

# Financial Services

Providing Strategic Legal Guidance to the Global Financial Services Industry

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## The Airline Industry and the CARES Act: What Secured Lenders Need to Know

Since its enactment, aviation related companies have received well over \$50 billion in grants and loans under the Coronavirus Aid, Relief and Economic Security Act (the "CARES Act") that was passed in March 2020. But how do these grants and loans impact existing secured lenders to those companies? This client alert briefly highlights the types of funds that have been made available to the airline industry under the CARES Act and the issues that secured lenders should consider.

### TYPES OF FUNDS MADE AVAILABLE TO AIRLINE INDUSTRY

There are three distinct pools of funds that have been made available to the airline industry under the CARES Act. First, is the Air Carrier Worker Support Program ("ACWSP"), available under Section 4112 of the CARES Act, which provides a total of \$25 billion in payroll support to passenger airlines and certain airline contractors to maintain employment and avoid job cuts. Second, is the business lending program authorized by Section 4003 of the CARES Act (the "Business Lending Program"), which makes loans to eligible businesses, including up to \$25 billion for passenger air carriers and certain maintenance facilities. Third, is the Paycheck Protection Program ("PPP"), which was implemented by the Small Business Administration with support from the Department of Treasury (the "Treasury"), which provides small businesses with funds to pay payroll costs, including benefits, and certain other business expenses.

Given that each of these sources of funds comes with their own requirements and restrictions, it is critical for secured lenders to understand the specific source of any funds received and the various restrictions that are attached.



## SECURED LENDERS MUST DO THEIR DILIGENCE

To that end, secured lenders need to do their diligence with respect to any loans or grants that may have been received by their borrowers. Copies of all application materials, including amendments and modifications, should be requested, as well as any correspondence with the applicable governmental agency. Secured lenders may also want to amend their underlying credit documents to require the borrower to share such materials. This will help keep lenders informed and will be essential to understanding what funds the borrower has received and what, if any, restrictions apply.

## KNOWING THE PERMITTED USES OF, AND A LENDER'S ACCESS TO, SUCH FUNDS

While CARES Act funds have provided a tremendous lifeline to the airline industry, such loans and grants may only be used for prescribed purposes. For example, loans made under the PPP program will be forgiven, but only when used for payroll costs and certain other permitted expenses. Lenders therefore have an interest in ensuring that borrowers use the funds in a manner that permits forgiveness. In contrast, loans made under the Business Lending Program may not be forgiven, regardless of their use. Funds under the Business Lending Program are collateralized and come with a slew of restrictions. For example, the \$7.5 billion loan and loan commitment issued to American Airlines generally prevents, among other things, the repurchasing of equity securities and the payment of dividends and other capital distributions.

Funds received under the ACWSP are only permitted to be used for salaries, wages, and benefits of certain employees and recipients may not furlough employees involuntarily and may not reduce salary or benefits owed to employees through September 30, 2020. These restrictions (which again, only applied through September 30) resulted in a number of mass layoffs on October 1. The House Select Subcommittee on the Coronavirus Crisis (the "Subcommittee") has since contacted a number of contractors who received funds under the ACWSP to request that they voluntarily continue to abide by the restrictions (beyond the September 30 deadline) until all of the contractor's ACWSP proceeds have been used in full. While not mandated by the CARES Act, the Subcommittee has received such a commitment from some contractors that were contacted and is expected to use such concessions to pressure other contractors to make the same commitment.

Aside from knowing the permitted uses of such funds, it is also important to know how the funds were issued and how they are required to be held. For example, while PPP loans were distributed all at once without restrictions on how such funds needed to be held, funds distributed under the ACWSP have certain holding requirements based on whether they were received in one-lump sum or in multiple distributions. Recipients who elected to receive funds in one-lump sum were required to keep such funds in a segregated account subject to an account control agreement in favor of the Treasury. However, recipients who elected to receive proceeds in multiple distributions were not required to segregate funds.

Relatedly, a secured lender should be aware of its ability to compel the borrower to use the proceeds (rather than hoard the funds). If the borrower has free cash flow available to satisfy its payroll and other obligations, the borrower may choose to hold the CARES Act proceeds in reserve. Given the ability of the Treasury to retract these loans under certain circumstances or to penalize the borrower for CARES Act or Payroll Support Program Agreement violations, some borrowers may be concerned about liability if an error or other issue is discovered either in the underlying loan application or in the use of the proceeds. If the borrower holds the proceeds in reserve, the funds could potentially be used as a "war chest" to fund a future bankruptcy proceeding.

## BANKRUPTCY ISSUES

Given the current market distress, secured lenders should also have an eye toward what happens if the borrower files for bankruptcy. The Payroll Support Agreement, which governs funds received pursuant to the ACWSP, states that in the



event that the borrower files for bankruptcy, the funds that were advanced under the program shall be segregated and shall not constitute or become property of the borrower's estate under Section 541 of the Bankruptcy Code (*i.e.*, the provision of the Bankruptcy Code that provides that upon the filing of a bankruptcy case, an "estate" is created that is comprised of all of the debtor's property). If this provision is enforced by the bankruptcy court, the borrower will no longer have access to the payroll support provided under the program. However, bankruptcy courts may conclude that the provision is unenforceable because parties are generally not permitted to alter the scope of a debtor's bankruptcy estate or bankruptcy protections by private contract. *See In re Huang*, 275 F.3d 1173, 1177 (9th Cir. 2002) (holding it is against public policy for a debtor to waive prepetition, protection provided by the Bankruptcy Code).

In contrast to ACWSP, borrowers that received funds under the Business Lending Program were typically required to provide collateral for such loans, meaning the Treasury would be a secured creditor in a bankruptcy. A potential bankruptcy under that scenario raises several important questions. Will the Treasury act like a rational, economically motivated secured lender or will policy and politics drive its decisions? How supportive will the Treasury be of the borrower's bankruptcy process? And what (if anything) will they require in exchange for that support? The answers to these questions remain to be seen and may vary depending on the circumstances.

### CONCLUSION

Ultimately, the influx of cash to the airline industry under the CARES Act has given distressed recipients a lifeline to continue operations notwithstanding deteriorating revenue and profitability. These loans and grants raise concerns and questions for secured lenders, specifically with respect to their interest in the proceeds received by the borrower. Accordingly, secured lenders should remain vigilant with respect to their respective borrower's receipt of CARES Act proceeds, should be aware of the permitted use of, and access to, such proceeds, and should consider the potential issues that may arise in what, in this climate, may be an inevitable bankruptcy.

King & Spalding will continue to provide further updates on the airline and transportation industries. Please be on the lookout for additional information and in the meantime, please reach out to us with any questions.

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