

Client Alert: Relief for Aircraft Industry and Auto Manufacturers under Title IV of the CARES Act

by Elitsa Dimitrova

A FREEBORN & PETERS LLP CLIENT ALERT



ABOUT THIS CLIENT ALERT

Companies need to evaluate whether seeking relief under the CARES Act is desirable from a business standpoint, taking into account the availability of other financing, the eligibility terms of the relief, the cost of compliance and the reputation of the business.

On March 27, President Trump signed into law H.R. 748, the “Coronavirus Aid, Relief, and Economic Security Act” also known as the CARES Act. The legislation provides relief to individuals and businesses through a number of programs. The Act is likely not the last legislation to be enacted in response to the pandemic, and its implementation mechanisms are evolving on a daily basis through the guidelines published by the Department of Treasury and the Federal Reserve.

The crisis comes at a difficult time for the commercial aircraft sector, which already experienced slower growth in 2019. With the swift collapse of air travel over the last few weeks, airline customers are likely to defer buying new aircrafts and making pre-delivery down payments. The pain of the aircraft industry will be felt throughout the supply chain. Boeing

has stated that typically about 70% of its revenue flows to its 17,000 suppliers and that without significant assistance the entire U.S. aviation manufacturing sector could collapse. In March, Boeing asked the government for more than \$60 billion in government loan guarantees, and last week it announced the hiring of investment banks to evaluate the terms of government relief and private loans. While it does not appear that demand for aircrafts will increase in the near future, Boeing has announced the reopening of plants as soon as next week in an effort to stabilize the industry and help support its suppliers.

As for the auto manufacturing industry, while Chinese supplier factories are slowly reopening operations, the crisis has hit close to home, with most of the States imposing mandatory stay-at-home orders and closures of non-essential businesses.

Over the last few months, customer demand for vehicles has collapsed first in China, and then in Europe and the United States. On Friday, April 17, Ford Motor Co announced raising \$8 billion from corporate debt investors at an interest rate between 8.50% and 9.625% and estimated a loss of about \$2 billion for the first quarter.

Even though the impact of the crisis is yet unknown and hardly predictable, it is likely that the pandemic will have lasting effects and a lot of companies will need to turn to governments for relief. Without the stimulus coming from the CARES Act, lending could have become more scarce and expensive for the distressed sectors of the U.S. economy. Businesses in the aircraft industry and auto manufacturers will have to evaluate the availability of private lending and compare the terms with those offered by the CARES Act.

Businesses in “severely distressed sectors,” such as the aircraft industry and auto manufacturers, that have not otherwise received aid under the Act (with the exceptions discussed below) can apply for loans and loan guarantees under Title IV of the Act, “Economic Stabilization and Assistance to Severely Distressed Sectors of the United States Economy.” A qualifying business that receives such assistance will (i) need to comply with a number of requirements over the period of the assistance and for a year (and in some cases two years) after repayment of the loan and (ii) be subject to several layers of federal agency and congressional oversight.



Title IV of the Act allocates \$500,000,000,000 for “loans, loan guarantees, and other investments” in support of eligible businesses and the States. The funds are allocated in two main programs (which contain a number of sub-programs) as follows:

1. Loans for Air Carriers and Businesses Critical to National Security (Treasury Program)

The Secretary of Treasury will have the ability to allocate up to \$46 billion to sectors of the economy that are particularly impacted by COVID-19 and that are critical to national security. \$25 billion of this program are earmarked to passenger and cargo air carriers, with the balance of up to \$17 billion to be allocated to “businesses critical to maintaining national security.” While guidelines are yet to be published, it is anticipated that the aircraft industry, and particularly Boeing, will qualify for assistance through the Treasury program.

Terms of the Loans under the Treasury \$17 Billion Program

Loans under the Treasury program will need to be “sufficiently secured” or made at the market rate (based on market conditions prior to the outbreak of the coronavirus) and with duration no longer than 5 years. The borrower will need to meet the following requirements:

- its intended obligation should be incurred prudently;
- it does not have access to another reasonable credit;
- the business and its affiliates may not buy the business’ or its parent company’s equity securities that are listed on a national securities exchange for one year after repayment of the loan;
- the business may not pay dividends or make other capital distributions with respect to its *common stock* for one year after repayment of the loan;
- the business will need to maintain its employment levels as of March 24, 2020, to the extent practicable, and in any case not reduce its employment levels by more than 10 percent from the levels on such date;
- the business certifies 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 are based in the United States;
- the business must have incurred or is expected to incur covered losses, i.e., incurred directly or indirectly as a result of coronavirus, as determined by the Secretary, such that the continued operations of the business are jeopardized, as determined by the Secretary; and
- it must comply with limitations on compensation for certain executives during the period of the loan and for one year after repayment of the loan, including (i) employees who received more than \$425,000 in total compensation in 2019, may not receive more than that or an amount exceeding twice the 2019 amount in case of severance pay upon termination of employment, and (ii) employees receiving more than \$3,000,000 in total compensation, may not receive total compensation more than the sum of \$3,000,000 plus half of the excess over \$3,000,000 of their total compensation in 2019.

