

COVID-19 Update: : US Senate Passes \$61 Billion Relief Package for Aviation Industry

March 26, 2020

On Wednesday, March 25, the United States Senate passed by unanimous vote the Coronavirus Aid, Relief and Economic Security Act (CARES Act). The Cares Act marks the third round of economic stimulus in response to the outbreak of the coronavirus disease 2019 (COVID-19). Under Title IV of the CARES Act (also known as the Coronavirus Economic Stabilization Act of 2020 or the Act), Senators approved \$500 billion in federal assistance to severely distressed sectors of the economy as part of the larger \$2 trillion stimulus package. The approved programs include \$61 billion to the aviation sector as follows:

- \$29 billion in loans and loan guarantees for air carriers, Part 145 aircraft repair stations and ticket agents;
- \$32 billion in payroll protection grants for air carriers and their contractors; and
- Relief to air carriers from federal excise taxes that apply to transporting passengers and cargo and the purchase of aviation jet fuel.

\$17 billion in loans and loan guarantees will be available for businesses critical to the national security of the United States, and \$454 billion will be available to backstop the Federal Reserve's emergency lending facilities.

The Act provides much-needed liquidity support to the US aviation industry, an important segment of the US economy that is directly responsible for more than 750,000 jobs and that indirectly supports more than 10 million additional jobs. At the same time, the Act includes many of the safeguards for the federal government that were built into the post-9/11 support measures provided to airlines.

This advisory will focus on the specific portions of the Act that will affect businesses in the US aviation sector. A summary of these provisions is set forth below.

- **Loans and loan guarantees** – Under Section 4003(b) of the Act, the Secretary of the US Treasury Department is authorized to make loans and loan guarantees to US passenger and cargo air carriers, Part 145 aircraft repair stations and ticket agents. Up to \$25 billion is available to passenger air carriers, Part 145 aircraft repair station operators and ticket agents. Up to \$4 billion is available to cargo air carriers. Loans and loan guarantees made by the Treasury Secretary may be modified, restructured or otherwise amended, but no loan or loan guarantee under the program is eligible for loan forgiveness. The Treasury Secretary's authority to make loans and loan guarantees terminates on December 31, 2020.
 - **Loan eligibility requirements** – To qualify for a loan or loan guarantee under the Act, airlines must be an "air carrier" (as defined under section 40102 of Title 49 of the United States Code (the Transportation Code). Aircraft repair station operators must be certified under Part 145 of title 14, Code of Federal Regulations, and be approved to perform inspection, repair, replacement or overhaul services. Ticket agents must be a "ticket agent," as defined under section 40102 of the Transportation Code. Following an application process,
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the Treasury Secretary may enter into a loan or loan guarantee agreement with a borrower if it determines (in its discretion) that:

- Credit is not reasonably available to the applicant at the time of the transaction;
 - The intended obligation is prudently incurred by the applicant; and
 - The applicant must have incurred or is expected to incur COVID-19 related losses such that the continued operations of the applicant's business are jeopardized.
- Application procedures – The Treasury Secretary is required to publish as soon as practicable after the date of enactment of the Act, but in no case later than 10 days thereafter, procedures for application and minimum requirements, which may be supplemented from time to time in the Treasury Secretary's discretion for making loans and loan guarantees under the Act.
- Required terms and conditions – The loans and loan guarantees shall be in the form and on the terms, conditions, representations, warranties and requirements (including audit requirements) as the Treasury Secretary determines appropriate. The Act requires loan and loan guarantee agreements to provide certain terms and conditions, including:
- *Interest rate* – The Treasury Secretary will determine the applicable interest rate based on the risk and the current average yield on outstanding Treasury obligations of comparable maturity;
 - *Collateral* – The relevant loan or loan guarantee is sufficiently secured or is made a rate that (1) reflects the risk of the loan or loan guarantee and (2) is, to the extent practicable, not less than an interest rate based on market conditions for comparable obligations prevalent before the COVID-19 pandemic;
 - *Duration* – The duration of the loans or loan guarantees shall be as short as practicable and shall not in any case exceed five years. Any loan or loan guarantee that is modified, restructured or otherwise amended cannot be extended beyond five years from the origination date of such loan or loan guarantee;
 - *Prohibition of share buybacks* – Until 12 months after the date on which the loan or loan guarantee is no longer outstanding, neither the borrower nor any affiliate of the borrower may purchase the publicly listed equity securities of the borrower or any parent company of the borrower, except as provided in a pre-existing contractual obligation;
 - *Prohibition on dividend payments* – Until 12 months after the date on which the loan or loan guarantee is no longer outstanding, the borrower shall not pay dividends or make other capital distributions with respect to its common stock;
 - *Workforce retention covenants* – The borrower must agree that it will maintain its existing employment levels as of March 24, 2020 to the extent practicable, and that in any case it will not reduce its March 24 employment levels by more than 10 percent (10%) up to and including September 30;
 - *Certification as to status* – The borrower must certify that it is created or organized in the United States (or under the laws thereof) and that it maintains significant operations in and a majority of its employees are based in the United States.
- Tax treatment of loans as indebtedness – Pursuant to Section 4003(h) of the Act, any loan made by or guaranteed by the Treasury Department shall be treated as indebtedness for purposes of the Internal Revenue Code of 1986 (the Tax Code). Any such loan shall be treated as issued for its stated principal amount, and the stated interest on such loans shall be treated as qualified stated interest. The Treasury Secretary shall prescribe such regulations or guidance as may be required, including guidance providing that the acquisition of warrants, stock options, common or preferred stock, or other equity by the Treasury Secretary does not result in a change in ownership under the Section 382 of the Tax Code.

