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CARES Act Provides Relief for Aviation Industry; Significant Conditions Apply

Coronavirus Aid, Relief, and Economic Security Act Offers More than \$50 billion in Financial Assistance for Certain Aviation-Related Companies, Subject to Significant Restrictions on Capital Allocation, Employee Retention and Compensation and Other Conditions, Including the Issuance of Warrants or Other Instruments to the U.S. Government.

INTRODUCTION

On Friday, President Trump signed into law the “Coronavirus Aid, Relief, and Economic Security Act,” or the “CARES Act,” which authorizes the Secretary of the Treasury to make up to \$500 billion in loans, loan guarantees and other investments in support of certain businesses affected by the coronavirus outbreak, as well as states and municipalities.

This memorandum summarizes the provisions of the CARES Act that are most relevant to the aviation industry. The legislation contains more than \$50 billion in financial assistance for passenger air carriers (and related businesses), cargo air carriers and contractors in the form of loans, loan guarantees, grants and tax relief, subject to the conditions and procedures discussed below. Aviation companies that are considering applying for relief under the CARES Act should carefully consider the conditions for receiving assistance (and the limitations on future business activities and flexibility these conditions may impose) in relation to their current business outlook, liquidity position and capital allocation strategy.

We note that the provisions discussed in this memorandum are in addition to a number of other provisions of general applicability contained in the CARES Act, which are outside the scope of this memorandum. Companies that are not eligible for, or otherwise choose not to participate in, the financial assistance programs discussed in this memorandum may be eligible for assistance under other provisions of the

CARES Act. We describe those provisions in a separate publication available at <https://www.sullcrom.com/corona-virus-update>.

LOANS AND LOAN GUARANTEES AVAILABLE UNDER CESA

Overview. Title IV, Subtitle A of the CARES Act (the Coronavirus Economic Stabilization Act of 2020 (“CESA”)) authorizes the Treasury Secretary to use \$500 billion for four separate categories of loans, loan guarantees and other investments, including: (1) up to \$25 billion in loans and loan guarantees for U.S. passenger air carriers and related businesses, such as inspection, repair and overhaul service providers and ticket agents; (2) up to \$4 billion in loans and loan guarantees for U.S. cargo air carriers; and (3) up to \$17 billion in loans and loan guarantees for “businesses critical to maintaining national security.”

Companies that do not qualify for loans or loan guarantees under the three categories mentioned above may qualify under CESA’s additional authorization of up to \$454 billion (plus any amounts not used under the other three categories) in loans and loan guarantees to, or other investments in, certain Federal Reserve programs or facilities. In order to be eligible for this fourth category, a company must either be (1) an air carrier or (2) another U.S. business that has not received “adequate economic relief” in the form of loans or loan guarantees under CESA.¹ The legislation does not define what constitutes “adequate economic relief,” leaving the contours of this term to be determined by the Treasury Secretary. Notably, certain of the conditions discussed below do not apply to loans or loan guarantees made under this fourth category. We describe the conditions applicable to category-four investments in a separate publication available at <https://www.sullcrom.com/corona-virus-update>.

The provision of loans and loan guarantees under CESA will be funded from an appropriation made to a fund under the exclusive control of the Treasury Secretary, subject to approval by the President. The Treasury Secretary has substantial discretion, subject to oversight, to determine the form, terms and conditions of any loan or loan guarantee, including any applicable covenants, representations, warranties or other requirements. For any loans, the Treasury Secretary will set the interest rate based on the risk and the current average yield on outstanding U.S. government obligations of comparable maturity. Further, the principal amount on any obligation incurred by a borrower under CESA may not be reduced through loan forgiveness; however, loans may be restructured or otherwise modified (provided, that the duration of any loan may not be extended beyond five years from the loan’s origination date).

The procedures for applying for the aforementioned relief and certain minimum requirements will be published by the Treasury Secretary within ten days of CESA’s enactment.

