

## **CORONAVIRUS RESOURCE CENTER**

# **CARES Act: Implications for PE-Sponsored Portfolio Companies**

**March 31, 2020**

- The Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act” or the “Act”), which was signed into law on March 27, 2020, authorizes the federal government to make an extraordinary amount of funding broadly available to businesses struggling with the impacts of COVID-19. This alert outlines what private equity sponsors and their U.S. portfolio companies need to know about two major sources of this funding—\$500 billion in emergency liquidity support for distressed industries by the U.S. Treasury and the Federal Reserve Bank, and a \$349 billion “paycheck protection program” established under the Small Business Act.
- The liquidity support program is the more promising of these two funding sources, but many details remain unresolved. While the CARES Act specifies tenor and interest rates for certain types of loans under the Treasury and FRB programs, these and other basic economic terms are otherwise left largely to the discretion of the Secretary of the Treasury. Crucially, for portfolio companies with outstanding leveraged loans or high yield bonds, the extent to which CARES Act financing will need to be secured (and by what assets) is not clear; nor is there any indication where the government might require these loans to sit in a borrower’s corporate structure (e.g., whether they can be structurally subordinated at a holding company outside the existing credit group).
- If the FRB programs legislate that the loans must be made within a portfolio company’s existing credit group, which they may in order to preserve a senior claim for the government on the assets and cash flows of a portfolio company, private equity sponsors will need to consider on a case by case basis the debt and lien capacity of each of its portfolio company under its existing credit documents. Some portfolio companies may have limited or no capacity, and in order to access the Fed programs those companies may need to seek lender consent, which may be difficult

and costly to obtain given the distressed credit markets and depressed values in secondary trading. Alternatively, if the FRB is amenable, in most cases, portfolio companies should be able to structure these loans as holdco facilities (hopefully with PIK (pay if you can) interest). This alternative may not be available for portfolio companies that already have hodco facilities or have a non-US holdco stack (as noted below, the CARES Act is only available to entities formed in the United States).

- Treasury and FRB program financing will also come with significant strings attached, including limitations on stock buybacks and dividends, employee compensation and workforce reduction, among others. These limitations would apply during the loan period, and in some cases, for up to 1 or 2 years even after loan repayment.
- The second funding program, the “paycheck protection program”, will be available to some businesses that would not otherwise have qualified for SBA loans. However, with limited exceptions (e.g., for hotels and restaurants, and certain franchisees), the CARES Act does not explicitly waive the SBA’s normal affiliation rules , which tend to aggregate all of a private equity sponsor’s portfolio companies for purposes of determining eligibility based on size. For that reason, these loans may not be available to most private equity sponsored companies.
- The most relevant provisions of the CARES Act to sponsored portfolio companies are summarized below.

---

## Emergency Financial Support from the U.S. Treasury and the Federal Reserve Bank

Title IV of the CARES Act authorizes \$500 billion in loans, loan guarantees, and other investments to support a wide spectrum of U.S. businesses adversely impacted by COVID-19. To distribute these funds, the Act establishes two similar, but separate, programs: (A) loans and loan guarantees made directly by the United States Treasury (the “Treasury”) to select industries; and (B) loans, loan guarantees and other investments to programs or facilities established by the Federal Reserve Board (the “FRB”)<sup>1</sup>, which will then use those funds to support eligible lending to businesses, states or municipalities. Key terms of each of these programs are described below.

---

<sup>1</sup> The FRB has recently established a number of new programs to support the corporate debt markets, including the Primary Market Corporate Credit Facility and the Commercial Paper Funding Facility. For further discussion of the recent actions by the FRB and other federal regulators, please see Debevoise In Depth, Financial Regulator Responses to COVID-19, <https://www.debevoise.com/insights/publications/2020/03/financial-regulator-responses-to-covid19>.