The Treasury program allows for both direct loans and loan guarantees, which could be full or partial depending on the need of the business and the availability of other credit. The \$46 billion Treasury program is administered entirely by the Secretary of Treasury, and businesses may apply directly with the Treasury Department. While the application process is still being finalized, businesses are encouraged to collect their supporting application materials, which can be found [here](#).

Financial Protection of the Government

Loans and loan guarantees under the Treasury program may not be issued unless the government receives (i) in the case of public companies, a warrant or an equity interest in the business, and (ii) in the case of companies that are not public, either a warrant or an equity interest or a senior debt instrument if warrants and equity cannot feasibly be issued. In either case, the Treasury may sell, exercise or surrender the instruments for the benefit of the taxpayers but in the case of equity, it may not vote its shares.



2. Loans for Other Businesses (Federal Reserve Programs and Facilities)

\$454 billion plus any amounts that remain unused by the Treasury program above are allocated for loans and loan guarantees and other investments to programs and facilities of the Board of Governors of the Federal Reserve System. The Federal Reserve program is not restricted to a single industry or sector of the economy, and aircraft companies and auto manufacturers that do not qualify for the \$17 billion earmarked for “businesses critical to maintaining national security” could qualify for one of the Federal Reserve programs. The PMCCF and SMCCF programs described below are available to investment grade companies only, while the Mid-Sized and Main Street Lending programs below are likely to reach mid-sized and smaller manufacturers.

Terms of Loans under the Federal Reserve \$454 Billion Program

In general, the term of the loans will be at market rate and for duration no longer than five years. To qualify the borrower will need to meet the following requirements:

- it may not purchase the business’ or its parent’s stock that is listed on a national securities exchange for one year after repayment of the loan (unless it has prior obligation to do so existing as of the date of the Act);
- it may not pay dividends or make other capital distributions with respect to the common stock for one year after repayment of the loan;
 - The Secretary may grant a waiver of this restriction when necessary to protect the interests of the Federal Government and if it testifies regarding such waiver in the House and the Senate.
- it must comply with the limitations on compensation described above;
- any applicable requirements under Section 13(3) of the Federal Reserve Act (12 U.S.C. 343(3)), including requirements relating to loan collateralization, taxpayer

- protection, and borrower solvency continue to apply; and
- the business 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 are based in the United States.

The Federal Reserve program is intended to provide liquidity for the financial system that supports lending by: (i) purchasing obligations (bonds or notes) issued by companies; (ii) purchasing obligations in secondary (mainly public) markets; and (iii) making secured and unsecured loans. The Federal Reserve program also allows for both direct loans and partial and full loan guarantees. A likely scenario is for the government to guarantee a portion of most loans, allowing its assistance to reach more businesses.

For both the Treasury and Federal Reserve programs, there is no loan forgiveness, in contrast to the SBA under 500 employee program under the Act. U.S. subsidiaries of foreign companies or U.S. companies that are otherwise foreign-owned appear to satisfy the U.S. nexus requirements. The employment compensation limits and the restrictions on share buybacks for “stock listed a on national securities exchange” indicate that they will be of concern mostly for large and public companies and not for smaller manufacturers.

Primary Market Corporate Credit Facility (PMCCF)

The PMCCF, through a special purpose vehicle, will invest up to \$50 billion in bond issuances or portions (no more than 25%) of syndicated loans or bonds, and is available to investment grade companies (as of March 22, 2020) that have at least BB-/Ba3 ratings at the time of the issuance. The term of the loans will be up to four years. The business must be created or organized in the United States or under the laws of the United States with significant United States operations and a majority of United States-based employees, and must not have received relief under the Main Street Lending program described below or other provisions of the Act. The maximum loan funding may not exceed 130 percent of the issuer’s maximum outstanding bonds and loans on any day between March 22, 2019 and March 22, 2020 and \$11.25 billion (1.5 percent of the combined potential size of the facility and the SMCCF described below). The PMCCF and the SMCCF will provide for a total leveraged investment of up to \$750 billion.

Secondary Market Corporate Credit Facility (SMCCF)

The SMCCF, through the same special purpose vehicle, will invest up to \$25 billion to purchase in the secondary markets corporate bonds and ETFs with the objective of securing broad exposure to the market. Requirements similar to the ones for the PMCCF apply, but participation in the Main Street Lending program is not prohibited. The term of the investments must be no longer than five years.

Programs Specifically Tailored to Mid-Sized and “Main Street” Businesses.