General Conditions. CESA imposes a number of conditions on recipients of the loans or loan guarantees described above, including restrictions on capital allocation, employee retention and executive compensation. First, the Treasury Secretary must determine that an applicant for a loan or loan guarantee “is an eligible business for which credit is not reasonably available at the time of the transaction,” which

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may potentially make it more difficult for a business otherwise eligible for CESA to qualify for assistance. In addition, before the Treasury Secretary grants a loan or loan guarantee under the three categories discussed above, the Treasury Secretary must determine that:

- the intended obligation is “prudently incurred” by the applicant;
- the loan or loan guarantee is either (1) sufficiently secured or (2) made at a rate that (a) reflects the risk of the loan or loan guarantee and (b) to the extent practicable, is not less than a rate based on market conditions for comparable obligations prevalent prior to the coronavirus outbreak;
- the duration of the loan or loan guarantee is as short as practicable and, in any case, not longer than five years;
- the loan or loan guarantee agreement provides that, until the date that is one year after the loan or loan guarantee is no longer outstanding, the eligible business and any affiliate may not purchase any equity security listed on a national securities exchange of the eligible business or any parent entity, except to the extent required under a contractual obligation in effect as of CESA’s enactment date (the “*Repurchase Restriction*”);²
- the loan or loan guarantee agreement provides that, until the date that is one year after the loan or loan guarantee is no longer outstanding, the eligible business may not pay dividends or make other capital distributions with respect to its common stock;
- the loan or loan guarantee agreement provides that, until September 30, 2020, the eligible business must maintain its employment levels to its March 24, 2020 employment levels to the extent practicable, and, in any case, may not reduce its employment levels through September 30, 2020 by more than 10% from the levels as of March 24;
- the loan or loan guarantee agreement includes a certification that the eligible business (1) is created or organized in the United States or under U.S. law and (2) has significant operations in, and a majority of its employees based in, the United States (the “*U.S. Business Requirement*”);³ and
- the eligible business incurred or is expected to incur losses directly or indirectly as a result of the outbreak that jeopardize the business’s continued operations.

Until one year after any applicable loan or loan guarantee ceases to remain outstanding, to protect collective bargaining agreements, the federal government is restricted from conditioning financial assistance on an air carrier’s or contractor’s implementation of measures to enter into negotiations with the certified bargaining representative of a class of employees regarding pay or other terms and conditions of employment.

Limitations on compensation to highly compensated employees. In addition, as a condition for entering into any loan or loan guarantee under the three categories discussed above, the loan agreement or guarantee must include certain terms related to employee compensation that apply until one year after the date on which the loan or loan guarantee is no longer outstanding. Until the period ends, the agreement must provide that:

- no officer or employee of the eligible business whose total compensation—including salary, bonus, stock awards, and other financial benefits—exceeded \$425,000 in calendar year 2019 (other than an employee whose compensation is determined under a preexisting collective bargaining agreement executed before March 1, 2020) may receive from the eligible business (1) total compensation in any 12 consecutive months during that period that exceeds his or her 2019 total

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compensation or (2) severance pay or other benefits upon termination of employment that exceed twice his or her 2019 total compensation; and

- no officer or employee of the eligible business whose total compensation exceeded \$3 million in calendar year 2019 may receive from the eligible business total compensation in any 12 consecutive months during that period that exceeds the sum of \$3 million plus half of the amount by which his or her 2019 total compensation exceeded \$3 million.

Receipt of warrants or other instruments. Lastly, as a condition for entering into any loan or loan guarantee to an eligible business under the three categories discussed above, the Treasury Secretary must receive:

- if the eligible business has issued publicly traded securities, a warrant or other equity interest in the eligible business; or
- if the eligible business does not have publicly traded securities, a warrant or other equity interest in, or a senior debt instrument issued by, the eligible business.

If the Treasury Secretary determines that the eligible business “cannot feasibly issue warrants or other equity interests,” the Treasury Secretary may instead accept a senior debt instrument in an amount and on terms determined by the Treasury Secretary. The Treasury Secretary may sell, exercise or surrender any warrant or senior debt instrument it receives; however, the Treasury Secretary may not exercise voting power with respect to any shares of common stock.