- **Payroll protection grants** — Under Section 4112 of the Act, the Treasury Secretary is directed to provide air carriers and passenger airline contractors (including subcontractors) with direct aid to be used exclusively for the continuation of the payment of employee wages, salaries and benefits. Up to \$25 billion is available to passenger air carriers, up to \$4 billion is available to cargo air carriers, and up to \$3 billion for airline contractors.
 - **Capped grant amounts** — Grant amounts will be capped at the amounts of salaries and benefits reported to the Department of Transportation by recipients during the period from April 1, 2019 through September 30, 2019 pursuant to 14 CFR Part 241. If a recipient was not required to report such data to the Transportation Department, then based on a certified statement, using sworn financial statements or other appropriate data, grant amounts will be for an amount equal to the certified amount of wages, salaries, benefits and other compensation that such recipient paid its employees from April 1, 2019 through September 30, 2019;
 - **Payment requirements** — The Treasury Secretary is directed to publish within five days after enactment of the Act streamlined and expedited procedures for air carriers and contractors to submit grant requests. The Treasury Secretary must make initial payments within 10 days after the date of enactment of the Act to air carriers and contractors seeking financing assistance that have been approved by the Treasury Secretary.
 - **Required terms and conditions** — The direct aid given to air carriers and their contractors shall be in the form and on such terms and conditions, including audit requirements and clawback provisions, as the Treasury Secretary determines appropriate. To be eligible for grants under the Act, air carriers and contractors must:
 - *Workforce Retention* — Agree to refrain from conducting involuntary furloughs or reducing pay rates and benefits until September 30;
 - *Prohibition on Share Buybacks* — Agree that, through September 30, 2021, neither the recipient nor any affiliate of such recipient may, in any transaction, purchase a publicly listed equity security of the recipient or any parent company of the recipient;
 - *Prohibition on Dividend Payments* — Agree that, through September 30, 2021, the recipient shall not pay dividends or make other capital distributions with respect to the common stock of the recipient,
- **Executive compensation restrictions** — Borrowers and grant recipients must agree to limit the total compensation of certain officers and employees as follows:
 - No officer or employee who received total compensation in calendar year 2019 that exceeded \$425,000 may receive:
 - During any 12 consecutive months of a relevant period, an amount of total compensation that exceeds the total compensation received by such officer or employee in calendar year 2019; and
 - During the relevant period, severance pay or other benefits upon termination of employment that exceeds twice the maximum total compensation received by such officer or employee in calendar year 2019.
 - No officer or employee who received total compensation in calendar year 2019 that exceeded \$3 million may receive, during any 12 consecutive month period of the relevant period, total compensation that exceeds the sum of: (1) \$3 million and (2) fifty percent (50%) of the excess over \$3 million received by such officer or employee in calendar year 2019.
 - The term “relevant period” means: (1) for loans and loan guarantees, the date on which the agreement is executed until the date that is one year after the date on which the loan or loan guarantee is no longer outstanding, and (2) for grants, March 24, 2020 to March 24, 2022.
 - The term “total compensation” includes salary, bonuses, awards of stock and other financial benefits provided to an officer or employee. These limitations on total compensation do not apply to employees whose compensation is determined by a collective bargaining agreement entered into before March 1.

