

Coronavirus Aviation Industry Relief Legislation

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On March 27, 2020, the “Coronavirus Aid, Relief, and Economic Security Act” or the “CARES Act” (the “**Act**”) was signed into law. This bulletin focuses on those aspects of the Act that address aviation industry relief, including (1) loan guarantees for air carriers, operators and other eligible businesses (with a lookback at the ATSB program following 9/11), (2) air carrier employee protections, (3) small business relief, subject to the various conditions and restrictions imposed within the Act, and (4) federal excise tax relief for certain applicable air transportation taxes.

1. Loan Guarantees

The Act provides liquidity in the form of loans, loan guarantees and other investments to aviation industry eligible businesses that incurred, or are expected to incur, covered losses such that the continued operations of the business are jeopardized, as determined by the Secretary of the Treasury (the “**Treasury**”). The term “**covered loss**” includes losses incurred directly or indirectly as a result of COVID-19 coronavirus, as determined by the Treasury. The loan and loan guarantee amounts will not exceed the following amounts:

- \$25 billion for passenger air carriers, including general aviation operators that conduct flights under Federal Aviation Regulations (“**FAR**”) Part 135, and eligible businesses that are certified under FAR Part 145 approved to perform inspection, repair, replace or overhaul services and ticket agents;
- \$4 billion for cargo air carriers;
- \$17 billion for businesses critical to maintaining national security; and
- \$454 billion, plus any unused amounts available above, through a program to be established by the Federal Reserve Board to support eligible businesses and state and municipal governments through a variety of means, including loans and loan guarantees for other eligible businesses, as defined below.

An “**air carrier**” means a “**citizen of the United States**” undertaking by any means, directly or indirectly, to provide air transportation as provided in 49 U.S.C. § 40102(a)(2) and (15).

An “**eligible business**” means: (1) an air carrier; or (2) a U.S. business that has not otherwise received adequate economic relief in the form of loans or loan guarantees provided under the Act. Further, the intended obligation by the obligor must be “prudently incurred” and “sufficiently secured” in the Treasury’s discretion, and the accompanying interest rate of such loans shall be, subject to the Treasury’s discretion and to the extent applicable, “not less than an interest rate based on market conditions for comparable obligations prevalent prior to the outbreak of the coronavirus disease 2019 (COVID-19).”

The Act authorizes the Department of Transportation (“DOT”) to provide, to the extent reasonable and practicable, to an air carrier receiving loans or loan guarantees under the Act to maintain such scheduled air transportation service as DOT deems necessary to ensure services to any point served by that carrier before March 1, 2020 until March 1, 2022.

The Treasury shall publish procedures for application and minimum requirements to receive the benefits of the Act by April 6, 2020. As such, we would urge clients to ensure comprehensive data is compiled daily to help determine actual losses.

The Restrictions

The Act provides several restrictions on eligible businesses that make participation much less desirable. First, like the Air Transportation Stabilization Board (the “ATSB”) program discussed below, the Act will require government equity or debt participation by eligible businesses utilizing the loan or loan guarantee program, and “the principal amount of any obligation issued to an eligible business ... shall not be reduced through loan forgiveness.”¹ In other words, eligible businesses must exchange warrants, an equity interest or debt in their companies to take advantage of the loan or loan guarantee programs, and the loans cannot be forgiven. Yet, potential fund recipients may be reluctant to give the government equity in exchange for a participation in the program. For example, Boeing CEO David Calhoun told Fox Business News on March 24 that Boeing was not willing to give the U.S. government stock in return for a bailout. “I don’t have a need for an equity stake,” Calhoun said. “If they forced it, we’d just look at all the other options, and we have got plenty.” Whether other companies would be willing to surrender equity depends primarily on how long this crisis lasts and the companies’ cash on hand. Fortunately for many airlines, at the start of this crisis many of them had a record amount of available cash as well as sizable available credit lines (which most have recently drawn on). It is unclear how *or even if* the equity or debt exchange requirement will work for Part 135 charter operators, Part 145 repair stations or ticket agents.

