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CLIENT MEMORANDUM

COVID-19 – The CARES Act: Federal Reserve Board Issues Additional Guidance on The Main Street Lending Program

May 6, 2020

The Coronavirus Aid, Relief and Economic Security Act (the "CARES Act"), signed into law on March 27, 2020, established multiple financial assistance programs to support businesses, non-profits and governmental entities affected by the COVID-19 pandemic.

The first direct loan program, the Paycheck Protection Program ("PPP"), is administered by the Small Business Administration ("SBA") and is generally aimed at small businesses and non-profits with 500 or fewer employees. As its name suggests, the PPP is intended primarily to help borrowers continue paying their employees during the COVID-19 crisis. Information about the program is available on our COVID-19 Resources page.

The Main Street Lending Program (the "Program"), is the second direct loan program. The Program, administered by the Federal Reserve, authorizes eligible lenders to originate up to $600 billion in eligible loans targeted towards small and medium-sized businesses that were unable to access the PPP or that require additional support after receiving a PPP loan. Unlike PPP loans, loans originated under the Program are full recourse loans and are not forgivable. The Program has significant differences from the CARES Act section on "Assistance for Mid-Sized Businesses" and does not import all of the terms specified therein.

On April 9th the Board of Governors (the "Board") of the Federal Reserve System (the "Federal Reserve") issued its initial guidance regarding the Program. After reviewing more than 2,200 comment letters, on April 30th the Board significantly revised the Program and issued additional interim guidance, including a "Frequently Asked Questions" document. Among the numerous changes announced on April 30th were: (i) the addition of the Main Street Priority Loan Facility, a third loan facility option in the Program enabling higher leveraged loans to borrowers and which may be used to refinance a borrower's existing third party debt (i.e., not owed to the new lender); (ii) a reduction of the minimum loan size for certain loans to $500,000; (iii) expansion of the pool of businesses eligible to borrow from a maximum of 10,000 employees or $2.5 billion in revenue to a maximum of 15,000 employees or $5 billion in revenue; and (iv) a change to the reference rate used in computing interest from the Secured Overnight Financing Rate to LIBOR.

This Client Alert summarizes the principal features of the Program. The Program rules have not been finalized yet but the Board's interim guidance provides sufficient detail for lenders and borrowers to start considering how to best engage with it. We expect that the Board will publish additional information, including the Program's official launch date and application procedures, in the near future.

OVERVIEW

The Department of Treasury will make a $75 billion investment in a special purpose vehicle (an "SPV"), which in turn will purchase up to $600 billion in participations in eligible loans. The Program consists of three separate facilities:

- the Main Street New Loan Facility (the "New Loan Facility");
- the Main Street Priority Loan Facility (the "Priority Loan Facility"); and
- the Main Street Expanded Loan Facility (the "Expanded Loan Facility").

Unlike PPP loans, lenders are required to retain a portion of the loans originated under the Program and thus share in the credit risk, which incentivizes appropriate care in assessing borrower creditworthiness and making underwriting decisions. Under the New Loan Facility the SPV will purchase a 95% participation in each eligible loan. Under the Priority Loan Facility, which is intended to allow for higher leveraged loans to borrowers, the SPV will purchase 85% participations in each eligible loan. Under the Expanded Loan Facility the SPV will purchase 95% participations in the upsized tranche of an eligible loan (we'll refer to loans in which an SPV has purchased a participation under the New Loan Facility, the Priority Loan Facility or the Expanded Loan Facility (collectively, the "Loan Facilities") as "Main Street Loans"). The Board has not provided an indication of the Loan Facilities' relative size.

ELIGIBLE LENDERS

Only U.S. insured depository institutions (including a bank, savings association, or credit union), U.S. bank holding companies, U.S. savings and loan holding companies, U.S. branches or agencies of foreign banks, U.S. intermediate holding companies of foreign banking organizations, or U.S. subsidiaries of any of the foregoing, are eligible to participate as lenders in the Program. At this time, nonbank financial institutions are not eligible to be lenders under the Loan Facilities.

