

Congress Passes \$2 Trillion Stimulus Bill that Limits or Reduces Pay for Employees of Companies Receiving Federal Loans or Loan Guarantees

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The largest stimulus bill in U.S. history conditions the granting of federal loans and loan guarantees on recipient companies' agreement to limit (or in some cases reduce) employee compensation for up to a six-year period.

On March 27, 2020, President Donald Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") which passed both the U.S. Senate and the House of Representatives earlier last week with bipartisan support. The CARES Act includes various financial assistance programs for employers, including a \$500 billion loan program ("Liquidity Program") that allows the federal government to improve the liquidity of eligible businesses¹ through direct loans, loan guarantees and investments. Of the \$500 billion, \$46 billion is earmarked for loans and loan guarantees to air carriers and related contractors and businesses critical to national security and the remaining \$454 billion is intended to provide liquidity to the financial system that supports lending to eligible businesses, States, or municipalities.

To obtain financial assistance under the Liquidity Program, recipient companies must meet rigorous requirements, including limiting or reducing compensation of certain employees, ceasing the payment of dividends and capital distributions on common shares and ensuring certain levels of employment. These requirements as well as the scope of the Liquidity Program are discussed below.

Scope of Liquidity Program

The CARES Act authorizes the federal government to provide financial assistance to eligible businesses in the form of direct loans, loan guarantees and investments, which may not exceed, in the aggregate, \$500 billion. This pool of funds will be allocated among the following four categories of eligible businesses:

1. Up to \$25 billion in loans and loan guarantees is available for passenger air carriers, eligible businesses that are certified and approved to perform inspection, repair, replace or overhaul services, and ticket agents;
2. Up to \$4 billion in loans and loan guarantees is available for cargo air carriers;
3. Up to \$17 billion in loans and loan guarantees is available for businesses critical to national security; and
4. Up to \$454 billion (plus any amounts not used under the above categories) in loans, loan guarantees and investments in support of programs or facilities established by the Board of Governors of the Federal Reserve System for the purpose of providing liquidity to the financial system that supports lending to eligible businesses ("Category 4 Business"), States or municipalities by (i) purchasing obligations or other interests directly from issuers of such obligations or other interests; (ii) purchasing obligations or other interests in secondary markets or otherwise and (iii) making loans, including loans or other advances secured by collateral.

¹ Under the CARES Act, the term eligible businesses refers to air carriers or a United States business that has not otherwise received adequate economic relief in the form of loans or loan guarantees provided under this Act.

Limitation on Certain Employee's Compensation and Severance

In exchange for receiving direct loans or loan guarantees, a loan recipient would be required to limit employee compensation, and in certain cases, reduce employee compensation (as well as meet a host of other requirements), in accordance with the following rules.

■ Compensation Limitations²

- For any employee whose “total compensation” in calendar year 2019 exceeded \$425,000 but was not in excess of \$3 million, such employee’s “total compensation” could not exceed 2019 levels during any 12 consecutive months occurring within the “effective period.”
- For any employee whose “total compensation” in calendar year 2019 exceeded \$3 million, such employee’s “total compensation” during any 12 consecutive months occurring within the effective period could not exceed the sum of (i) \$3 million and (ii) 50% of 2019 total compensation that exceeded \$3 million.

For example, if an employee received \$6 million of total compensation in 2019, the employee could receive no more than \$4.5 million of total compensation during any 12 consecutive months occurring within the effective period.

Union employees would not be subject to any of the compensation limits.

- Cap on severance amounts. Severance payments and other benefits received during the effective period by an employee whose 2019 compensation exceeded \$425,000 would be capped at twice the maximum “total compensation” received by such employee in 2019.
- Effective period. Defined as the period beginning on the date on which a loan or loan guarantee agreement is executed and *ending on the date that is 1 year after the date on which the loan or loan guarantee is no longer outstanding.*

For example, assume an eligible business (other than an air carrier or contractor) obtains a loan on April 1, 2020 and fully repays the loan on April 1, 2025. Under these circumstances, the effective period would be the six-year period beginning on April 1, 2020 and ending on March 31, 2026. During that period, the compensation limits described above would remain in place.

- Definition of total compensation. Total compensation would include salary, bonuses, awards of stock and other financial benefits provided to an officer or employee.

Meridian observations. The compensation limits imposed by the CARES Act are not surprising given current public and political sentiment on executive pay levels and the precedent set by the Troubled Asset Relief Program, which imposed restrictions on compensation paid to executives who were employed by financial institutions that received federal assistance during the 2008 financial crisis.

However, the compensation provisions under the CARES Act raise a number of significant issues in their application and interpretation.

