

# CARES Act: Mid-Sized Business Lending Program

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Under Title IV of the Coronavirus Aid, Relief, and Economic Security Act (the “**CARES Act**”), Congress has authorized US\$500 billion of funding for certain industries and businesses that have been severely impacted by COVID-19.

## A. Introduction

Under Title IV of the Coronavirus Aid, Relief, and Economic Security Act (the “**CARES Act**”), Congress has authorized US\$500 billion of funding for certain industries and businesses that have been severely impacted by COVID-19. The emergency funds allocated under the CARES Act are intended to provide liquidity to businesses in specific industries, as well as to small and mid-sized businesses that are experiencing economic hardship as a result of the COVID-19 public health emergency.

Three industry groups are entitled to direct loans and loan guarantees from the U.S. Treasury under Sections 4003(b)(1)-(3) of the CARES Act, amounting to US\$46 billion of the US\$500 billion authorized: (i) passenger air carriers and related businesses, (ii) cargo air carriers and (iii) businesses critical to the maintenance of national security.

The remaining US\$454 billion<sup>1</sup> of funding is allocated under Section 4003(b)(4) of the CARES Act to the U.S. Treasury for programs established by the Board of Governors of the Federal Reserve System to facilitate a combination of direct lending and guarantees and to support and encourage lending through bank or non-bank lenders. Among these programs, the CARES Act directs the U.S. Treasury under Section 4003(c)(3)(D) to make low-interest loans available to mid-sized businesses.

## B. Mid-Sized Business Lending Program

The U.S. Treasury is authorized to implement a lending program under Section 4003(c)(3)(D) of the CARES Act through which financing will be made available to banks or other similar lending institutions to enable such lenders to provide “*direct loans*”<sup>2</sup> to mid-sized businesses or non-profits, in order to provide liquidity to the financial system that supports lending to eligible businesses. The interest rates on such loans will not exceed 2 percent annually and, for the first six (6) months, no principal or interest payments will be due on the loans.<sup>3</sup> To be an eligible business under Section 4003(c)(3)(D), an applicant must employ between 500 and 10,000 employees and must certify to the following in good-faith pursuant to Section 4003(c)(3)(D)(i):

- as of the date of the application, the requested loan is necessary to support the ongoing operations of the applicant due to the economic uncertainty related to the COVID-19 public health emergency;

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<sup>1</sup> Any amounts available under Sections 4003(b)(1)-(3) that are not used as provided under those paragraphs shall be available under Section 4003(b)(4).

<sup>2</sup> Direct loans are “a loan under a bilateral loan agreement that is (i) entered into directly with an eligible business as borrower; and (ii) not part of a syndicated loan, a loan originated by a financial institution in the ordinary course of business, or a securities or capital markets transaction” (as defined in Section 4003(c)(3)(A)(i)).

<sup>3</sup> At the discretion of the U.S. Treasury Secretary, the deferral period on payments may be extended.

- the funds received by the applicant must be applied to retain at least 90 percent of the applicant's current workforce (including full compensation and benefits) through at least September 30, 2020;
- the applicant will commit to reinstating no less than 90 percent of their workforce that was employed as of February 1, 2020 (including full compensation and benefits) no later than four (4) months after the termination of the COVID-19 public health emergency<sup>4</sup>;
- the applicant is domiciled in the US and has significant operations and employees located within the US;
- the applicant is not a debtor in a bankruptcy proceeding;
- the applicant was "created or organized" in the US or under the laws of the US, and the applicant has significant operations and a majority of its employees in the US<sup>5</sup>;
- the applicant will not pay any dividends or repurchase any common stock<sup>6</sup> (whether of the applicant or a parent company) while the loan is outstanding<sup>7</sup>;
- the applicant agrees that it will not outsource or offshore jobs for the duration of the loan and for at least two (2) years after the loan is repaid;
- the applicant will not abrogate any existing collective bargaining agreements for the duration of the loan and for at least two (2) years after the loan is repaid; and
- the applicant agrees to remain neutral in any union-organizing efforts for the period the loan is outstanding.

The CARES Act does not impose any deadlines on the U.S. Treasury or the Federal Reserve System to provide guidance or procedures for the applications to the mid-sized business lending program under Section 4003(c)(3)(D). By looking to other programs that the U.S. Treasury is running, we can only imagine what the application process may look like. Please see [Annex A](#), attached hereto, for our thoughts on some examples of application requirements that could be included in the application forms.

### C. Compensation Restrictions and the CARES Act's Internal Conflict

In addition to the limitations and certifications described in [Section B](#) above (the "**Mid-Sized Restrictions**"), other restrictions included in the CARES Act may also apply to the direct loans provided to mid-sized businesses. A specific restriction that may apply to such loans are the compensation restrictions outlined in Section 4004.

Upon first review, the restrictions contained in Section 4003(c)(3)(A)(ii) (the "**Broader Program Restrictions**") appear to apply to all direct loans made under Section 4003(b)(4), which would include the lending to mid-sized companies. However, the CARES Act contains several internal conflicts that call into question whether the Broader Program Restrictions apply to the direct loans to mid-sized businesses described in Section 4003(c)(3)(D).