## Treasury Direct Lending Program

- *Availability Period:* From enactment until December 31, 2020.
- *Program Amount and Eligibility:*
  - The Secretary of the Treasury or its designee (the “Secretary”) may make up to \$46 billion of direct loans and loan guarantees (the “Treasury Direct Lending Program”), allocated as follows:
    - \$25 billion for passenger air carriers<sup>2</sup>, repair stations certified by the Federal Aviation Administration, and ticket agents;
    - \$4 billion for cargo air carriers; and
    - \$17 billion for businesses critical to maintaining national security.
  - To make loans or loan guarantees using these funds, the Secretary must determine in its discretion that:
    - the obligor is an eligible business for which credit is not reasonably available at the time of the transaction, and has not (with the exception of air carriers) otherwise received adequate economic relief under the Act;
    - the obligor has incurred or is expected to incur covered losses such that its continued operations are jeopardized;
    - the intended obligation is prudently incurred by the obligor; and
    - the obligations are (x) sufficiently secured or (y) made at a rate that reflects the risk and is not less than an interest rate based on market conditions for comparable obligations prevalent prior to the outbreak of COVID-19, to the extent practicable.
  - An eligible business must be created or organized in the United States and have significant operations in, and a majority of its employees based in, the United States.

---

<sup>2</sup> Air carriers receiving loans and loan guarantees under Title IV of the Act may be required, until March 1, 2022, to maintain scheduled air transportation service if the Secretary of Transportation deems it necessary (taking into consideration the needs of small and remote communities) to ensure services to any point served by the carrier before March 1, 2020.

- *Interest Rate:* The minimum interest rate applicable to the loans and loan guarantees will be determined by the Secretary, based on the risk and the current average yield on outstanding marketable obligations of the United States of comparable maturity.
- *Maturity:* The tenor of the loans or loan guarantee is to be as short as practicable and, in any case, not longer than 5 years.
- *Forgiveness:* The principal amount of a loan issued under the Treasury Direct Lending Program may not be reduced through loan forgiveness.
- *Limitations on Restricted Payments:* The Secretary must determine, in its discretion, that an agreement to make loans or loan guarantees under this program:
  - prohibits the eligible business and its affiliates from buying back any equity security that is listed on a national securities exchange of the eligible business or any parent company (except to the extent required under contractual obligation in effect as of the date of enactment of the Act) until the date 12 months after the obligation is no longer outstanding; and
  - prohibits the eligible business from paying dividends or making other capital distributions with respect to its common stock until the date 12 months after the obligation is no longer outstanding;
- *Limitation on Employee Compensation:*
  - The Secretary may only enter into an agreement to make loans or loan guarantees to an eligible business if the agreement requires that, until 1 year after the obligation is no longer outstanding:
    - total compensation for officers and employees who received more than \$425,000 in 2019 will be limited for any 12-consecutive-month period to the total compensation received in 2019, and any severance payable to those officers and employees may not exceed two times the amount of total compensation in 2019; and
    - total compensation for any 12-month period for officers and employees who received more than \$3,000,000 in 2019 will be capped at the sum of \$3,000,000 plus 50 percent of total 2019 compensation in excess of \$3,000,000.
  - “Total compensation” for these purposes means salary, bonus, stock and other financial benefits the officer or employee received.

- *Limitation on Workforce Reduction:* The Secretary must determine, in its discretion, that an agreement to make loans or loan guarantees under this program requires the eligible business to maintain its employment levels as of March 24, 2020 to the extent practicable, and in any case not to reduce its employment levels by more than 10% from the levels on such date.
- *Other Terms and Conditions:* The loans and guarantees will contain such other covenants, warranties and requirements (including for audits) as the Secretary determines appropriate.
- *Financial Protection of Government:* In connection with a loan or a loan guarantee, the Treasury generally must receive a warrant or equity interest in the borrower. However, the Treasury may accept a senior debt instrument if the borrower is not publicly traded or the Secretary determines that it is not feasible for the borrower to issue warrants or other equity interests.
  - The CARES Act permits the Treasury to give borrowers relief in connection with section 382 tax ownership changes relating to equity interests acquired by the Treasury. Otherwise, acquisitions of equity interests that result in an ownership change could prevent borrowers from using their tax loss carryforwards and other tax attributes.
  - *Disclosure:* Not later than 72 hours after it extends any financial accommodation under the Treasury Direct Lending Program, the Secretary must publish on its website a plain-language description of the transaction, including the amount of the loan or loan guarantee, the interest rate and any other material or financial terms, and copies of any term sheets or documents governing the transaction.