² The CARES Act also provides direct financial assistance of up to \$32 billion to support air carriers and contractors continued payment of employee wages, salaries and benefits (“Payroll Assistance Program”). The Payroll Assistance Program includes compensation limits that are identical to those under the Liquidity Program, except in one respect. The effective period under the Payroll Assistance Program is the 2-year period ending on March 24, 2022.

Most problematic is the definition of total compensation, which is ambiguous. The definition clearly is not tied to the notion of total compensation under the proxy disclosure rules. The discussion below identifies several issues with respect to each element of compensation described in the definition of total compensation:

- Base salary. Base salary presumably refers to base salary paid during 2019.
- Bonuses. It is unclear if bonuses refer to bonus payments received during 2019 or earned for 2019 performance.
- Awards of stock. It is unclear if awards of stock refers to stock awards *granted* during 2019 (whose value presumably would be determined under ASC Topic 718) or stock awards *settled* during 2019 (whose value would be based on the fair market value of received shares upon settlement of an award or exercise of a stock option).
- Other financial benefits. Other financial benefits is not a term of art that is widely understood to refer to a specific basket of compensatory benefits. The term could refer to a number of compensation items, including perquisites, employer contributions to qualified and nonqualified defined contribution plans, annual accrual of defined pension benefits and health and welfare benefits.

Another area of ambiguity relates to the cap on severance. The cap limits the payment of “severance and other benefits” to twice a covered employee’s total compensation for 2019. The term “other benefits” is not defined and could refer to a number of benefits such as continuation of health and welfare benefits, outplacement services, financial planning/tax services and, potentially, the value of equity awards subject to accelerated vesting.

Lastly, the compensation provisions make no reference to employees hired during or after 2019. For employees hired during 2019, these provisions do not indicate whether such employees’ 2019 compensation should be annualized to determine whether, and to what extent, the compensation limits are applicable to such employees. For employees hired after 2019, the absence of relevant provisions suggests that post-2019 hires are exempt from the pay limitations mandated under the CARES Act. This would seem at odds with the spirit of the CARES Act. In addition, it is unclear how the limitation on severance benefits would be applied to employees hired during or after 2019.

The foregoing ambiguities in the CARES Act will need to be resolved by regulatory guidance, which we expect will be forthcoming from the Treasury Department.

Affected companies will need to consider the long-term implications of the required limitations on employee pay before making any decision to obtain loans or loan guarantees under the CARES Act.

Other Requirements for Air Carriers and Related Contractors and Businesses Critical to National Security³

Loan recipients that are air carriers and related contractors and businesses critical to national security (referred to collectively and individually as “eligible businesses”) are subject to the following additional requirements under the Liquidity Program.

- At the time a loan or loan guarantee is made, an eligible business must demonstrate that:
 - Credit is not reasonably available to the eligible business;
 - The loan obligation is prudently incurred by the eligible business;
 - Covered losses (expected or incurred) places in jeopardy the continued operations of the eligible business; and
 - The eligible business is created or organized in the United States or under the laws of the United States and has significant operations in and a majority of its employees based in the United States (also applicable to Category 4 Businesses)
- The loan or loan guarantee must meet the following requirements:
 - The loan or loan guarantee is sufficiently secured or is made at a rate that
 - Reflects the risk of the loan or loan guarantee;
 - Is, to the extent practicable, not less than an interest rate based on market conditions for comparable obligations prevalent prior to the outbreak of the coronavirus disease 2019; and
 - The loan or loan guarantee term is as short as practicable and may not exceed 5 years
- The eligible business must agree to:
 - Not repurchase its own shares on the open market during the effective period⁴, except to the extent required under a contractual obligation in effect as of March 27, 2020 (also applicable to Category 4 Businesses);
 - Not make dividend payments or other capital distributions on common stock during the effective period (also applicable to Category 4 Businesses); and
 - Maintain at least 90% of employment levels as of March 24, 2020 through September 30, 2020
- Special rule for air carriers:
 - An air carrier that is the recipient of a loan or loan guarantee must maintain scheduled air transportation service as the Secretary of Transportation deems necessary to ensure services to any point served by that carrier before March 1, 2020. The Transportation Secretary’s authority to direct air carriers to maintain scheduled air transportation services ends on March 1, 2022.

³ The Liquidity Program also includes separate and extensive requirements for loan recipients that are mid-sized businesses. A discussion of those requirements is beyond the scope of this Client Update.

⁴ The effective period is the period beginning on the date on which a loan or loan guarantee agreement is executed and *ending on the date that is 1 year after the date on which the loan or loan guarantee is no longer outstanding*, as discussed on page 2 of the Client Update, Air carriers and contractors appear subject to the foregoing effective period with respect to cessation of share buybacks, dividend payments and capital distributions on common shares.

Meridian comment. Due to the significant requirements imposed on eligible businesses to receive financial assistance under the CARES Act, some companies may choose to obtain funding from other sources, to the extent possible.

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