”[11]
- Until one year after the date of the loan or loan guarantee, the Eligible Business and its affiliates cannot engage in public company stock buybacks, unless contractually obligated as of the enactment date of the CARES Act, or pay dividends *on its common stock*. [our emphasis]
- The Eligible Business must agree to the executive compensation limitations (discussed below).
- The Eligible Business cannot be the subject of a bankruptcy proceeding.
- It cannot outsource or offshore jobs during the loan and for 2 years after loan repayment.
- The recipient will not abrogate existing collective bargaining agreements for the term of the loan plus an additional two years.
- The recipient must remain neutral in any union organizing effort for the term of the loan.

Employee Compensation (Section 4004)

While an Eligible Business has a CESA loan or loan guarantee outstanding and for 1 year thereafter:

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[9] Although we understand that the hope is that lenders to mid-sized businesses will be incentivized to grant loans to Eligible Businesses that exceed the amounts funded under CESA, we suspect that any additional funds provided by lenders will be structured as separate tranches with more market rate terms than the 2% interest offered under this program (albeit subordinated to the CESA loan).

[10] CESA Section 4003(c)(3)(D).

[11] This is a different standard than requiring majority U.S. employees as in the case of the carrier/ national security programs and the general rules for participating in Federal Reserve programs.

- No officer or employee whose total compensation exceeded $425,000 in 2019 can receive any compensation increase or severance pay that exceeds twice their 2019 total compensation.
- No officer of employee whose total compensation exceeded $3 million in 2019 can receive total compensation that exceeds $3 million + 50% of the amount above $3 million that they received in 2019. This applies for any 12 consecutive month period.

Total compensation includes salary, bonuses, stock awards and other financial benefits.

Conflicts of Interest (Section 4019)

A company in which the President, Vice President, an executive department head, Member of Congress or close relative owns over 20% of the outstanding *voting* stock shall not be eligible loan, loan guarantees or other investments under CESA.

Congressional Oversight Commission (Section 4020)

CESA establishes a Congressional Oversight Commission for these programs (with the power to solicit testimony and information) through September 30, 2025.