## FRB Liquidity Programs

- *Availability Period:* From enactment until December 31, 2020.
- *Program Amount, Structure and Eligibility:*
  - The Act makes up to \$454 billion, plus any unused portions allocated to the Treasury Direct Lending Program, available for loans and loan guarantees to, and other investments in, programs or facilities established by the FRB for the purpose of providing liquidity to the financial system (the programs and facilities receiving such funds, the “FRB Liquidity Programs”).

- Specifically, FRB Liquidity Programs are to lend to eligible business (that have not, with the exception of air carriers, otherwise received adequate economic relief under the Act), states or municipalities by
  - purchase of obligations or other interests directly from issuers,
  - purchasing obligations or other interests in the secondary market, or
  - making secured or unsecured loans or other advances.
- FRB Liquidity Programs may only make the above purchases of obligations of, or loans and advances to, businesses that are created or organized in the United States and that have significant operations in, and a majority of their employees based in, the United States.
- The Act also provides that the Secretary shall “endeavor to seek the implementation” of an FRB Liquidity Program that provides financing to lenders that make direct loans to eligible businesses (including nonprofits to the extent practicable) with between 500 and 10,000 employees (the “Mid-Sized Business Loan Program”).
- *Interest Rate:*
  - Loans made via the Mid-Sized Business Loan Program would bear interest at an annual rate of no higher than 2%.
  - Otherwise, the minimum interest rate applicable to the loans and loan guarantees are to be determined by the Secretary, based on the risk and the current average yield on outstanding marketable obligations of the United States of comparable maturity.
- *Payment Deferral:* Direct loans made to eligible businesses via the Mid-Sized Business Loan Program must not require any interest or principal to be payable within the first 6 months after such loan is made (or such longer period as the Secretary may determine in its discretion).
- *Forgiveness:* The principal amount of a loan made via an FRB Liquidity Program may not be reduced through loan forgiveness.
- *Limitations on Restricted Payments & Employee Compensation:* Same as for the Treasury Direct Lending Program. However, the Secretary may waive these

requirements with respect to any FRB Liquidity Program<sup>3</sup> if determined necessary to protect the interests of the federal government (and if the Secretary is willing to testify before Congress regarding the reasons for such waiver).

- *Borrower Certifications Under Mid-Sized Business Loan Program:* An applicant for loans under the Mid-Sized Loan Program must certify in good faith that:
  - it is domiciled, and created or organized, in the United States, and has significant operations in, and a majority of its employees based in, the United States;
  - it is not a debtor in a bankruptcy proceeding;
  - 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% of its workforce at full compensation and benefits until September 30, 2020;
  - it intends to restore not less than 90% of its workforce that existed as of February 1, 2020, and to restore all compensation and benefits to the workers of the recipient no later than 4 months after the COVID-19 public health emergency ends;
  - it will not pay any dividends with respect to its common stock, or buy back any equity security of it or of any parent company that is listed on a national securities exchange (except to the extent required under contractual obligation in effect as of the date of enactment of the Act); and
  - it will not outsource or offshore jobs for the term of the loan and for 2 years after repayment;
  - it will not abrogate any existing collective bargaining agreement for the term of the loan and for 2 years after repayment; and
  - it will remain neutral in any union organizing effort for the term of the loan.

---

<sup>3</sup> Note that the Act also independently requires borrowers under the FRB Liquidity Programs to certify that they will not pay dividends or buy back listed equity interests; read together literally, the provisions suggest that the Secretary's authority to waive these requirements in the context of the Mid-Sized Business Loan Program applies only to the 12-month period following repayment of the loans.

- *Other Terms and Conditions:*
  - The loans and loan guarantees to the FRB Liquidity Programs will contain such other covenants, warranties and requirements (including for audits) as the Secretary determines appropriate.
  - The Act also makes clear that requirements under the emergency lending provisions of the Federal Reserve Act that would otherwise be applicable, including those relating to loan collateralization, taxpayer protection, and borrower solvency, will apply to the FRB Liquidity Programs.<sup>4</sup>

The CARES Act establishes a Special Inspector General, who is appointed by the President with the advice and consent of the Senate, and is responsible for conducting, supervising and coordinating audits and investigations regarding the making, purchase, management and sale of the loan, loan guarantees and other investments made by the Treasury in connection with any program established under the CARES Act. Of particular note, the Act explicitly contemplates that the Special Inspector General will regularly collect and summarize a listing of eligible businesses receiving the loans, loan guarantees and other investments, as well as the total outstanding amount of, interest and fees accrued and received on, collateral (if any) associated with, and any losses or gains recorded or accrued for, each loan, loan guarantee or other investment.<sup>5</sup>

---

## Expanded Access to SBA Loans

Title I of the CARES Act establishes a new paycheck protection program (the “PPP”) under section 7(a) of the Small Business Act (15 U.S.C. 636(a)) (the “SBA”). The following are key terms and conditions of the PPP:

- *Availability Period:* From enactment until June 30, 2020.