In the case of the Expanded Loan Facility, the participating lender must hold an interest in the underlying loan at the time of the upsizing. If the loan that is being upsized is a syndicated facility at the time of the upsizing, only the eligible lender providing the upsized tranche is required to meet the eligibility requirements. Other members of the existing syndicated facility are not required to be eligible lenders.

> ***Observation***: *The interim guidance generally speaks in terms of a single "eligible lender." Syndication of Main Street Loans (other than to the SPV) do not appear to be contemplated and, once Main Street Loans are originated, assignments by the lender (other than to the SPV) are expressly prohibited. However, a business may receive multiple loans under the same Loan Facility. As a result, it appears that multiple syndicate members (conceivably including both eligible lenders and non-eligible lenders) may participate in the upsized*

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tranche of a syndicated facility, provided that each participant whose loans are to be assigned to the SPV pursuant to the Program must qualify as an "eligible lender."

ELIGIBLE BORROWERS

In order to participate in the Loan Facilities, a business[1] must satisfy eligibility criteria, including that:

- it was established prior to March 13, 2020;
- it and its affiliates collectively either: (i) have 15,000 or fewer employees (determined as set forth below), or (ii) had 2019 annual revenues (determined as set forth below) of $5 billion or less;
- it 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;
- it is not a type of business listed as ineligible under SBA loan regulations;[2]
- it does not participate in certain other CARES Act programs (see "Borrower Participation in Other Cares Act Programs" below); and
- it meets certain criteria relating to its financial condition and solvency (see "Borrower Financial Condition and Solvency" below).

Nonprofit organizations do not fall within the definition of "Business" and thus are not currently eligible for the Program. However, the Board is currently evaluating the feasibility of a separate approach for non-profit organizations to participate in the Program utilizing eligibility criteria and metrics more suited to evaluate their credit risk and meet their unique needs.

These are minimum requirements, and lenders must apply their own independent underwriting standards in determining a borrower's creditworthiness.

[1] The guidance requires that a "Business" be a legally formed entity that is organized for profit as a partnership, a limited liability company, a corporation, an association, a trust, a cooperative, a joint venture with no more than 49% participation by foreign business entities, or a tribal business concern. Other forms of organization may be considered for inclusion as a Business at the discretion of the Board.

[2] The guidance defines an "Ineligible Business" as a type of business ineligible for loans under the SBA regulations at 13 CFR 120.110(b)-(j) and (m)-(s), as modified by regulations implementing the PPP or otherwise modified at the discretion of the Board. The only subsections of such SBA regulations that are not included in this definition are the portions rendering non-profit organizations and businesses principally engaged in teaching religious beliefs (whether in a religious or secular setting) ineligible. However, a nonprofit organization does not fall within the definition of "business".

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> ***Observation**: U.S. subsidiaries of foreign entities may be eligible to participate in the Program as long as they meet the "significant operations" and "majority of employees" tests (neither of which is defined in the CARES Act or the guidance issued by the Board to date).*

Determining Eligibility - How to Count Employees

For purposes of determining program eligibility, the number of employees of a business is governed by the framework set out in the SBA regulations at 13 CFR 121.106, which calculates the average of the total number of employees for each pay period over the 12 months prior to the origination or upsizing of the loan. The calculation includes all full-time, part-time, seasonal, or otherwise employed persons of the business and its affiliates, but excludes volunteers and independent contractors.

***Observations**:*

1. *We expect that subsequent guidance will clarify that it is the responsibility of the borrower to determine which entities are its affiliates and determine the employee headcount, and that the lender is permitted to rely on the borrower's certifications, which would be consistent with the procedures applicable for the PPP. See the PPP Loans Frequently Asked Questions issued by the Department of Treasury dated May 3rd, 2020.*
2. *The interim guidance does not require that borrowers have at least 500 employees, although the CARES Act contemplates such a minimum for the Program.*

Determining Eligibility - How to Calculate 2019 Revenues

The 2019 annual revenues of a business and its affiliates for purposes of determining program eligibility may be calculated by use of (i) annual revenues for fiscal year 2019 as set forth in GAAP audited financial statements, or (ii) annual receipts for fiscal year 2019 as reported to the Internal Revenue Service.[3] If the business (or its affiliate) does not yet have audited financial statements or annual receipts for fiscal year 2019, then it (or its affiliate) should use its most recent audited financial statements or annual receipts.

