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Business Considerations: CARES Act Corporate Governance, Compensation and Employee-Related Obligations

By: Thomas P. Desmond, John T. Blatchford, Eugene A. Boyle, Philip L. Mowery

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On March 27, 2020, the President signed into law the Coronavirus Aid, Relief, and Economic Security Act or CARES Act (the "Act"). Subtitle A of Title IV of the Act, the "Coronavirus Economic Stabilization Act of 2020", creates a $500 billion economic stabilization fund ("ESF") and authorizes the Secretary of the Treasury (the "Secretary") and the Federal Reserve to establish facilities and programs to provide loans, loan guarantees and other investments in support of the aviation industry and other eligible businesses related to losses as a result of the coronavirus pandemic. Additional information about these facilities and programs, as well as other loan programs under the Act, can be found in our bulletin, "Federal Loan Relief Is On Its Way For Businesses Affected By COVID-19." The Act gives the Secretary broad authority to adopt procedures and regulations with respect to these facilities and programs.

The Act precludes the Secretary from providing financial assistance under the ESF unless the recipient enters into agreements which, among other things, include prohibitions on stock buybacks and dividends, limitations on certain employee compensation and, for certain business, agreements relating to workforce maintenance and collective bargaining and union campaigns. These provisions will undoubtedly generate questions and may be of concern as businesses consider whether or not to seek assistance under these programs. We provide insight on those questions and concerns, including a look back at the restrictions put on businesses that received financial assistance under the Troubled Asset Relief Program ("TARP") following the financial crisis in 2008.

No Buybacks

Any company that receives a loan or loan guarantee from the ESF must agree that, until the date that is 12 months after the date the loan or loan guarantee is no longer outstanding, neither the company nor its affiliates may purchase an equity security that is listed on a national securities exchange of the company or any parent company. There is an exception for purchases made pursuant to a binding agreement in effect as of March 27, 2020. By its terms, the buyback prohibition applies to businesses that are, or have a parent company that is, a public company, and then only with respect to the class of stock listed on an exchange.

Participants in TARP were, in general, subject to a similar buyback prohibition with respect to their common stock, although the restriction applied to both public and private companies. There were several exceptions. For example, redemptions or repurchases in connection with the administration of employee benefit plans in the ordinary course of business and consistent with past practice were permitted, including purchases to offset share dilution resulting from equity awards. Redemptions and repurchase of rights pursuant to a shareholders' rights plan (also known as a "poison pill") were also permitted.

Given the prominence of "no buybacks" in the rhetoric leading up the Act and creation of the ESF, it remains to be seen whether the Secretary will expand the restriction to private companies or equity securities not traded on an exchange, including equity securities issued by limited liability companies and partnerships. It is also unclear whether exceptions, such as the one relating to employee benefit plans, will be provided, raising the question whether companies could continue the practice of withholding shares to satisfy an employee's taxes that arise upon exercise or vesting of stock awards. Depending upon the terms of existing equity awards, the Act's exception for purchases made pursuant to a binding agreement in effect on March 27, 2020 could be applicable in these circumstances.

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No Dividends

A company that receives the loan or loan guarantee from the ESF must agree that, until the date that is 12 months after the date the loan or loan guarantee is no longer outstanding, no dividends or other capital distributions with respect to common stock of the company will be made. This prohibition applies to private as well as public companies.

Participants in TARP were prohibited from declaring or paying any dividend or making any distributions on their common stock, other than regular quarterly dividends based on the most recent dividend, dividends payable solely in shares of common stock or distributions under a shareholders' rights plan.

Because the Act's "no dividends" prohibition related to common stock, the prohibition by its terms would not apply to limited liability companies or partnerships that participate in the loan program. It remains to be seen whether the Secretary will extend the no dividends or distributions prohibition to limited liability companies or partnerships. Interestingly, the corresponding "no dividends" prohibition in the Act's provisions for direct payments to the aviation industry businesses prohibits dividends or other capital distributions with respect to "common stock (or equivalent interest)," (emphasis added), presumably intending to limit businesses that are limited liability companies or partnerships.

Compensation Limitations

A business that receives a loan or loan guarantee from the ESF must agree to the following limitations on certain on-going employee compensation and severance pay during the term of the loan or loan guarantee and until the date that is one year after the loan or loan guarantee is no longer outstanding (the "limitation period"):

- The compensation limitations apply to any officer or employee (other than those covered by a collective bargaining agreement) whose total compensation exceeded $425,000 in calendar year 2019 (each a "covered employee").
- Covered employees may not receive total compensation which exceeds, during any consecutive 12-month period during the limitation period, the total compensation received in calendar year 2019. Compensation is further limited if the covered employee's total compensation in calendar year 2019 exceeded $3,000,000. In that case, the covered employee may not, during any consecutive 12-month period during the limitation period, receive total compensation from the business in excess of $3,000,000 plus 50% of the excess of calendar year 2019 total compensation over $3,000,000.
- During the limitation period, covered employees may not receive severance pay or other benefits upon termination of employment that exceeds two times the maximum total compensation received by the covered employee in calendar year 2019. (Pending guidance, it is believed that "maximum total compensation" in calendar year 2019 is the same as "total compensation" in calendar year 2019.)
- A covered employee's total compensation includes "salary, bonuses, awards of stock, and other financial benefits" provided by the eligible business to the covered employee.