Mid-Sized Business Program

Under the Federal Reserve program, the Secretary will “endeavor” to establish a loan program or facility with banks and other lenders that provide loans directly to businesses with 500 to 10,000 employees. Such direct loans will be subject to an annualized interest rate that is not higher than 2 percent per annum, and for the first 6 months after any such direct loan is made, or for such longer period as the Secretary may determine in his discretion, no principal or interest shall be due and payable. Any applicant for such loan will be required to certify that:

- the uncertainty of economic conditions as of the date of the application makes necessary the loan request to support the ongoing operations of the recipient;
- the funds it receives will be used to retain at least 90 percent of the recipient’s workforce, at full compensation and benefits, until September 30, 2020;
- the recipient intends to restore not less than 90 percent 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 public health emergency declared by the Secretary of Health and Human Services on January 31, 2020, in response to COVID-19;
- the recipient is not a debtor in a bankruptcy proceeding;
- the recipient 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;
- the recipient will not pay dividends with respect to its common stock, or repurchase an equity security that is listed on a national securities exchange of the recipient or any parent company of the recipient while the direct loan is outstanding (except to the extent required under an existing contractual obligation as of the date of the Act);
- the recipient will not outsource or off-shore jobs for the term of the loan and two years after completing repayment of the loan;

- the recipient will not abrogate existing collective bargaining agreements for the term of the loan and two years after completing repayment of the loan; and
- that the recipient will remain neutral in any union organizing effort for the term of the loan.

Main Street Lending Program

On April 9, 2020, the Federal Reserve established the Main Street Lending Program for the purchase of loans issued by small and mid-sized businesses. Under the program, the Treasury will dedicate \$75 billion out of the \$454 billion of the Federal Reserve Program that will enable the program to provide up to \$600 billion in new financing to businesses. The program allows for new loan facility and expanded loan facility, and *is available* to businesses in addition to loans received under Paycheck Protection Program (PPP) for small businesses. Borrowers participating in the new facility loans may not also participate in the expanded loan facility, and vice versa. No direct loans will be available under this program. Similar to the PPP program, businesses will need to seek loans from banks that qualify as eligible lenders under the program, which are U.S.-insured depository institutions, U.S. bank holding companies, and U.S. savings and loan holding companies (note the limited approved lenders under the program). The program’s terms and requirements include:

- the Federal Reserve will only purchase 95% of the aggregate principal amount of loans made by eligible lenders, requiring eligible lenders to retain 5% of the risk of the loan on their own balance sheet;
- the loans may not be forgiven;
- the business has up to 10,000 employees or \$2.5 billion in 2019 annual revenues;
- the loans are unsecured;
- four-year maturity;
- amortization of principal and interest is deferred for one year;
- adjustable rate of SOFR plus 250-400 basis points;
- minimum loan size of \$1 million (the Secretary has received comments requesting that the minimum be decreased so that the program is accessible by more borrowers, but no such change to the rule has been made up to date);
- maximum loan size under the new facility is the lesser of (i) \$25 million or (ii) an amount, when added to the borrower’s existing outstanding and committed, but undrawn debt, does not exceed four times EBITDA;
- maximum loan size under the expanded facility is the least of (i) \$150 million, (ii) 30% of the eligible borrower’s existing outstanding and committed, but undrawn bank debt, or (iii) an amount that, when added to the borrower’s existing outstanding and committed, but undrawn debt, does not exceed six times the eligible borrower’s 2019 EBITDA;



- prohibits refinancing of pre-existing loans and other financial covenants;
- prepayment is permitted without penalty;
- each eligible borrower must be a business that is created or organized in the United States or under the laws of the United States with significant operations in and a majority of its employees based in the United States;
- loans are prudently incurred and needed due to the COVID-19 pandemic;
- borrower was solvent prior to the crisis;
- importantly, this program may be an option for private equity or venture capital-backed businesses (unlike the PPP program given the SBA's "affiliation" rules as to employee head count);
- the borrower must commit to make reasonable efforts to maintain payroll and retain employees during the term of the Facility loan (weaker standard than the one in PPP); and
- the borrower must make a number of attestations, including that the loans will not be used to repay prior obligations and that the business will follow the executive compensation limitations, stock repurchase restrictions (relating to equity listed on a national securities exchange), and capital distribution restrictions that apply to direct loan programs described above.

The Main Street Lending Program is not yet operative (the comment period ended on April 17, 2020), and the requirements will be updated in the days and weeks to follow. As the program will be implemented through certain eligible lenders, it is likely that additional requirements may be added based on the feedback such lenders provide.

Other provisions of the CARES Act may contain relief to the aircraft industry and auto manufacturers, [such as certain tax changes](#).



Oversight by the Pandemic Response Accountability Committee, the Office of the Special Inspector General for Pandemic Recovery and the Congressional Oversight Commission.