Although the exact amount, duration and other terms of any equity or debt instruments would presumably be developed at the time the loan or loan guarantee agreement is entered into, the terms of any such equity or debt instrument must be designed to “provide for a reasonable participation . . . for the benefit of taxpayers” in equity appreciation (in the case of a warrant or other equity interest) or a “reasonable” interest rate premium (in the case of a senior debt instrument). It remains to be seen how standardized (like similar instruments used for the 2008 Troubled Asset Relief Program, which provided for nearly uniform terms) or bespoke these instruments will be.

OTHER FINANCIAL ASSISTANCE AVAILABLE UNDER THE CARES ACT

Grants. In addition to the loans and loan guarantees made available to companies in the aviation industry discussed above, Title IV, Subtitle B of the CARES Act authorizes grants to the aviation industry to be used exclusively for the continuation of payment of employee wages, salaries and benefits. This includes \$25 billion for U.S. passenger air carriers, \$4 billion for U.S. cargo air carriers and \$3 billion for “contractors.” Contractors are defined as any person that performs functions on the property of an airport that are directly related to air transportation (e.g., loading and unloading property, security, airport ticketing or aircraft sanitization) or catering functions, in either case pursuant to a contract with a U.S. passenger air carrier. Subtitle B further provides an additional \$100 million for costs and administrative fees associated with providing the financial assistance described in this section.

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The formula to be used by the Treasury Secretary to allocate this financial assistance will be based on the salaries and benefits reported by an air carrier pursuant to Part 241 of Title 14 of the U.S. Code of Federal Regulations, for the period from April 1, 2019 through September 30, 2019. Smaller air carriers that are exempt from Part 241 and contractors are required to separately document wages, salaries, benefits and other compensation for the same time period.

As a condition to receiving grants under Subtitle B, air carriers (and related businesses) and contractors are required to:

- refrain from conducting involuntary furloughs or reducing pay rates and benefits until September 30, 2020;
- refrain from, and cause their affiliates to refrain from, purchasing any equity security of the air carrier or contractor or the parent company of the air carrier (or related business) or contractor that is listed on a national securities exchange until September 30, 2021;
- refrain from paying dividends or making other capital distributions with respect to the common stock or equivalent interest of the air carrier (or related business) or contractor until September 30, 2021; and
- comply with the executive compensation restrictions discussed above with respect to loans and loan guarantees from March 24, 2020 through March 24, 2022 (provided, that the exception with respect to compensation under preexisting collective bargaining agreements applies to collective bargaining agreements entered into prior to March 27, 2020 rather than March 1, 2020).

The CARES Act also temporarily authorizes the Secretary of Transportation to require, to the extent reasonable and practicable, that a U.S. air carrier receiving grants under Subtitle B maintain scheduled air transportation services as the Secretary of Transportation deems necessary to ensure services to any particular point serviced by that carrier before March 1, 2020, including in connection with health care and pharmaceutical supply chains. Any such requirement implemented by the Secretary of Transportation will terminate on March 1, 2022.

Until September 30, 2020, to protect collective bargaining agreements, the federal government is restricted from conditioning grants under Subtitle B on an air carrier's or contractor's implementation of measures to enter into negotiations with the certified bargaining representative of a class of employees regarding pay or other terms and conditions of employment.

Other Relief. The CARES Act also provides relief to the aviation industry through a temporary suspension of certain aviation-related excise taxes for the remainder of 2020. This tax relief specifically includes taxes paid on any amount paid for transportation by air under Section 4261 or 4271 of the Internal Revenue Code of 1986 (*i.e.*, ticket and cargo taxes) and taxes paid on kerosene used in commercial aviation as defined in Section 4083 of the Internal Revenue Code of 1986.