- **Continuation of service requirements** – The Secretary of the US Department of Transportation may require, to the extent reasonable and practicable, an air carrier receiving a loan, or loan guarantee, or payroll protection grant to maintain levels of scheduled air transportation service as the Secretary of Transportation deems necessary to ensure that services to any point served by that carrier before March 1, 2020 are continued. When determining whether to exercise this authority, the Secretary of Transportation shall consider the air transportation needs of small and remote communities and the need to maintain well-functioning health care and pharmaceutical supply chains. The Secretary of Transportation’s authority to require air carriers to maintain certain levels of service expires on March 1, 2022.
- **Equity interests held by federal government** – The Act also provides for the federal government to be compensated for issuing loans, loan guarantees and direct aid as follows:
 - For loans and loan guarantees, the Treasury Secretary must receive either a warrant or other equity interest in the borrower. Any borrower that is not publicly traded must also issue a senior debt instrument in favor of the Treasury Secretary. The terms and conditions of such instruments shall provide for reasonable participation in equity appreciation (in the case of a warrant or other equity interest) or a reasonable rate of return (in the case of a debt instrument). The Treasury Secretary may sell, exercise, or surrender a warrant or any senior debt instrument it receives under the Act. The Treasury Secretary is prohibited from exercising voting power with respect to any shares of common stock it acquires.
 - For payroll protection grants, the Treasury Secretary may receive warrants, options, preferred stock, debt securities, notes or other financial instruments issued by recipients which, in the sole determination of the Treasury Secretary, provide appropriate compensation to the federal government for providing grants under the program.
- **Federal excise tax relief** – The Act also provides relief to air carriers from certain federal excise taxes that normally apply to transportation services, such as the taxes and fees on airline passenger tickets, the cost of carrying cargo and the purchase of aviation jet fuel. The excise tax holiday period begins on the date of enactment and ends on January 1, 2021.

The Act must now be passed in the US House of Representatives, which is expected to occur (without further changes to the Act) by voice vote on Friday, March 27. If passed by the House, Congress will send the Act to President Trump for signature. In the coming days, the Treasury Department will be releasing proposed regulations setting forth the administrative procedures that apply to the loan and loan guarantee program and the application requirements for payroll protection grants. Under the Act, the Treasury Secretary is required to coordinate with the Secretary of Transportation in carrying out the Act’s provisions with respect to air carriers. Although funds for the program have been directly appropriated to the Exchange Stabilization Fund (the Treasury Department’s emergency reserve fund), the Act does not provide a specific framework to implement its programs, so additional guidance is needed.

Two oversight offices are established under the Act: (1) the Office of the Special Inspector General for Pandemic Recovery (to be organized within the Treasury Department); and (2) the Congressional Oversight Commission (to be organized within the legislative branch). The Special Inspector General for Pandemic Recovery – who is to be appointed by the President with the advice and consent of the Senate – is responsible for conducting, supervising, and coordinating audits and investigations of the making, purchase, management, and sale of loans, loan guarantees, and other investments made by the Treasury Secretary under the Act. The Congressional Oversight Commission is charged with overseeing the implementation of the Act’s programs by the Treasury Department and the Federal Reserve.

Moreover, the Treasury Secretary has to comply with robust disclosure obligations under the Act, including, but not limited to: (1) providing reports to Congress within seven days after entering into a loan/loan guarantee transaction and publishing such report on the Treasury Department website; (2) every 30 days while a loan or loan guarantee

is outstanding; (3) publishing a summary of the transactions the Treasury Department has entered into under the program; and (4) offering testimony to Congress on a quarterly basis regarding the Treasury Department's obligations under the Act and the transaction it has entered into thereunder.

Following stringent governmental travel restrictions put in place to curb the spread of COVID-19, demand for air travel has fallen to historic lows. As a result, on top of significant cuts to domestic air travel, most airlines around the world have cancelled up to 75–100 percent of international routes. The International Air Transport Association (IATA) recently predicted that global losses to airline revenue caused by COVID-19 could reach \$252 billion, increasing its previous estimate of \$113 billion in COVID-19 related losses. Together with the approval of governmental relief measures rolled out to airlines in Australia, Brazil, China, Denmark, France, India, Italy, New Zealand, Norway, South Korea, Sweden and Taiwan, passage of the Act will contribute significantly to the \$200+ billion in governmental support that is needed for the industry to survive the COVID-19.

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