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Treasury Releases New Procedures and Requirements for CARES Act Loans for Airlines and Businesses Critical to National Security

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The **CARES Act**, a $2 trillion relief package signed into law on Friday, authorizes the US Treasury Department to provide up to an aggregate of $500 billion for loans, loan guarantees and other investments for eligible businesses, non-profits, states and municipalities. This funding, provided under a component of the CARES Act, the Coronavirus Economic Stabilization Act of 2020 (CESA), is divided into two categories – $46 billion for air carriers and "businesses critical to maintaining national security," and $454 billion for programs or facilities established by the Federal Reserve. The Treasury has authority to determine specific terms and conditions for the financial support made available under both categories. To allow prospective borrowers to begin preparing to submit their loan applications, on March 30, 2020, the Treasury released **new procedures and minimum requirements** for funding under one of the categories: loans to air carriers and businesses critical to the national security. For the most part, other than the information requirements, the new procedures and requirements outlined by the Treasury largely parrot the relevant provisions of CESA. Importantly, even for companies not eligible to apply for these types of CESA loans, the new Treasury procedures and requirements may be instructive for prospective borrowers under other portions of CESA in indicating the direction and scope of the Treasury's requirements for loan applications.

CESA provides for funding in two categories as follows:

- **Businesses, nonprofits, states and municipalities**. Up to $454 billion (plus any amounts remaining from the program discussed below not expended on loans and loan guarantees) for loans, loan guarantees and other investments for programs or facilities established by the Federal Reserve for the purpose of providing liquidity to the financial system that supports lending to eligible businesses, non-profits, states or municipalities.
- **Airlines and National Security**. Up to $25 billion in loans and loan guarantees for passenger air carriers, including "eligible businesses" certified by the US Department of Transportation to perform inspection, repair, replace or overhaul services and ticket agents; up to $4 billion for cargo air carriers, and up to $17 billion for "businesses critical to maintaining national security," a term that has not yet been defined (ANS Loans).

"Eligible businesses" include air carriers and US businesses that have not otherwise received adequate economic relief in the form of loans or loans guarantees provided under the other provisions of the CARES Act. The Treasury's procedures and requirements do not provide guidance on the types of businesses that qualify as "businesses critical to maintaining national security."

Borrowers will be able to apply for ANS Loans directly to the Treasury, which will disburse approved loans directly to borrowers.

Information requirements for loan applications

To apply for an ANS Loan, borrowers will be required to provide certain information, including the following initial list, which prospective borrowers should begin compiling as soon as practicable:

- **Debt**. A description of the borrower's existing secured and unsecured debt, bank and other credit lines with outstanding and maximum balances, and major classes of existing security holders and creditors.

- **Debt service**. A description of the borrower's scheduled debt service for the next three years.
- **Employment levels**. The borrower's employment levels, by head count and total compensation amount, as of March 24, 2020, and any proposed changes to the borrower's employment levels during 2020, relative to March 24, 2020.
- **Financial statements**. The consolidated financial statements of the borrower and any corporate parents for the previous three years, audited (if available) by an independent certified public accountant, including notes, and any interim financial statements and notes for the current fiscal year.
- **Covered losses**. A description of the covered losses that the borrower has incurred or will incur as a result of the coronavirus, by line items, including details about the cause of the loss, such as reduced demand, unavailability of credit, unbudgeted medical expenses or other causes.
- **Lack of credit elsewhere**. Evidence that the borrower cannot reasonably obtain credit elsewhere, which may include information such as market conditions, the borrower's circumstances or relationships with existing and potential creditors.
- **Security**. A description of the type and general value of all security of the borrower and its subsidiaries, including but not limited to assets, property and revenue streams, available to be pledged as security for the loan on both a senior and a subordinated basis.
- **Use of proceeds**. The purposes for which the borrower will use the loan proceeds.
- **Financial needs**. Quantitative information about the borrower's financial needs for the remainder of 2020, including expected revenues, operating costs and credit and other sources of funding and financing, together with a discussion of how the loan will be applied to address those financial needs.
- **Operating plan**. A discussion of the borrower's operating plan for the remainder of 2020, assuming loan approval, including how the loan proceeds would be applied under the business plan and an analysis showing that the loan is prudently incurred.
- **Cost restructuring**. A description of any plans the borrower has to restructure its obligations, contracts, staffing or organization to improve the borrower's financial condition.
- **Industry-specific requirements**. There are also specific requirements applicable to borrowers that are passenger air carriers and cargo air carriers.