[3] Under the interim guidance, "receipts" has the same meaning used by the SBA regulations in 13 CFR 121.104(a).

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Affiliation Principles for the Employee and Revenue Eligibility Criteria

For purposes of determining the employee and revenue eligibility criteria, affiliated entities are determined in accordance with the affiliation principles set forth in the SBA's regulations at 13 CFR 121.301(f),[4] which include:

- affiliation based on ownership or the power to control more than 50% of the entity's voting equity, which may include a minority owner's rights to block actions by the board of directors or shareholders;
- affiliation arising under stock options, convertible securities or agreements to merge;
- affiliation based on common management, such as common officers, managers or directors who control the entity;
- affiliation based on identity of interest between individuals or firms with substantially identical business or economic interests (such as close relatives, or firms with common investments or that are economically dependent); and
- affiliation based on franchise agreements.

Observations:

1. *The Treasury Department's guidance implementing the PPP also measures a borrower's affiliation through the rules in 13 CFR 121.301(f), but utilizes only the first four affiliation tests listed above. The Board's interim guidance for the Loan Facilities does not limit affiliation to such four tests, and appears to permit the standard SBA affiliation exceptions under 13 CFR 121.103(b). However, the guidance has not adopted the special affiliation exceptions for franchisees, restaurants or Small Business Investment Company investees which are applicable for the eligibility calculations under the PPP.*
2. *These affiliation rules may prove problematic for a prospective borrower which is a portfolio company of a private equity or venture capital fund, as the employees and revenues of the fund's various other portfolio companies and affiliates may need to be included in calculations to determine the borrower's eligibility for the Loan Facilities.*

[4] The interim guidance directs references the version of 13 CFR 121.301(f) as in effect on January 1, 2019, as the amendments to 13 CFR 121.301(f) adopted by the SBA on February 10, 2020 (see *Express Loan Programs: Affiliation Standards* at 5 Fed. Reg. 7622) were rescinded pursuant to Section 1102(e) of the CARES Act.

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3. *We expect that subsequent guidance will clarify that a minority owner will not be deemed an affiliate by virtue of its rights to block actions by the board of directors or shareholders provided that such rights are irrevocably waived, which would be consistent with the guidance provided for the PPP. See the PPP Loans Frequently Asked Questions issued by the Department of Treasury dated May 3rd, 2020.*

Borrower Financial Condition and Solvency

The CARES Act requires that the Board establish procedures to prohibit borrowing under the program by businesses that are insolvent. The interim guidance includes a number of terms related to this requirement, including:

- Lenders are expected to conduct an assessment of the potential borrower's financial condition at the time of application.

- The borrower must have been in sound financial condition prior to the onset of the COVID-19 pandemic.

  Observation: *The interim guidance does not elaborate as to the meaning of "sound financial condition."*

- If the borrower had other loans outstanding with the lender as of December 31, 2019, such loans must have had an internal risk rating equivalent to a "pass" in the Federal Financial Institutions Examination Council's supervisory rating system on that date.

- The borrower must certify that it will be able to meet its financial obligations during the first 90 days after the loan, and that it does not expect to file for bankruptcy during such period. For further details, see "Borrower Certifications and Covenants" below.

Borrower Participation in Other Cares Act Programs

Businesses may not participate in more than one of the Loan Facilities, although a business may receive multiple loans under the same Loan Facility, subject to the maximum loan size applicable for such facility.

Businesses that participate in any of the Loan Facilities also may not:

- participate in the Primary Market Corporate Credit Facility, a separate program under the CARES Act that provides a funding backstop for corporate debt of certain investment grade companies; or

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- receive specific support pursuant to Section 4003(b)(1)-(3) of the CARES Act, which provides for $29 billion in support to the airline industry and $17 billion in support to businesses deemed critical to national security.