Second, eligible businesses will be prohibited from share buybacks, paying dividends or making capital contributions from the date of the loan until 12 months after the direct loan is repaid in full. These restrictions have received much media attention in the face of growing popular antipathy for bailing out large corporations. Interestingly, other restrictions that were being considered for participating airlines such as those requiring air service to under-served communities, carbon footprint limitations and airline passenger bills of rights did not find their way into the Act (but it is possible that some form of any of the foregoing may be included in enabling regulations).

Third, the Act places restrictions on fund recipients’ executive pay, including limiting pay increases and severance pay or other benefits upon terminations. Fourth, the issuance of a loan or loan guarantee cannot be made contingent upon an air carrier’s or eligible business’s implementation of measures to enter into negotiations with the certified bargaining representative or class of employees of the air carrier or eligible business regarding pay or other terms and conditions of employment. This is explicitly contrary to the ATSB process post 9/11, in which economic concessions from all significant stakeholders in the air carriers, including the labor unions, were a key government condition to receiving financial assistance in several negotiations. Fifth, all eligible businesses must also maintain employment levels as of March 24, 2020, to the extent practicable, and shall not reduce their employment levels by more than 10% from that date until September 30, 2020. Sixth, eligible businesses must be created or organized in the U.S. or under the laws of the U.S. and have significant operations in and a majority of its employees based in the U.S. Seventh, eligible business must have incurred or is expected to incur covered losses such that the continued operations of the business are jeopardized, as determined by the Treasury.

Air Transportation Safety and System Stabilization Act Precedent

If the past is any guide to what the U.S. government’s loan program will look like, it may be instructive to look back to the loan program instituted by the government to support U.S. airlines in the aftermath of the 9/11 catastrophe in 2001. We very much expect that many of the features of that earlier loan guarantee program will be applicable to the programs to be developed under the Act.

Following the attacks on the World Trade Center in New York City and the Pentagon near Washington, DC, and the resultant grounding of the world’s airlines and rather slow economic and airline recovery, the government, under the aegis of the Air Transportation Safety and System Stabilization Act (Public Law 107-42) (the “ATSB Act”), established the ATSB. The ATSB was an office of the Treasury and was authorized to issue up to \$10 billion in federal credit instruments (e.g., loan guarantees), to support U.S. airlines.

¹ CARES Act, Section 4003(d), Financial Protection of Government.

The credit support available under the ATSB Act was for U.S. air carriers for which “such agreement is a necessary part of maintaining a safe, efficient and viable commercial aviation system in the United States.” Additionally, the ATSB was required, before entering into an agreement to issue a guarantee, to determine the following:

- obligor was an air carrier for which credit was not reasonably available at the time of the transaction; and
- the intended obligation was prudently incurred (in other words, as per the ATSB’s evaluation guidelines, the government’s financial interests must have been adequately protected).

The above criteria proved to be a catch-22 for many airlines insofar as, on the one hand, an airline had to show that it was not able to access the credit markets, while, on the other hand, such airline had to prove its credit (plus any collateral) was of a sufficiently acceptable level to enable the government to find it to be a “prudent” credit. We certainly expect a comparable tension to be evidenced in the programs to be established under the Act.

Between 2001 and 2003, the ATSB approved applications for loan guarantees from seven carriers: Aloha Airlines, America West Airlines, American Trans Air, Evergreen International Airlines, Frontier Airlines and World Airways. The ATSB denied applications from nine carriers: Corporate Airlines, Frontier Flying Service, Gemini Air Cargo, Great Plains Airline, MEDjet International, National Airlines, Spirit Airlines (both their original and revised application), United Airlines (both their original and revised application) and Vanguard Airlines.

