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An Overview of the Midsize Business Loan Program under Title IV of the CARES Act

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In response to the Coronavirus pandemic, the President signed H.R. 748, known as the Coronavirus Aid, Relief, and Economic Security (“**CARES**”) Act on March 27, 2020. The bill provides more than \$2 trillion of aid to individuals and the public and private sector.

Title IV of the CARES Act, also referred to as the Coronavirus Economic Stabilization Act of 2020, provides \$500 billion to Treasury’s Exchange Stabilization Fund to provide liquidity to eligible businesses, states and municipalities. The lending facility has two components. First, there is a \$46 billion fund administered by the Treasury Secretary to provide direct loans for a short list of distressed, industry-specific and essential companies, including air carriers and businesses critical to maintaining national security (“**Section B(1)-(3) Funds**”). Second, the remaining funds are to be used for loans, loan guarantees and investments in support of eligible businesses, states and municipalities (such funds, collectively, the “**Section B(4) Funds**”).

The Section B(4) Funds, which will include at least \$454 billion (and any leftover amounts from the Section B(1)-(3) Funds) will be available to programs or facilities established by the Board of Governors of the Federal Reserve System that support lending to states, municipalities, and eligible businesses. Such funds may be used to (i) purchase obligations or other interests directly from issuers of such obligations or other interests; (ii) purchase obligations or other interests in secondary markets or otherwise; or (iii) make secured and unsecured loans.

Perhaps most relevant to midsize businesses is the portion of Title IV of the CARES Act directing the Treasury Secretary to establish a program to provide direct low-interest loans for eligible businesses, including, to the extent practicable, nonprofit organizations (the “**Midsize Business Loans**”).¹

Below is a high-level summary of the provisions relating to Midsize Business Loans under the CARES Act.² We expect the U.S. Department of Treasury and the Federal Reserve Board to provide guidance on the legislation within the next two weeks. Such guidance will provide further detail on administration of Section B(4) Funds and may materially change the summary below. Businesses are encouraged to seek advice from qualified legal counsel before applying for a Midsize Business Loan.

Importantly, the Midsize Business Loans are distinct from the loans offered to small businesses pursuant to the Paycheck Protection Program. For an overview of those loans, please see our March 27, 2020 alert titled “[Bridging the Gap - An Overview of SBA Loans under the Paycheck Protection Program.](#)”

OVERVIEW OF SECTION B(4) MIDSIZE BUSINESS LOAN PROGRAM

Who is eligible for Midsize Business Loans?	Midsize Business Loans may be provided to (i) “eligible businesses” and (ii) nonprofit organizations (to the extent practicable), with between 500 and 10,000 employees. (Sec. 4003(c)(3)(D)(i)).
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	<p>“Eligible businesses” are defined to include</p> <ol style="list-style-type: none"> 1. Air carriers (though such amount is limited); or 2. a United States business “that has not otherwise received adequate economic relief in the form of loans or loan guarantees provided under [the CARES Act].” (Sec. 4002(4)). <p>Such businesses must have been (i) created or organized in the United States or under the laws of the United States and (ii) have significant operations in and a majority of its employees based in the United States. (Sec. 4003(c)(3)(C)).</p>
Loan Timing	<p>Midsized Business loans under Section (B)(4) must be made prior to December 31, 2020. (Sec. 4029).</p>
Loan Repayment Terms	<p>Maximum interest rate of 2% per year. (Sec. 4003(c)(3)(D)(i))</p> <p>Automatic payment deferment for at least 6 months (or longer per the Treasury Secretary’s discretion). (Sec. 4003(c)(3)(D)(i)).</p>
Conditions for Eligible Businesses to Receive Midsized Business Loans	<p>Midsized Business Loans are subject to the following conditions (unless waived by the Treasury Secretary):</p> <ol style="list-style-type: none"> 1. <u>Dividends</u>. The borrower will be prohibited from paying dividends or making other capital distributions on its common stock during term of the loan, and for a year after the date the loan is no longer outstanding (Sec. 4003(c)(3)(A)(ii)(I)); 2. <u>Stock Buybacks</u>. The borrower cannot make stock buybacks of equity securities of the borrower, or any parent of borrower, that are listed on a national securities exchange (except to the extent required by a preexisting contract), during term of the loan, and for a year after the date the loan is no longer outstanding (Sec. 4003(c)(3)(A)(ii)(I)); 3. <u>Employee Compensation</u>. The borrower must agree to cap all employee compensation (including salary, stock, and bonuses) for a period ending one year after the loan is repaid as follows: <ol style="list-style-type: none"> a. Employees receiving more than \$425,000 per year cannot receive (i) more compensation than they received in 2019 (except for compensation determined through a collective bargaining agreement entered into prior to March 1, 2020) or (ii) severance pay or other benefits upon termination exceeding twice the 2019 compensation amount. (Sec. 4003(c)(3)(A)(ii)(III) referencing Sec. 4004(a)(1)).