---

<sup>4</sup> While the Act does not detail exactly how these requirements would apply to FRB Liquidity Programs, it is possible that the collateralization requirement in particular could be satisfied by program-level support from the Treasury as opposed to pledges by the borrowers themselves.

<sup>5</sup> For further discussion of the oversight requirements applicable to the Treasury Direct Lending Program and FRB Liquidity Programs, as well as various bank regulatory changes and other incentives for banks and other financial institutions to participate in the programs, see

<https://www.debevoise.com/insights/publications/2020/03/cares-act-fiscal-response-to-covid19>.

- *Eligible Borrowers:*

- PPP loans will be available to any business concern<sup>6</sup> that has no more than 500 employees (including those employed on a full-time, part-time or other basis), or such lower size standard in number of employees as is established for the applicable industry by the Small Business Administration (the “Administration”).
- Businesses in the accommodation (e.g. hotels) and food service industries with more than one physical location are eligible so long as they have no more than 500 employees per physical location.
- The Act waives the normal SBA requirement that a business concern be unable to obtain credit elsewhere.
- *Waiver of Affiliation Rules:* The normal SBA rules on entity affiliation<sup>7</sup> are waived for certain eligible borrowers under the PPP, including (i) any business in the accommodation and food service industries with not more than 500 employees per physical location, (ii) any business concern operating as a franchise that is assigned a franchise identifier code by the Administration, and (iii) any business that receives financial assistance from an investment company licensed under the Small Business Investment Act.

- *Loan and Program Amounts:*

- The CARES Act authorizes an additional \$349.0 billion for SBA loans (including those made under the PPP) to be made between February 15, 2020 and June 30, 2020.
- The maximum amount of each PPP loan must not exceed:
  - \$10 million; or
  - if less, (i) the applicants’ average total monthly Payroll Costs during the past year (or, for seasonal employers, during the 12-week period beginning on February 15, 2020 or, at the election of the applicant, March 1, 2019 and

---

<sup>6</sup> Certain nonprofits, veterans organizations, Tribal business concerns, sole proprietors, independent contractors and self-employed individuals are also eligible, subject to requirements that are not summarized herein.

<sup>7</sup> The Administration is subject to a specific set of regulations that require it to aggregate an applicant together with all of its affiliates for purposes of making determinations regarding the applicant’s size. These rules generally define an “affiliate” of a business as a person who controls, is controlled by, or is under common control with, such business. However, “control” in this context is broadly construed, and the Administration may consider the totality of the circumstances even when no single factor is sufficient to constitute affiliation.

ending on June 30, 2019), times 2.5, or (ii) if requested by an otherwise eligible recipient that was not in business during the period beginning on February 15, 2019 and ending on June 30, 2019, the applicant's average total monthly Payroll Costs during the period beginning on January 1, 2020 and ending on February 29, 2020, times 2.5 (plus, in each case, the outstanding amount of certain other loans permitted to be refinanced by PPP loans, as further described below).