However, businesses that have taken advantage of the PPP may also take out Main Street Loans under the Program.

FEATURES OF ELIGIBLE LOANS

FEATURE	NEW LOAN FACILITY	PRIORITY LOAN FACILITY	EXPANDED LOAN FACILITY*
Origination Date	On or after April 24, 2020	On or after April 24, 2020	Upsizing on or after April 24, 2020 of a loan made by a lender to a borrower before April 24, 2020 and that has a remaining maturity of at least 18 months (includes any extensions pursuant to the upsizing).
Maturity	4 years	4 years	4 years
Amortization of Principal and Capitalized Interest	Year 1: Deferred (with unpaid interest capitalized) Year 2: 33.33% Year 3: 33.33% Year 4: 33.33%	Year 1: Deferred (with unpaid interest capitalized) Year 2: 15% Year 3: 15% Year 4: 70%	Year 1: Deferred (with unpaid interest capitalized) Year 2: 15% Year 3: 15% Year 4: 70%
Interest Rate	LIBOR (1 or 3 month) + 3%	LIBOR (1 or 3 month) + 3%	LIBOR (1 or 3 month) + 3%
Security	May be secured or unsecured.	May be secured or unsecured.	Secured if the underlying loan is secured. Otherwise, may be secured or unsecured. The lender may require the borrower to pledge additional collateral to secure the upsize.

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FEATURE	NEW LOAN FACILITY	PRIORITY LOAN FACILITY	EXPANDED LOAN FACILITY*
Priority	Must not be contractually subordinated in terms of priority to any of the borrower's other debt.	Must be senior to or pari passu with all of the borrower's other debt, other than mortgage debt.	Upsized tranche must be senior to or pari passu with all of the borrower's other debt, other than mortgage debt.
Minimum loan size	$500,000	$500,000	$10 million
Maximum loan size	Lesser of (i) $25 million or (ii) an amount that, when added to existing outstanding and undrawn available debt, does not exceed four (4) times the adjusted 2019 EBITDA of the borrower.	Lesser of (i) $25 million or (ii) an amount that, when added to existing outstanding and undrawn available debt, does not exceed six (6) times the adjusted 2019 EBITDA of the borrower.	Lesser of (i) $200 million, (ii) 35% of existing outstanding and undrawn available debt, or (iii) an amount that, when added to existing outstanding and committed but undrawn debt, does not exceed six (6) times the adjusted 2019 EBITDA of the borrower.
Lender Loan Participation	5%	15%	5% of the upsized tranche
Prepayments	Permitted without penalty	Permitted without penalty	Permitted without penalty

* In the case of the Expanded Loan Facility, the loan terms generally only need to apply to the upsized tranche.

***Observations**:*

1. *Revolving credit loans are not permitted under the New Loan Facility or the Priority Loan Facility. However, borrowers participating in the Expanded Loan Facility can upsize their existing term loan or revolving credit facility.*

2. *The interim guidance does not indicate whether affiliation rules apply in calculating adjusted 2019 EBITDA for purposes of determining the maximum loan size.*

3. *During the month of April 2020, the 1 month and 3 month USD LIBOR rates have generally been below 1%, and thus the initial interest rate on Main Street Loans will*

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likely be in the 3-4% range. The interim guidance does not specify how frequently LIBOR rates are to be adjusted.

4. *Although all of the Loan Facilities use EBITDA-based loan metrics, the Board and the Treasury Department are evaluating the feasibility of providing alternative loan metrics which are more suited to evaluate the credit risk and meet the needs of asset-based borrowers.*

5. *Loans under the New Loan Facilities and Expanded Loan Facilities are designed to co-exist with existing third-party credit facilities arranged outside the Program. Unlike the other two Loan Facilities, the Priority Loan Facility can be used to refinance a borrower's existing credit facilities, subject to the maximum loan amount. Accordingly, the need to obtain consents from existing lenders for the incurrence of additional debt, and/or to arrange intercreditor terms with them, may impose significant obstacles to otherwise Eligible Borrowers accessing these Loan Facilities.*

   Furthermore, although the lien priority requirements under the Priority Loan Facility and Expanded Loan Facility excludes the need to share in collateral for existing mortgage debt, the interim guidance has no such exclusion with respect to other purchase money acquisitions and asset specific financings (e.g., equipment finance transactions). Hopefully, further guidance from the Board will clarify that, like mortgage debt, all asset specific financing arrangements are excluded from the lien priority requirements so that lien sharing would not be necessary.