	<p>b. Officers or employees receiving more than \$3 million per year cannot receive total compensation in excess of (i) \$3 million plus (ii) 50% of the excess over \$3 million. (Sec. 4003(c)(3)(A)(ii)(III) referencing Sec. 4004(a)(2).</p> <p>The Treasury may waive the foregoing conditions as necessary “to protect the interests of the Federal Government.” (Sec. 4003(c)(3)(A)(iii)).</p>
<p>Required Borrower Certifications</p>	<p>Additionally, to participate in the Midsize Business Loan program, prospective borrowers are required to certify to the following:</p> <ol style="list-style-type: none"> 1. <u>Impact of COVID-19</u>. The uncertainty of economic conditions as of the date of the application makes necessary the loan request to support the ongoing operations of the recipient; 2. <u>Intent to Maintain Compensation</u>. Funds will be used to retain at least 90% of the borrower’s workforce, at full compensation and benefits, until September 30, 2020; 3. <u>Intent to Maintain Workforce</u>. The borrower intends to restore not less than 90% of the workforce that existed as of February 1, 2020, and to restore all compensation and benefits to the workers of the borrower no later than 4 months after the termination date¹ of the public health emergency in response to COVID-19; 4. <u>Domestic Status</u>. The borrower is (i) created or organized in the United States, (ii) domiciled in the United States, and (iii) has significant operations and a majority of its employees based in the United States. 5. <u>No Bankruptcy</u>. The borrower is not a debtor in a bankruptcy proceeding. 6. <u>No Outsourcing</u>. The borrower will not outsource or offshore jobs for the term of the loan and 2 years after completing repayment; 7. <u>Collective Bargaining Obligations</u>. The borrower will not abrogate existing collective bargaining agreements for the term of the loan and 2 years after; and

	<p>8. <u>Neutral in Organizing Efforts</u>. The borrower will remain neutral in any union organizing effort for the term of the loan. (Sec. 4003(d)(2)(D)(i)(I)-(X)).</p> <p>These certifications are expected to be included on a form provided as part of the application for the Midsize Business Loan.</p>
<p>Additional Eligibility Restrictions are Likely to be Included in Forthcoming Regulations</p>	<p>The Midsize Business Loan requirements currently do not include any specific conditions related to prudential considerations (<i>i.e.</i>, borrowers’ ability to pay back the loan), minimum amounts of collateral, or limitations on uses of loan proceeds. Such conditions (or others) may be added as the Treasury Department and the Federal Reserve publish additional details concerning the implementation of the Midsize Business Loan program pursuant to future regulations and guidance.</p> <p>Additionally, subsequent guidance and regulations may include “class” waivers of specific restrictions on stock buybacks, dividends or executive compensation on a sector-wide or case-by-case basis, as contemplated by Section 4003(c)(3)(A)(iii) of Title IV.</p>
<p>No Loan Forgiveness</p>	<p>Midsize Business Loans are not eligible for loan forgiveness. (Sec. 4003(d)(3).</p>
<p>Tax Treatment</p>	<p>Note that Midsize Business Loans shall be treated as indebtedness for tax purposes. (Sec. 4003(h)).</p>
<p>Loan Timing; Application Procedures</p>	<p>There is no process available today to apply for a Midsize Business Loan. Regulations are in the process of being prepared that will implement the program, but the CARES Act does not include a specific timeline for the launch of this particular program.</p>
<p>Conflicts of Interest</p>	<p>Midsize Business Loans are not permitted to be made to “covered entities”, which are defined as any entity in which 20% or more (by vote or value) of the equity of such entity is owned by the President, Vice President, head of an Executive department, or Member of Congress, or any spouse, children, son-in-law, or daughter-in-law of the foregoing (each, a “Covered Individual”). (Sec. 4019).</p> <p>The Chief Executive Officer and Chief Financial Officer (or individuals performing similar functions) of the borrower must certify to the Secretary and Board of Governors of the Federal Reserve that the entity is eligible to obtain the Midsize Business Loan and is not an</p>

	entity in which a Covered Individual directly or indirectly holds a controlling interest.
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ADDITIONAL CONSIDERATIONS FOR LENDERS CONSIDERING OFFERING MIDSIZE BUSINESS LOANS

Lender Restrictions	<p>Although the forthcoming regulations may provide additional restrictions, Title IV of the CARES Act only provides that the direct loans would be made by “banks and other lenders”.</p> <p>While the Treasury Secretary has broad discretion over the Midsize Business Loan Program, note that the applicable taxpayer protections and other requirements under section 13(3) of the Federal Reserve Act related to collateralization, taxpayer protection and borrower solvency still apply. (Sec. 4003(c)(3)(B)).</p>
Syndication Rights	<p>Midsize Business Loans must be offered as part of a bilateral loan agreement and may not be issued as part of (i) a syndicated loan, (ii) a loan originated by a financial institution in the ordinary course of business, or (iii) a securities or capital markets transaction. (Sec. 4003(c)(3)(A)(i)(II)).</p>

Additional Questions? Contact a member of the Haynes and Boone Finance or Corporate Practice Groups at Haynes and Boone.

¹ The implementation of a midsize direct lending program or facility does not preclude the Federal Reserve from establishing a Main Street Lending Program to support lending to small and mid-sized businesses. (Sec. 4003(c)(3)(D)(ii)).

² Note that this Overview does not provide all information relevant to the extension of loans to states, municipalities, air carriers, cargo air carriers, and businesses critical to maintaining national security. If you are considering a loan involving air carriers, cargo air carriers, or critical businesses, please also see our March 30, 2020 alert titled [“Congress Provides COVID-19 Relief to Airlines and Aviation Workers.”](#)

³ The termination date is to be determined by the Secretary of Health and Human Services pursuant to the Public Health Services Act.