For applying carriers, the ATSB imposed general restrictions on executive compensation and repayments of third-party debt, required a detailed business plan from the airline and a partnering with a major financial institution for the making of the loans and favored applications of airlines that were able to show concessions by creditors, employees or others that would strengthen the financial condition of the company. In addition, the ATSB imposed strict financial covenants on covered airlines to ensure that these airlines performed within expected financial parameters. While limits on executive compensation and stock buybacks are express provisions of the Act, we would expect that these other constraints will be mimicked in the Act’s enabling regulations and in practice.

The ATSB also required substantial compensation from each approved airline for granting the loan guarantees. This included hefty up-front fees and stock warrants. The warrants were the result of the need for the government to “participate, contingent on the financial success of the borrower, in the gains of the Borrower or its security holders through the use of such instruments as warrants, stock options, common or preferred stock, or other appropriate equity instruments.” The Act likewise requires similar provisions for protection of the taxpayer, and we anticipate the regulations will reflect guidance on the government’s expectations with respect to warrants or other equity participation. However, we believe that a number of the (stronger) airlines will decline to participate in the program due to this requirement, as noted above with Boeing.

One important feature of the ATSB guarantee program was that there was a requirement that a component of the credit facility (either the guaranteed lenders or lenders lending side by side with the guaranteed lenders) had to be non-guaranteed by the government; that is, the federal guarantee must be for less than 100% of the amount of principal and accrued interest of the loan to be guaranteed. We would expect to see this feature in the new program.

Also, while the ATSB gave positive consideration to the posting of collateral by the airlines (including aircraft, gates and slots), the provision of collateral was not dispositive for approving a guarantee program. However, where collateral was not provided, the government required a greater level of participation in airline upside benefits. For example, the guaranteed program for America West was not collateralized by any of that airline’s assets, but the government received equity warrants in about 30% of the company (compared to comparable programs with collateral where the government received equity warrants in approximately 10% of the airline’s equity).

The ATSB board consisted of three members, one from the Federal Reserve, one from the Treasury and one from the DOT. This board was managed by an executive director, who, in turn, hired staff (including financial analysts and lawyers), as well as outside consultants (including an accounting firm (KPMG), rating agency (Fitch) and industry experts (GRA)). We would expect a similar management arrangement for the upcoming program to be initiated under the Act, thereby creating interesting employment/retention opportunities for professionals in the aircraft-finance space.

As a prologue to the ATSB story, it is worth noting that the ATSB only guaranteed \$1.6 billion of loans (out of the available \$10 billion) and such program netted a profit for the government of over \$300 million.

2. Air Carrier Worker Support

The Act provides financial assistance that is to be exclusively used for the continuation of payment of employee wages, salaries and benefits to (1) passenger air carriers, in an aggregate amount up to \$25 billion; (2) cargo air carriers, in the aggregate amount up to \$4 billion; and (3) contractors, in an aggregate amount up to \$3 billion.

The Treasury shall provide financial assistance to: (1) an air carrier in an amount equal to the salaries and benefits reported by such air carrier to the DOT pursuant to 14 C.F.R. 241 (“**Part 241**”) for the period from April 1, 2019 through September 30, 2019; (2) an air carrier that does not transmit Part 241 reports, in an amount that such air carrier certifies, using sworn financial statements or other appropriate data, as the amount of wages, salaries, benefits, and other compensation that such air carrier paid the employees of such air carrier during the period from April 1, 2019 through September 30, 2019; and (3) a contractor, in an amount that the contractor certifies, using sworn financial statements or other appropriate data, as the amount of wages, salaries, benefits and other compensation that such contractor paid the employees of such contractor during the period from April 1, 2019 through September 30, 2019. Financial assistance provided to an air carrier or contractor shall be in such form and on such terms and conditions (including requirements for audits and the clawback of any financial assistance provided upon failure by a passenger air carrier, cargo air carrier or contractor to honor the assurances specified in section 4114 of the Act described below) as the Treasury determines appropriate.