   Existing third party debt may be less problematic under the New Loan Facility's less stringent priority requirement that its loans not be contractually subordinated. The interim guidance clarifies that "contractually subordinated" only requires that the priority afforded debt under the New Loan Facility is sufficient to rank said debt at least on a par with other unsecured debts of the borrower in a bankruptcy. If a borrower has existing third party credit facilities that are secured, then an unsecured loan under the New Loan Facility might be palatable to the existing third party lender. However, the third party lender would be unlikely to be comfortable with a secured loan under the New Loan Facility absent intercreditor terms, even if the lien afforded the New Loan Facility debt is inferior in priority to the lien securing the existing credit facility.

   The guidance does not expressly address structural subordination of loans (e.g., by making the loan to an upper tier holding company) although it is presumably permitted for the New Loan Facility and not permitted under the Priority Loan Facility or the Expanded Loan Facility.

6. *"Existing outstanding and undrawn available debt" includes all debt for borrowed money, including under loan facilities and issued bonds, whether public or private. It*

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also includes all unused commitments under any loan facility, other than undrawn commitments (i) that serve as backup lines for commercial paper issuance, (ii) that are used to finance receivables (including seasonal inventory financing), (iii) that cannot be drawn without additional collateral, or (iv) that are no longer available due to a change in circumstances.

How to Calculate Adjusted 2019 EBITDA for Leverage Requirement

In calculating adjusted 2019 EBITDA for the leverage requirement of the Loan Facilities, the lender is required to use:

- for the New Loan Facility or the Priority Loan Facility, the methodology the lender previously used for adjusting EBITDA when extending credit to the borrower or to similarly situated borrowers on or before April 24, 2020; and

- for the Expanded Loan Facility, the methodology the lender previously used for adjusting EBITDA when originating or amending the underlying loan on or before April 24, 2020.

> ***Observation****: Some borrowers having an existing loan facility with a lender may, rather than upsizing the facility, elect to enter into a new facility (e.g., the borrower may desire a loan smaller than the $10 million minimum upsize required under the Expanded Loan Facility). In such a case, the language in the guidance appears to permit the lender to elect for the new loan facility to use either (i) the same EBITDA adjustment methodology used in the existing loan facility or (ii) another EBITDA adjustment methodology that the lender uses for similarly situated borrowers.*

LIBOR Alternative Rate

Although the initial guidance issued by the Board on April 9 had announced that the Secured Overnight Financing Rate (“***SOFR***”) would be used as the reference rate for interest under the Loan Facilities, during the comment period many middle market lenders raised concerns about the challenges and diversion of resources implicated in rapidly implementing new systems to issue loans based on SOFR. As a result, the subsequent guidance issued on April 30 abandoned SOFR and established LIBOR as the reference rate.

In light of the U.K. Financial Conduct Authority’s plans to phase out LIBOR by the end of 2021, the guidance recommends that the loan documents include LIBOR alternative rate fallback language consistent with the recommendations of the Alternative Reference Rates Committee.

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LOAN PARTICIPATIONS

The SPV will purchase at par (a) 95% participations in each loan made under the New Loan Facility, (b) 85% participations in each loan made under the Priority Loan Facility and (c) 95% participations in the upsized tranche of each loan made under the Expanded Loan Facility. Each loan participation will be pari passu with the lender's retained interest in the loan and will be secured by any collateral securing the loan on a pro rata basis.