Terms and conditions for ANS Loans

As CESA provides, to make an ANS loan, the Treasury, in its sole discretion, must make the following determinations:

- **No credit elsewhere**. The borrower is an eligible business for which credit is not reasonably available at the time of the transaction.
- **Prudent borrowing**. The intended obligation by the borrower is prudently incurred.
- **Security/interest rate**. The loan is sufficiently secured or is made at a rate that reflects the risk of the loan and that is, to the extent practicable, not less than an interest rate based on market conditions for comparable obligations prevalent prior to the outbreak of the coronavirus.
- **Term**. The duration of the loan is as short as practicable and, in any case, not longer than five years.
- **No stock buybacks**. The agreement requires that the borrower (and its affiliates) be prohibited from buying back listed stock of the borrower or its parent (except to the extent required under a contractual commitment existing on the date of the CARES Act) while the loan or loan guarantee is outstanding and for 12 months thereafter.
- **No dividends.** The agreement requires that the borrower be prohibited from paying dividends or making other capital distributions on its common stock while the loan or loan guarantee is outstanding and for 12 months thereafter.
- **Employment levels**. The agreement provides that, until September 30, 2020, the borrower will maintain its employment levels as of March 24, 2020, to the extent practicable and, in any case, will not reduce its employment levels by more than 10% from the levels on that date.

- **US business**. The agreement includes a certification by the borrower that it is created or organized in the United States or under the laws of the United States and has significant operations in and a majority of its employees based in the United States.
- **Covered losses**. The borrower has incurred or is expected to incur losses due to the coronavirus that jeopardize the continued operations of the business.

In addition, under CESA, with respect to ANS Loans, the agreement must provide for the following additional terms and conditions:

- **Financial protection of the government**. The Treasury Department may not provide a loan or loan guarantee unless: (1) for borrowers that have securities traded on a national securities exchange, the Treasury receives a warrant or equity interest in the borrower, or (2) for other borrowers, the Treasury receives, in its discretion, a warrant or equity interest in the borrower or a senior debt instrument issued by the borrower. The borrower must identify the financial instruments it proposes to issue to the Treasury. The purpose of this requirement is to provide for a reasonable participation by the Treasury, for the benefit of taxpayers, in equity appreciation or a reasonable interest rate premium. The Treasury is prohibited from exercising voting power with respect to any shares of common stock acquired under CESA.
- **Prohibition on loan forgiveness**. No loan forgiveness is available.
- **Limitation on certain employee compensation**. Borrowers must agree to refrain from (1) increasing the compensation of any employee whose total compensation exceeded $425,000 in 2019 (other than compensation determined through an existing collective bargaining agreement entered into prior to March 1, 2020), and (2) offering severance pay or other termination benefits in excess of two times the maximum total compensation received by that employee in 2019. Borrowers must also agree to prohibit officers or employees who received more than $3 million in total compensation in 2019 from receiving total compensation, during any 12-month period, in excess of the sum of $3 million, plus 50% of the amount of total compensation received by the employee in 2019 that exceeded $3 million. The Treasury's procedures and requirements today do not prescribe how compensation should be calculated nor do they prescribe what compensation is considered "received."
- **Continuation of certain air service**. A borrower that is an air carrier must comply with requirements to maintain scheduled air transportation service that the Secretary of Transportation deems necessary to ensure services to any point served by that air carrier before March 1, 2020.
- **Conflicts of interest certification**. The borrower's principal executive officer and the principal financial officer, or individuals performing similar functions, must certify that the borrower is eligible to enter into the transaction, including that the borrower is not a "covered entity," i.e., it is not an entity in which the President, the Vice President, the head of an Executive Department or Member of Congress (or their spouse, child, daughter-in-law or son-in-law) has a "controlling interest" as defined under the CARES Act.

The procedures and requirements outlined above are preliminary and subject to future modification or waiver in the Treasury Secretary's discretion. In addition, the Treasury has indicated that it plans to promptly issue supplemental procedures, including a loan application form and instructions, additional program rules and policies, certifications and disclosures to be required of all borrowers, further loan terms and conditions and information regarding how the principal amount of individual loans will be determined, as well as loan application evaluation criteria. The Treasury Secretary may reject non-compliant loan applications and will approve or disapprove loan applications, based on the published criteria, in his sole discretion.

Observations and commentary: capital structure considerations

Special thought must be given to how the Treasury's debt and equity interests resulting from ANS Loans interact with existing capital structures of borrowers.

- Though the Treasury is prohibited from exercising voting power for any voting equity it may obtain through ANS Loans, the Treasury still maintains the right to exercise any warrant and/or transfer any equity interests it receives from borrowers. Accordingly, businesses must consider whether their existing shareholder agreements will need to be amended to satisfy the Treasury's equity ownership requirements.

- Equity ownership by the Treasury may also raise special regulatory and legal compliance issues that will need to be evaluated. For example, robust federal laws that govern federal agencies' privacy and information security requirements may apply to companies in which the Treasury has an equity stake. For an overview of how these regimes may impact participating businesses, **see our alert**.
- Whether or not the loan provided by the Treasury is secured or unsecured, existing debt arrangements may contain restrictions that would require amendment to permit borrowers to incur any new debt from the Treasury.

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