The Act is not quite "TARP 2.0," as its compensation limitations differ greatly from those that applied under TARP. TARP did not impose caps with respect to ongoing compensation. The TARP rules prohibited bonuses and equity-based incentive compensation, but permitted the award of limited amounts of time-vesting restricted stock and grandfathering of certain existing agreements. The TARP restrictions applied to the top five executive officers and up to 20 of the other most highly compensated employees based on prior year's compensation, which resulted in a changing roster of employees subject to the limitations from year-to-year. The determination of prior year's compensation was based on the compensation that would be reported in the summary compensation table of the company's proxy statement ("proxy compensation"). TARP barred "golden parachute payments," effectively defined as amounts paid on or after termination of employment or a change in control, other than amounts that had vested and would be paid upon a voluntary termination of employment, death or disability. To reinforce the compensation limitations under TARP, the Secretary required the affected officers and employees to execute waivers of the right to any prohibited compensation.

The initial question created by the Act is the determination of "total compensation." Is the definition intended to mean "proxy compensation"—salary received during a period, bonuses paid for the period (i.e, a bonus paid in 2020 for 2019), the grant date value of equity awards (as opposed to amounts received on the exercise or vesting of awards of stock) and other benefits accrued for the period (such as deferred compensation contributions)? We read the use of "awards of stock" to signal an intent to follow the TARP rules on this point and use proxy compensation for determining total compensation and anticipate regulations along those lines.

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Similarly, we anticipate the regulations will adopt the framework from TARP, and interpret “severance pay or other benefits” to include only incremental amounts that would not have been paid had the employee simply resigned, or employment was terminated due to death or disability.

Eligible businesses should anticipate that the Secretary will require that they obtain letters or some form of acknowledgment from covered employees that compensation may be limited and waiving any rights they may have under existing agreements or otherwise to receive prohibited compensation. Businesses that plan to participate in the Act’s economic stabilization programs should begin now to take steps to be in a position to be able to calculate total compensation for calendar year 2019, identify the employees subject to the compensation limitations and track on-going compensation to ensure compliance during the rolling 12-month periods.

In addition to the matters above, questions arise with respect to individuals who were employed for only part of 2019, but whose total compensation exceeded $425,000. In the absence of guidance, their partial-year 2019 total compensation will apply to determine the cap for ongoing compensation as well as severance pay.

Employee-Related Obligations

The Act requires certain businesses that receive a loan or loan guarantee from the ESF to agree to maintain certain workforce levels and/or to make certain commitments with respect to collective bargaining agreements or union organizing efforts.

Eligible businesses in the aviation industry or critical to maintaining national security must agree that until September 30, 2020, the business will maintain its employment levels as of March 24, 2020, to the extent practicable, and in any case not reduce the employment levels by more than 10% from the March 24, 2020 levels.

Eligible “mid-sized businesses” (500 to 10,000 employees) must provide a good-faith certification that:

- the funds received will be used to retain at least 90% of its workforce, at full compensation and benefits, until September 30, 2020;
- the recipient intends to restore not less than 90% of its workforce that existed as of February 1, 2020, and to restore all compensation and benefits to the workers no later than four months after the termination date of the public health emergency declared by HHS on January 31, 2020;
- the recipient will not outsource or offshore jobs for the term of the loan and two years after repaying the loan;
- the recipient will not abrogate existing collective bargaining agreements for the term of the loan and two years after repaying the loan; and
- the recipient will remain neutral in any union organizing effort for the term of the loan.

No guidance on how the Secretary will apply these requirements can be learned from TARP. Participants in TARP were not subjected to any commitments with respect to workforce or union relationships. As a result, the aviation industry and mid-sized businesses will need to be aware of language issued by the Secretary defining levels of the workforce. Mid-sized businesses will also need to be aware of how the Secretary defines outsourcing and offshoring, and compensation and benefits in the context of the “90% requirements.”

Mid-sized businesses considering whether or not to participate in the loan program should also be aware of the restrictions on the manner in which they deal with labor unions that represent or seek to represent their employees. The requirement that the business “will not abrogate existing collective bargaining agreements” means that any efforts by the business during the term of the existing agreement to have it (or parts of it) set aside would be foreclosed. However, it would not appear to have any impact on a business’s ability to re-negotiate contract terms following expiration of the existing collective bargaining agreement, as normally occurs. Whether or not the provision would have any impact on the ability of the business in a bankruptcy proceeding to move to set aside a collective bargaining agreement is an open question under the Act, however, it is likely that unions who oppose such motions will attempt to use the provision for such purpose.

The second union-related condition for a mid-sized business to consider is the requirement to “remain neutral in any union organizing effort for the term of the loan.” Neutrality is a powerful weapon in the hands of a union seeking to represent a company’s employees, as it effectively prevents the employer from telling its employees that it opposes unionization, sharing its opinions and experiences regarding unions or educating the employees regarding the realities, risks and disadvantages of being represented by a union. Employers almost never win union elections when placed under such restrictions. There is also a possibility that unions may ultimately be able to obtain the names and other information of companies who obtained loans through the program so as to target them. All mid-sized businesses, and particularly those

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that may be vulnerable to union organizing, need to weigh these risks when considering whether to participate in the loan program.

If you have any questions regarding the topics discussed in this article, please contact **Thomas P. Desmond** (Chicago) at +1-312-609-7647, **John T. Blatchford** (Chicago) at +1-312-609-7605, **Eugene A. Boyle** (Chicago) at +1-312-609-7692, **Philip L. Mowery** (Chicago) at +1-312-609-7642, or any Vedder Price attorney with whom you have worked.

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