For example, the Broader Program Restrictions contain a prohibition on the repurchase of stock and the payment of dividends or other capital distributions until twelve (12) months after a loan or loan guarantee is no longer outstanding. A similar restriction in clause (VII) of the Mid-Sized Restrictions applies only while the direct loan remains outstanding. One could read the apparent conflict as indicating that the Broader Program Restrictions do not apply to mid-sized business direct loans because the more specific language of clause (VII) should be read to indicate that Congress intentionally listed all of the restrictions for the mid-sized direct loans in the Mid-Sized Restrictions. A more narrow reading of the conflicting sections could determine that the

<sup>4</sup> The public health emergency in response to COVID-19 was declared by the Secretary of Health and Human Services on January 31, 2020, under section 319 of the Public Health Services Act (42 U.S.C. 247d).

<sup>5</sup> Section 4003(c)(3)(D)(IV) confusingly requires a certification that the applicant is an entity or business that is domiciled in the United States with significant operations and employees located in the United States. This is less onerous than the language set out in Section 4003(c)(3)(D)(VI), which seems to cover the same subject matter.

<sup>6</sup> There is an exception to the restrictions on dividend payments and common stock repurchases if they are required under a contractual obligation that is in effect as of the date of enactment of the CARES Act.

<sup>7</sup> See below for a discussion of the time period that may apply to this restriction.

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Broader Program Restrictions apply to *all* direct loans, and that the more specific restriction of clause (VII) of the Mid-Sized Restrictions controls the outcome only as to the time period for the restrictions contain therein.

If a narrow reading of the statutory conflict prevails and the Broader Program Restrictions are interpreted to apply to the mid-sized business direct loans, then the compensation restrictions contained in Section 4004 of the CARES Act would apply to the borrowers of the mid-sized business direct loans. Clause (III) of the Broader Program Restrictions incorporates Section 4004's compensation restrictions.

Applying the Section 4004 compensation restrictions to all direct loans made under the Section 4003(b)(4) programs exposes one more oddity in the CARES Act's language. The introductory language in Section 4004 specifically applies its restrictions to "loans or loan guarantees under paragraph (1), (2) or (3) of section 4003(b)[.]" If the restrictions in Section 4004 applied to *any* loan made under Section 4003, why would the statute reference only (b)(1), (2) and (3)? One could argue that it is accounted for in the difference between the U.S. Treasury's direct lending and the lending through a Section 4003(b)(4) program, but that result feels like a stretch when the other provisions in Section 4003(b) did address the two types of credit together. Specific references to those three paragraphs seem to imply that at least some lending covered by Section 4003(b)(4) is excluded from Section 4004's compensation restrictions. If the alternative was the intent, why not include a reference to all lending under Section 4003(b)?

For now, we believe clients should plan on the Section 4004 compensation restrictions applying to loans under the mid-sized business lending program. Ultimately, we will have to see how the U.S. Treasury and the Board of Governors of the Federal Reserve System interpret the clause.

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## ANNEX A

### Sample Application Requirements

The U.S. Treasury has not yet provided any guidance or procedures for applications to the mid-sized business lending program under Section 4003(c)(3)(D). However, recently released guidelines on application procedures for the loans provided under Sections 4003(b)(1)-(3) of the CARES Act may provide some indication as to what mid-sized business applicants will face. The application for mid-sized businesses may include the same application requirements or similar requirements with reduced time periods, fewer deliverables, etc. While we caution that the below list is purely speculative, for those wanting to get a head start, the following may be required:

- Debt: A description of your existing secured and unsecured debt, bank and other credit lines with outstanding and maximum balances, and major classes of existing security holders and creditors.<sup>8</sup>
- Debt Service: A description of your scheduled debt service for the next three (3) years.
- Employment Levels: Description of your employment levels, by head count and total compensation amount, as of February 1, 2020 and March 24, 2020, and any proposed changes to your employment levels, relative to March 24, 2020, during 2020.
- Financial Statements: The consolidated financial statements of the applicant and any corporate parents for the previous three (3) years, including, if available, financial statements that have been audited by an independent certified public accountant, including any associated notes, and any interim financial statements and associated notes for the current fiscal year.
- Lack of Credit Elsewhere: Provide evidence that the borrower cannot reasonably obtain credit elsewhere based on factors such as market conditions, the applicant's circumstances, or relationships with existing and potential creditors.<sup>9</sup>
- Use of Proceeds: The purposes for which the applicant will use the loan proceeds.
- Financial Needs: Quantitative information on the applicant's financial needs for the remainder of 2020, including expected revenues, operating costs and credit, and how the loan will address those needs together with any other sources of funding and financing available to the applicant.
- Operating Plan: A discussion of the applicant's operating plan for the remainder of 2020 if the loan is approved, including how the proposed loan fits within the applicant's business plan, and an analysis showing that the loan is prudently incurred.
- Cost Restructuring: A description of any plans the applicant has to restructure its obligations, contracts, staffing, or organization to improve the applicant's financial condition.

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<sup>8</sup> Additional considerations: Borrowers should consider whether these government loans would be permitted under their existing credit agreements and indentures (unless intending to refinance their capital structure in full). Certain terms (e.g. inside maturity date, restrictive covenants, etc.) may conflict with existing documentation and require lender/bondholder consent.

<sup>9</sup> Additional considerations: Applicants will need to consider in their responses whether *no other credit* is available to them or if the credit solutions that are available are simply too burdensome (or expensive) under current operations or difficult to reconcile with existing credit obligations.