Title XII of the CARES Act sets aside \$10 billion for airports to aid in their COVID-19 prevention and response efforts. Such amounts are only available to sponsors of "airports" as defined in Section 47102 of Title 49 of the U.S. Code, which include (1) any area of land or water used or intended to be used for the

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landing and taking off of aircraft, appurtenant area used or intended to be used for airport buildings or other airport facilities or rights of way and airport buildings and facilities located in any of those areas; or (2) any heliport. Funds apportioned to airports in Title XII are subject to several conditions for the treatment of employees—importantly, airports must maintain 90% of their workforces as of March 27, 2020 until December 31, 2020, subject to adjustments for retirements or voluntary employee separations. Airports may request a hardship waiver from the Department of Transportation for compliance with this employment condition in the case of economic hardship or concerns regarding aviation safety or security.

CONCLUSION

The CARES Act authorizes more than \$50 billion in financial assistance to aviation companies, including: (1) loans and loan guarantees to passenger air carriers (and related businesses) and cargo air carriers; (2) grants to passenger air carriers, cargo air carriers and contractors to be used exclusively for the continuation of payment of employee wages, salaries and benefits; and (3) a temporary suspension of certain aviation-related excise taxes for the remainder of 2020.

This relief is subject to substantial conditions including restrictions on capital allocation, employee retention and executive compensation as well as the issuance of warrants or other instruments to the U.S. government. Aviation companies that are considering applying for relief under the CARES Act should carefully consider the conditions for receiving assistance (and the limitations on future business activities and flexibility these conditions may impose) in relation to their current business outlook, liquidity position and capital allocation strategy.

Moreover, the relief discussed in this memorandum is in addition to a number of other provisions of general applicability contained in the CARES Act, which are outside the scope of this memorandum. Companies that are not eligible for, or otherwise choose not to participate in, the financial assistance programs discussed in this memorandum may be eligible for assistance under other provisions of the CARES Act. We describe those provisions in a separate publication available at <https://www.sullcrom.com/corona-virus-update>.

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ENDNOTES

- ¹ This condition also applies to the first three categories; however, in order to fit into the first three categories, a company must also meet the conditions described above (*i.e.*, the company must be either a U.S. passenger air carrier or related business, a U.S. cargo air carrier or a U.S. business critical to maintaining national security as determined by the Treasury Secretary).
- ² Companies should consider the potential impact of the Repurchase Restriction on their existing repurchase programs and any future programs they might otherwise expect to implement. We describe certain issues to consider with respect to the Repurchase Restriction in a separate publication available at <https://www.sullcrom.com/corona-virus-update>.
- ³ Notably, the U.S. Business Requirement does not appear to limit the ability of a business with a non-U.S. parent company to receive assistance under these categories.

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CONTACTING SULLIVAN & CROMWELL LLP

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CONTACTS

New York

Francis J. Aquila	+1-212-558-4048	aquilaf@sullcrom.com
Thomas C. Baxter Jr.	+1-212-558-4324	baxtert@sullcrom.com
Ari B. Blaut	+1-212-558-1656	blauta@sullcrom.com
Robert E. Buckholz	+1-212-558-3876	buckholzr@sullcrom.com
Whitney A. Chatterjee	+1-212-558-4883	chatterjee@sullcrom.com
Catherine M. Clarkin	+1-212-558-4175	clarkinc@sullcrom.com
Audra D. Cohen	+1-212-558-3275	cohen@sullcrom.com
H. Rodgin Cohen	+1-212-558-3534	cohenhr@sullcrom.com
Heather L. Coleman	+1-212-558-4600	colemanh@sullcrom.com
Donald R. Crawshaw	+1-212-558-4016	crawshawd@sullcrom.com
Elizabeth T. Davy	+1-212-558-7257	davye@sullcrom.com
Robert G. DeLaMater	+1-212-558-4788	delamaterr@sullcrom.com
Eric M. Diamond	+1-212-558-4044	diamonde@sullcrom.com
Robert W. Downes	+1-212-558-4312	downesr@sullcrom.com
Mitchell S. Eitel	+1-212-558-4960	eitelm@sullcrom.com
Michael T. Escue	+1-212-558-3721	escuem@sullcrom.com
John E. Estes	+1-212-558-4349	estesj@sullcrom.com
William G. Farrar	+1-212-558-4940	farrarw@sullcrom.com
Jared M. Fishman	+1-212-558-1689	fishmanj@sullcrom.com
C. Andrew Gerlach	+1-212-558-4789	gerlacha@sullcrom.com
Wendy M. Goldberg	+1-212-558-7915	goldbergw@sullcrom.com
Shari D. Leventhal	+1-212-558-4354	leventhals@sullcrom.com