In the case of the New Loan Facility or the Priority Loan Facility, the lender must retain its 5% or 15% (as applicable) loan participation interest until the loan matures or the SPV sells its loan participation, whichever comes first. In the case of the Expanded Loan Facility, the lender must (a) retain its 5% participation interest in the upsized tranche until the upsized tranche matures or the SPV sells its loan participation in the upsized tranche, whichever comes first, and (b) retain its interest in the underlying loan until that loan matures, the upsized tranche matures or the SPV sells its loan participation in the upsized tranche, whichever comes first.

> ***Observation***: *The Board's guidance does not address the SPV's rights or the lender's obligations under the participation agreement, such as voting, reporting, etc. We expect that the Board will subsequently issue a form of participation agreement which lenders will be required to use for the Loan Facilities.*

REQUIRED REPRESENTATIONS AND COVENANTS

Lender Certifications and Covenants

Lenders participating in any of the Loan Facilities will be required to make the following certifications and covenants for each loan:

- The lender will not request that the borrower repay any debt which the borrower owes to the lender or pay interest thereon until the Main Street Loan is repaid in full, unless the debt or interest payment is mandatory and due (including by reason of default and acceleration).

- The lender will not cancel or reduce any existing committed lines of credit to the borrower, except in an event of default or upon their expiration in accordance with their terms.
  - This requirement does not prohibit the reduction of availability under existing lines of credit in accordance with their terms due to changes in borrowing bases or reserves in asset-based or similar structures.

- The lender must certify that the methodology used for calculating the borrower's adjusted 2019 EBITDA for the leverage requirement discussed above is the

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methodology it previously used for adjusting EBITDA when extending credit to the borrower or similarly situated borrowers on or before April 24, 2020.

- The lender must certify that it is eligible to participate in the Facility, including in light of the conflicts of interest prohibition in section 4019(b) of the CARES Act, which is intended to prohibit any business that is directly or indirectly owned by the president, senior executive branch officials or members of congress (or certain of their immediate family members) from receiving any relief funds.

Borrower Certifications and Covenants

A borrower participating in any of the Loan Facilities will be required to make the following certifications and covenants upon the origination of each loan:

- The borrower will not repay any principal or pay any interest on any other debt (whether owed to the lender of the Main Street Loan or any other entity) until the Main Street Loan is repaid in full, unless the principal or interest payment is mandatory and due.
    - This requirement will not (i) prevent the refinancing of maturing debt, or (ii) prevent the borrower from taking on and paying additional debt obligations required in the normal course of business and on standard terms, including inventory and equipment financing; provided that such debt under clause (ii) is secured by newly acquired property (e.g., inventory or equipment), and, apart from such security, is of equal or lower priority than the Main Street Loans taken.
    - The Priority Loan Facility has an exception to this requirement - at the origination of the loan, the borrower may refinance existing debt owed to a lender other than the Eligible Lender.

> ***Observation***: *This requirement would prevent any entity that wants to take advantage of the New Loan Facility and Expanded Loan Facility programs from switching lenders, severely limiting the universe of potential transactions for those programs and leaving the Priority Loan Facility as the only viable program option for such entities.*

- The borrower will not seek to cancel or reduce any of its outstanding lines of credit, although it may repay a line of credit (including a credit card) in accordance with its normal course of business usage for such line of credit. Similarly, the lender would not be prevented from accepting regularly scheduled, periodic repayments on a line of credit from the borrower in accordance with the borrower's normal course of business usage for such line of credit

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> ***Observation**: The interim guidance's usage of the term "regularly scheduled, periodic repayments" appears solely in its reference to repaying lines of credit with the lender and so presumably does not apply to repaying a third party's line of credit. While corporate credit/purchase cards often require regularly scheduled periodic payments to reduce the principal balance, many commercial lines of credit only require payment of the balance at maturity, except for line "clean-down" requirements and periodic reductions of availability to coincide with the borrower's trade cycles.*

- The borrower has a reasonable basis to believe that, as of the date of origination of the loan and after giving effect to such loan, it has the ability to meet its financial obligations for at least the next 90 days and does not expect to file for bankruptcy during that time period.