The Treasury will publish streamlined and expedited procedures not later than five days after the date of enactment of the Act for air carriers and contractors to submit requests for financial assistance. On or about April 6, 2020, the Treasury will make initial payments to air carriers and contractors that submit requests for financial assistance approved by the Treasury.

Section 4114 of the Act provides, that to be eligible for financial assistance, an air carrier or contractor will need to enter into an agreement with the Treasury that the air carrier or contractor shall do the following:

(1) refrain from conducting involuntary furloughs or reducing pay rates and benefits until September 30, 2020;

(2) through September 30, 2021, ensure that neither the air carrier or contractor nor any affiliate of the air carrier or contractor may, in any transaction, purchase an equity security of the air carrier or contractor or the parent company of the air carrier or contractor that is listed on a national securities exchange;

(3) through September 30, 2021, ensure that the air carrier or contractor shall not pay dividends, or make other capital distributions, with respect to the common stock (or equivalent interest) of the air carrier or contractor; and

(4) meet the requirements of sections regarding collective bargaining collections and executive compensation restrictions.

The DOT is authorized to require, to the extent reasonable and practicable, an air carrier provided financial assistance under this subtitle to maintain scheduled air transportation service, as the DOT deems necessary, to ensure services to any point served by that carrier before March 1, 2020.

3. Small Business Relief SBA Section 7(a) Loans

To the extent entities are unable to take advantage of aviation industry loans and loan guarantees, entities may be able to obtain relief from the Small Business Administration’s (“**SBA**”) Section 7(a) loan program, called the Paycheck Protection Program (the “**PPP**”). The Act provides for \$349 billion for guaranteed, low-interest, no-fee loans, with repayment deferred for at least six months. Significantly, the PPP permits loan forgiveness up to 100% of the loan principal amount, subject to maintaining employment and compensation level requirements.

Members of the general aviation community, Part 135 charter operators, Part 145 repair stations, including elements of the supply chain, may be eligible for the PPP in the form if they unable or unwilling to participate with the loan or loan guarantees noted above. Section 7(a) loans will be provided through approved SBA banks and non-bank lenders. The covered period of the program is February 15, 2020 to June 30, 2020. The maximum loan amount is the lesser of (i) the average total monthly payments by the recipient for payroll costs incurred during the one-year period before the date on which the loan is made multiplied by 2.5; or (ii) \$10 million.

Allowable uses of the PPP loans payroll, health care benefits, mortgage interest payments, rent, utilities and interest on any other debt obligations that were incurred before the covered period. Recipients applying for a PPP loan will also be required to make a good-faith certification as follows:

- that the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient;
- acknowledging that funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments and utility payments;
- that the recipient does not have an application pending for another PPP loan for the same purpose and duplicative of amounts applied for or received under a PPP loan; and
- during the period from February 15, 2020 to December 31, 2020, that the recipient has not received amounts under the PPP for the same purpose and duplicative of amounts applied for or received under a PPP loan.

Finally, the Act also contains additional tax policy changes likely to benefit smaller companies such as the delay of payments for employer payroll taxes, net operating loss limitations and carrybacks, and the delay of estimated corporate tax payments until October 15, 2020.

Entities and companies that believe they may be eligible for such assistance should track and document the business impact of the reduced operations related to the coronavirus, in order to support eligibility for assistance.

4. Federal Excise Tax Relief

Finally, the Act provides for federal excise tax relief for certain air transportation taxes, including the following:

- suspension of air transportation excise taxes (i.e., 7.5% tax on amounts paid for air transportation and applicable segment fees), applicable to Part 135 operators and other types of operations subject to the tax; and
- a similar suspension of the \$.043/gallon tax on jet fuel used in commercial operations.

Each of the foregoing excise tax relief measures would apply from the date of the Act's enactment through January 1, 2021.

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