Marion Leydier	+1-212-558-7925	leydierm@sullcrom.com
John P. Mead	+1-212-558-3764	meadj@sullcrom.com
Mark J. Menting	+1-212-558-4859	mentingm@sullcrom.com
Scott D. Miller	+1-212-558-3109	millersc@sullcrom.com
Camille L. Orme	+1-212-558-3373	ormec@sullcrom.com
Robert W. Reeder III	+1-212-558-3755	reederr@sullcrom.com
Robert S. Risoleo	+1-212-558-4813	risoleor@sullcrom.com
Stephen M. Salley	+1-212-558-4998	salleys@sullcrom.com
George J. Sampas	+1-212-558-4945	sampasg@sullcrom.com
Robert M. Schlein	+1-212-558-4848	schleinr@sullcrom.com
Rebecca J. Simmons	+1-212-558-3175	simmonsr@sullcrom.com
William D. Torchiana	+1-212-558-4056	torchianaw@sullcrom.com
Donald J. Toumey	+1-212-558-4077	toumeyd@sullcrom.com
Marc Trevino	+1-212-558-4239	trevinom@sullcrom.com
Benjamin H. Weiner	+1-212-558-7861	weinerb@sullcrom.com
Michael M. Wiseman	+1-212-558-3846	wisemanm@sullcrom.com

Washington, D.C.

Eric J. Kadel, Jr.	+1-202-956-7640	kadelej@sullcrom.com
Stephen H. Meyer	+1-202-956-7605	meyerst@sullcrom.com
Robert S. Risoleo	+1-202-956-7510	risoleor@sullcrom.com
Jennifer L. Sutton	+1-202-956-7060	suttonj@sullcrom.com
Andrea R. Tokheim	+1-202-956-7015	tokheima@sullcrom.com
Samuel R. Woodall III	+1-202-956-7584	woodalls@sullcrom.com

Los Angeles

Patrick S. Brown	+1-310-712-6603	brownp@sullcrom.com
Eric M. Krautheimer	+1-310-712-6678	krautheimere@sullcrom.com
Alison S. Ressler	+1-310-712-6630	resslera@sullcrom.com

London

Chris Beatty	+44-20-7959-8505	beattyc@sullcrom.com
Kathryn A. Campbell	+44-20-7959-8580	campbellk@sullcrom.com
John Horsfield-Bradbury	+44-20-7959-8491	horsfieldbradburyj@sullcrom.com
John O'Connor	+44-20-7959-8515	oconnorj@sullcrom.com
Oderisio de Vito Piscicelli	+44-20-7959-8589	devitopiscicellio@sullcrom.com
Evan S. Simpson	+44-20-7959-8426	simpsons@sullcrom.com

Palo Alto

Scott D. Miller	+1-650-461-5620	millersc@sullcrom.com
Sarah P. Payne	+1-650-461-5669	paynesa@sullcrom.com
John L. Savva	+1-650-461-5610	savvaj@sullcrom.com

Paris		
William D. Torchiana	+33-1-7304-5890	torchianaw@sullcrom.com
Frankfurt		
Krystian Czerniecki	+49-69-4272-5525	czernieckik@sullcrom.com
Melbourne		
Waldo D. Jones Jr.	+61-3-9635-1508	jonesw@sullcrom.com
Sydney		
Waldo D. Jones Jr.	+61-2-8227-6702	jonesw@sullcrom.com
Tokyo		
Keiji Hatano	+81-3-3213-6171	hatanok@sullcrom.com
Hong Kong		
Garth W. Bray	+852-2826-8691	brayg@sullcrom.com
Ching-Yang Lin	+852-2826-8606	linc@sullcrom.com
Chun Wei	+852-2826-8666	weic@sullcrom.com
Beijing		
Gwen Wong	+86-10-5923-5967	wonggw@sullcrom.com