- The borrower is eligible to participate in the Program, including in light of the conflicts of interest prohibition in section 4019(b) of the CARES Act (see the discussion of this prohibition under "Lender Certifications and Covenants" above).

  ***Observation**: Although the interim guidance does not indicate how this eligibility certification will be structured, the certificate would likely be required to list specified eligibility criteria, including the above discussions of "Eligible Borrower" criteria, the leverage test for the maximum loan value, and the conflicts of interest prohibition in section 4019(b) of the CARES Act.*

- The borrower will comply with certain compensation, stock repurchase, and capital distribution restrictions imposed under the CARES Act, as follows:

  - As long as the loan is outstanding and for 12 months thereafter, it will not repurchase any equity security of the borrower or any parent company that is listed on a national securities exchange while the loan is outstanding, except to the extent required under a contractual obligation that was in effect on March 27, 2020;

    ***Observation**: The CARES Act prevents only the repurchase of listed securities, so this restriction will likely not be a material factor in deciding whether a U.S. subsidiary of a foreign company should apply for a Main Street Loan. However, the restriction on capital distributions below may, as a practical matter, prohibit the repurchase of unlisted securities.*

  - As long as the loan is outstanding and for 12 months thereafter, the borrower will not pay dividends or make other capital distributions with respect to its common stock, except that an S corporation or other tax pass-through entity may make

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distributions to the extent reasonably required to cover its owners' tax obligations in respect of the entity's earnings; and

> ***Observation**: Although the restriction on capital distributions applies only to common stock, it is reasonable to assume that it was intended to apply to preferred stock, membership interests and other forms of equity, as well as to redemptions of privately held equity.*

- As long as the loan is outstanding, the borrower will limit total compensation paid to its officers and other highly paid employees in accordance with the CARES Act. Section 4004 of the CARES Act imposes limits during the life of the loan, plus one year, as follows:

  (i) For officers or employees whose total compensation exceeded $425,000 in 2019 (other than employees whose compensation was determined through a collective bargaining agreement), their compensation for any 12-month period is limited to their 2019 total compensation paid and their severance pay or other benefits on termination of employment is limited to 200% of their 2019 total compensation.

  (ii) For officers or employees whose total compensation exceeded $3 million in 2019, their compensation for any 12-month period is limited to $3 million plus 50% of the amount by which such person's total compensation exceeded $3 million in 2019.

  The CARES Act defines total compensation by stating that it "includes salary, bonuses, awards of stock and other financial benefits."

  Observations:

  1. *Neither the Program's interim guidance nor the PPP guidance to date provides further clarity on how to calculate total compensation, and significant uncertainty remains. Some of the key issues that remain unresolved include:*

     (a) Is total compensation based on the same rules public companies use to prepare the summary compensation table in their proxy statements and annual reports?

     (b) Does "other financial benefits" include non-taxable benefits?

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(c) How are awards of stock valued and, if they are unvested, must they be included?

(d) Is total compensation annualized for employees who were first hired by the borrower after January 1, 2019?

We expect that the Board and Department of Treasury will subsequently issue guidance on these and other issues.

2. *Total compensation under the CARES Act appears to be calculated in a different manner than compensation determinations for purposes of the $100,000 employee compensation test under the PPP. The relevant guidance for the latter test clearly states that only cash compensation (not non-cash benefits) is included and thus would exclude, among other things, awards of stock. See the PPP Loans Frequently Asked Questions issued by the Department of Treasury dated May 3rd, 2020.*

3. *Employment and equity grant agreements that provide for acceleration of vesting upon termination of employment would need to be taken into consideration in determining the amount of severance benefits payable upon termination of employment.*

The Board's interim guidance also states that a borrower that participates in the Program "should make commercially reasonable efforts to maintain its payroll and retain its employees" during the term of the loan, which means that it should "undertake good-faith efforts to maintain payroll and retain employees, in light of its capacities, the economic environment, its available resources, and the business need for labor." However, borrowers that have already laid-off or furloughed workers as a result of the disruptions from COVID-19 are eligible to apply for Main Street Loans under the Program.