- “Payroll Costs” is defined to include salaries, wages, cash tip payments, vacation, parental, family, medical or sick leave, group health care benefits, retirement benefits and state or local taxes on employee compensation. However, the term specifically excludes all employee compensation in excess of an annual salary of \$100,000 per individual employee (as prorated for the program availability period), as well as all compensation of employees residing principally outside the U.S.
- *Borrower Certification Requirement:* Applicants for PPP loans must certify in good faith that
  - the loan is needed to support ongoing operations due to the uncertainty of current economic conditions,
  - the loan will be used to retain workers and maintain payroll or make mortgage, lease and utility payments, and
  - the applicant does not have pending applications for, and has not previously received, PPP loans for the same purpose and duplicative amounts.
- *Uses of Proceeds:*
  - PPP loans may also be used for any purpose already permitted for SBA loans more generally, including: start-up; construction; conversion or expansion; equipment purchases; material and supplies purchases; commercial real-estate purchases; working capital; and debt refinancing.
  - In addition, proceeds of the PPP loans may be used for the following: Payroll Costs; costs related to continuation of group health care benefits during periods of paid sick, medical or family leave, and insurance premiums; employee salaries, commissions or similar compensation; rent; utilities; mortgage interest; and interest on any other debt obligations that were incurred before February 15, 2020.
  - PPP loan proceeds may also be used to refinance any economic injury disaster loans the borrower obtained under section 7(b)(2) of the SBA during the period

beginning on January 31, 2020 and ending on the date on which the PPP loans are made available.

- *Interest Rate:* The Act sets maximum of 4%; however, the Administration has since proposed that all PPP loans will bear interest at 1%.
- *Payment Deferral:* Each eligible borrower applying for a 7(a) loan will be presumed to be an “impacted borrower” adversely impacted by COVID-19, and lenders must provide at least 6 months and up to 1 year of complete payment deferment relief for impacted borrowers.
- *Loan Forgiveness:*
  - PPP loans are generally eligible for forgiveness in an amount equal to the cost of maintaining basic operating continuity during the period from February 15, 2020 to June 30, 2020. The amount of loan forgiveness must not exceed the sum of the following:
    - Payroll Costs incurred during such period;
    - the amount of payments of interest on any indebtedness of the borrower incurred in the ordinary course that is a mortgage on real or personal property,
    - the amount of rent payments under leases in force before February 15, 2020; and
    - the amount of payments for electricity, gas, water, transportation, telephone or internet access services that began before February 15, 2020.
  - The amount of any loan forgiveness will be reduced by (i) the percentage of any reduction in the number of full-time (or full-time equivalent) employees during the 8-week period following origination of the loan, as compared to the business’s prior employment levels, and (ii) the amount of salaries and wages for employees that was reduced by more than 25% during such 8-week period. However, these reductions will be disregarded to the extent any employees are re-hired and any applicable salaries return to prior levels by June 30, 2020. “Employees” for these purposes are limited to those who did not receive wages or salary at an annualized rate of pay during any single pay period of more than \$100,000 in 2019.
  - The SBA and the Treasury may grant by regulation *de minimis* exceptions to the loan forgiveness reduction requirements.

- Loan forgiveness under the PPP is not taxable.
- *Maturity:* The Act sets a maximum maturity of 10 years for any remaining balance of PPP loans after applying the loan forgiveness rules described above; however, the Administration has since advised that all PPP loans will have a 2-year maturity.
- *Other Waivers:* The Act also provides that certain other SBA rules will be waived for purposes of the PPP, including prepayment penalties, certain fees, and requirements for collateral and personal guarantees.
- *Sense of the Senate:* The Act includes a “Sense of the Senate” provision that directs the SBA to issue guidance to ensure PPP loans are processed and disbursed in a manner that prioritizes businesses in underserved and rural markets, including veterans and members of the military community, small businesses owned and controlled by socially and economically disadvantaged individuals, women, and business in operation for less than 2 years.

The CARES Act provides enhanced incentives and reduces administrative burden for lenders participating in the PPP. The Act also directs the Treasury to establish criteria, and issue regulations and guidance, in order to broaden the range of banks and other specialized lenders that can participate in the SBA loan programs (including the PPP) more generally.

\* \* \*

For more information regarding the coronavirus, please visit our [Coronavirus Resource Center](#).

Please do not hesitate to contact us with any questions.

**NEW YORK**



Matthew E. Kaplan  
mekaplan@debevoise.com



David Portilla  
dlportilla@debevoise.com



Jeffrey E. Ross  
jerross@debevoise.com



Sunil William Savkar  
ssavkar@debevoise.com



Peter F.G. Schuur  
pfgschuur@debevoise.com



Scott B. Selinger  
bselinger@debevoise.com



Steven J. Slutzky  
sjslutzky@debevoise.com



Zahra J. Khosrovi Sowder  
zksowder@debevoise.com



Will C. Giles  
wgiles@debevoise.com

**WASHINGTON, D.C.**