Pandemic Response Accountability Committee

The Act establishes the Pandemic Response Accountability Committee to “prevent and detect fraud, waste, abuse, and mismanagement” and serve as a connector across programs and agencies. The committee has the broadest authority, including ability to conduct its own independent investigations and audits, broad power of subpoena, and may refer matters to the Department of Justice (DOJ) for criminal or civil investigation. It is required to submit twice-yearly reports to Congress, which has dedicated \$80 million to the Committee, and it will terminate on Sept. 30, 2025.

Office of the Special Inspector General for Pandemic Recovery

Any business that receives relief from the Treasury and the Federal Reserve Programs will be subject to oversight by the Office of the Special Inspector General for Pandemic Recovery, which is to be established by the Department of Treasury pursuant to the Act and whose head will be appointed by the President and approved by the Senate. The Special Inspector General is tasked with conducting, supervising, and coordinating audits and investigations of the making, purchase, management, and sale of loans, loan guarantees, and other investments made by the Secretary of the Treasury under any program established by the Secretary under this Act, and the management by the Secretary of any program established under this Act. The Special Inspector General will operate for five years, has \$25 million in appropriations to fulfill its mission, must report to Congress under a number of circumstances and periodically, and has the powers and duties outlined by the Inspector General Act of 1978. This includes the authority to receive full access to all records and materials relevant to its areas of oversight; to determine which audits, investigations, and reviews are necessary; to issue administrative subpoenas and execute warrants; and to refer criminal and civil matters to the DOJ.

Congressional Oversight Committee

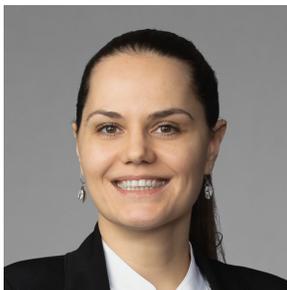
The Act also establishes the Congressional Oversight Committee tasked with conducting oversight of the implementation of the Treasury and the Federal Reserve programs and the rest of the provisions of Subtitle A of Title IV of the Act and submitting reports to Congress regarding the use of the programs and the contracting authority under the Act and their impact and effectiveness.

Summary

The aircraft industry and auto manufacturers will have several avenues to seek relief from the government. It is anticipated that the Treasury and the Federal Reserve Program (and their sub-programs) will secure the supply of lending in a period of increased demand. The advantage of qualifying for relief under the Treasury program is the availability of direct loans for businesses essential to national security. Such loans, however, will come with a premium as their terms include a requirement that the government receive an equity interest (or warrant) in the borrowing company. The terms of the Main Street Lending program may be more financially lucrative but include additional eligibility requirements, and no direct lending will be provided. The terms of the Mid-Size Business program are yet to be announced. Each business will have to evaluate whether participating in any of these programs is desirable from a business standpoint and whether complying with the loan terms is feasible. Furthermore, the discourse of the Treasury's recent pandemic aid to airlines has demonstrated the Treasury's appetite for aggressive negotiations and desire to secure lucrative terms for the government. Businesses need to continue communicating with their banks and legal counsel for future developments, requirements and guidance on the programs. Looking to the future, corporate legal departments will need to be proactive in not simply negotiating and securing the loans, but also developing internal compliance protocols in relation to the restrictions imposed by the terms of the loans.

We will continue to follow this and the other CARES Act programs and offer updates as further developments arise. If you have any questions, please contact Elitsa Dimitrova, or a member of the CARES Act team: Anthony Zeoli, Steven Hartmann, Karen Hayes and Meghan Tepas, and stay tuned for more developments on [Freeborn's COVID-19 webpage](#).

ABOUT THE AUTHOR



Elitsa Dimitrova

Associate

Chicago Office
(312) 360-6839

edimitrova@freeborn.com

Elitsa is an Associate in the Corporate Practice Group. Her practice is concentrated in representing private companies and venture funds with respect to offering of equity and debt securities; joint ventures and private equity investments; mergers and acquisitions; and compliance with federal and state securities laws. Elitsa also consults clients as it relates to general corporate matters.

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CHICAGO

311 South Wacker Drive
Suite 3000
Chicago, IL 60606
(312) 360-6000
(312) 360-6520 fax

NEW YORK

230 Park Avenue
Suite 630
New York, NY 10169
(212) 218-8760
(212) 218-8761 fax

SPRINGFIELD

217 East Monroe Street
Suite 202
Springfield, IL 62701
(217) 535-1060
(217) 535-1069 fax

RICHMOND

901 East Byrd Street
Suite 950
Richmond, VA 23219
(804) 644-1300
(804) 644-1354 fax

TAMPA

1 Tampa City Center
201 North Franklin Street
Suite 3550
Tampa, FL 33602
(813) 488-2920

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