***Observations**:*

1. *The initial Board guidance issued on April 9th expressly required the borrower certifications to include an attestation that it would use reasonable efforts to maintain its payroll and retain its employees. In the April 30th guidance, such attestation was removed from the borrower certifications and a new separate Program section was added stating that the borrower "should" make such efforts. The interim guidance does not clarify the purpose behind such change or specify what a lender's obligations are, if anything, with respect to such efforts.*

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2. *If a borrower is contemplating reductions in personnel (layoffs or furloughs) or their wages, it should first perform and document an appropriate analysis of "its capacities, the economic environment, its available resources, and the business need for labor" and the necessity of such reductions in order to evidence that its decision was made in good faith.*

Certain other good faith certifications of the borrower required by the CARES Act were not mentioned in the Board's interim guidance, including:

- The borrower requires the financing due to the exigent circumstances presented by the COVID-19 pandemic.

- The funds received will be used to retain at least 90% of the borrower's workforce, at full compensation and benefits, until September 30, 2020.

- The borrower intends to restore not less than 90% of its workforce as of February 1, 2020, and to restore all compensation and benefits to its workers no later than 4 months after the termination date of the COVID–19 public health emergency declared by the Secretary of Health and Human Services on January 31, 2020.

- The borrower will not during the life of the loan, plus two years, (i) outsource or offshore jobs or (ii) abrogate existing collective bargaining agreements; and

- The borrower will remain neutral in any union organizing effort for the term of the loan.

Observations:

1. *The interim guidance does not clarify why the foregoing certifications were omitted from the Program terms.*
2. *The initial Board guidance issued on April 9th expressly included in the borrower certifications an attestation as to exigent circumstances. In the April 30th guidance, such attestation was removed from the borrower certifications.*

FEES ASSOCIATED WITH THE LOAN FACILITIES

SPV Facility Fee

For each Main Street Loan purchased by the SPV, the SPV will be entitled to a facility fee from the lender equal to 1% of the original principal amount of a loan under the New Loan Facility or the Priority Loan Facility, and 0.75% of the original principal amount of the upsized tranche of a loan under the Expanded Loan Facility. The lender may, at its option, require the borrower to pay this fee.

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Lender Origination Fee

In addition, the borrower will be required to pay the lender an origination fee of up to 1% of the original principal amount of any loan under the New Loan Facility or the Priority Loan Facility, and up to 0.75% of the original principal amount of the upsized tranche of any loan under the Expanded Loan Facility. Lenders have discretion over whether and when to charge borrowers this fee.

Servicing Fee

The SPV will pay the lender servicing a Main Street Loan an annual loan servicing fee equal to 0.25% of the principal amount of the SPV's participation in such loan.

> ***Observation:*** *The interim guidance does not clarify whether lenders are permitted to charge borrowers additional fees, such as for outside counsel expenses and other closing costs.*

REQUIRED PUBLIC DISCLOSURES

The Federal Reserve will disclose information regarding the Loan Facilities during their operation, including names of lenders and borrowers, amounts borrowed and interest rates charged. Furthermore, one year after the effective date of termination by the Board of authorization for the Loan Facilities, the Federal Reserve will disclose additional information concerning the Loan Facilities, including names and identifying details of each participant in the Loan Facilities, the amount borrowed, the interest rate or discount paid, and information concerning the types and amounts of collateral pledged or assets transferred in connection with participation in the Facilities.

> ***Observation:*** *These disclosure obligations may have a chilling effect on potential lenders and borrowers and significantly reduce participation in the Program.*

TERMINATION OF THE PROGRAM

The SPV will cease purchasing participations in Eligible Loans on September 30, 2020, unless the Board and the Treasury Department extend the Program.

A launch date has not yet been set for the Program, and the terms of the Loan Facilities are subject to further rulemaking and guidance from the Treasury and the Federal Reserve. We will continue to monitor developments and provide additional details as they become available. In the meantime, please feel free to contact us if you have any questions about the Program.

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CONTACT

Please do not hesitate to contact your Windels Marx relationship lawyer or a member of our Financial Transactions Practice Group with any questions or comments.

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