

Five Things to Know About the Pre-Launch Update to the Main Street Lending Program

By **Lowell A. Citron** and **Bryan D. LaPlant**

Certain provisions of the coronavirus economic stimulus legislation are subject to the ongoing issuance of government regulations and other government action; thus, certain details regarding the legislation may be clarified, revised, or added.

Potential Main Street Lending Program borrowers and lenders have been lying in wait for more than two months, since before the launch of the SBA's Paycheck Protection Program, to see how the CARES Act's mandate to provide support to midsized "Main Street" businesses would be finally implemented. With its latest May 27 guidance, the Federal Reserve Board signaled that the wait is nearly over and funds would soon be made available. While prior guidance from the Federal Reserve Board emphasized expanding the scope and eligibility of credit under the three Main Street programs—the Main Street New Loan Facility (the MSNLF), the Main Street Expanded Loan Facility (the MSELF), and the Main Street Priority Loan Facility (the MSPLF and, collectively with the MSNLF and the MSELF, the Main Street Lending Program)—the latest updated FAQs and legal documentation also highlight the Federal Reserve's strict mandate to avoid risky lending and protect taxpayer funds.

With this latest pre-launch update, borrowers and lenders alike have finally been given certainty as to the definite legal documents they will be required to sign. The complete list of changes included in the 16 new and updated documents totaling over 200 pages is beyond the scope of this Client Alert; we urge interested lenders and borrowers to reach out as soon as possible to discuss eligibility and complete program terms. However, some of the noteworthy information included in the latest

guidance and described in greater detail below include, among others: (1) the Federal Reserve Board's ability to trigger mandatory repayment for certain breaches of required covenants and representations, (2) further guidance on the application of affiliation rules under 13 CFR 121.301(f) limiting all affiliates to a single Main Street Lending Program facility, (3) applicability of a requirement that borrowers be unable to secure "adequate credit accommodations" elsewhere, (4) updates to collateral and security requirements for MSPLF and MSELF (including permitting split collateral structures), and (5) lenders' eligibility certifications and option to have their loan conditioned on a binding participation commitment from the applicable Federal Reserve SPV (as applicable, the "Main Street SPV").

Our prior Client Alerts, "[Federal Reserve—Initial Launch, Main Street Loan Facilities](#)" and "[Major Updates to Main Street Lending Program](#)," provide a comprehensive overview of the initial term sheets and FAQs for the Main Street Lending Program through early May, including as to eligibility of borrowers and lenders, loan sizing, required certifications by borrowers and lenders, and limitations on share repurchases, dividends, and executive compensation. This Client Alert is intended to highlight noteworthy updates and new information provided by the Federal Reserve Board's May 27 pre-launch (*final?*) updates to Main Street Lending Program FAQs, as well as new information included in the forms of documents provided for lenders and borrowers to use in making loan and participation applications, but it does not restate all relevant features and requirements of the Main Street Lending Program facilities. ***All signs point to availability of funds being sooner rather than later, and interested borrowers or***

lenders should reach out as soon as possible to assess eligibility and discuss overall program requirements.

1. Mandatory Prepayment for Breach of Material Covenants and Representations

Prior to this most recent May 27 update from the Federal Reserve Board, consequences for breaching the Main Street Lending Program's required covenants and/or representations were not fully detailed. The latest updated FAQs and forms for a borrower's required certifications and covenants now expressly provide that if the Federal Reserve Board determines a borrower has materially breached one of the Main Street required covenants, or made a material misrepresentation in any Main Street required certification, *the Federal Reserve Board may trigger mandatory prepayment of the loan within two business days.* Additionally, borrowers will be required to indemnify the Federal Reserve Board (including the Secretary of the Treasury, among others) for their material breaches of Main Street required covenants and certifications, and they may face further civil and/or criminal liability for making any knowingly false material representations.

Consequences for breach here should not come as a huge surprise to businesses familiar with prior government loan assistance programs, but they certainly highlight the importance of thoughtfully considering all relevant circumstances with counsel. How the Federal Reserve Board will address enforcement of covenants restricting executive compensation, share buybacks, and distributions on common equity—which, by their terms, apply for one year after the loan has been repaid (at which point mandatory prepayment can obviously no longer be triggered, and “damages” under an indemnity are difficult to assess)—remains to be seen.

2. Private Equity Disqualified; Unlikely Affiliates Stand Together

Ineligibility of private equity funds seemed likely prior to this most recent update, but it has now been made explicit (as an “Ineligible Business” determined by the Federal Reserve Board to be engaged in investment or speculation). However, many portfolio companies of private equity funds (among others) have struggled applying the SBA's broad affiliation rules under **13 CFR 121.301(f)** to determine eligibility for purposes of the requirement that a borrower have less than 15,000 employees or less than \$5 billion in 2019 annual revenue, when aggregated with affiliates. Generally, these rules will impute affiliation to any owner of greater than 50

percent voting equity, as well as to minority equity owners with certain “bad” negative controls such as a consent right over debt incurrence or issuance of dividends.

Under prior guidance, both private equity fund portfolio companies and businesses with more than one source of equity capital have sometimes found that the affiliation rules swept in unlikely affiliates (with potentially more affiliates of their own), leading to ineligibility. Under new guidance, the issue is compounded by the clarification that even if an affiliated group is eligible by employee headcount or 2019 revenue, that entire affiliated group is limited to borrowing under a single Main Street Lending Program facility and subject to an aggregated maximum loan size (e.g., \$25 million in the case of MSNLF and MSPLF and \$200 million in the case of MSELF).

Among affiliates who do not otherwise act in concert, the first applicant to apply for and receive a Main Street Lending Program loan appears to have the ability to determine how the affiliated group's availability is utilized, and under which facility.

3. Adequate Credit Accommodations Unavailable

Latest FAQs and borrower certifications and covenants also include an explicit reference to 12 CFR 201.4(d)(8), which provides in relevant part that the Federal Reserve Bank must obtain evidence that borrowers seeking taxpayer funds are unable to secure adequate credit accommodations from other banking institutions. The latest FAQs attempt to give greater clarity to the requirement in stating that this certification may be given by Main Street borrowers if the amount, price, or terms of credit available from other sources are inadequate for the borrower's needs during the current unusual and exigent circumstances. Although the FAQs state that a borrower will not be required to demonstrate that applications for credit have been denied by other lenders, or otherwise document that the amount, price, or terms of credit available elsewhere are inadequate, we would be inclined to carefully consider what support a borrower might provide if asked to “back up” this certification.

4. Priority and Security Clarifications—MSPLF and MSELF

Clarifications added for the MSPLF and MSELF now expressly permit these facilities to be unsecured if a borrower has no other secured debt (except debt secured by real estate, which

is disregarded for this purpose). Debt incurred under each of these facilities must simply be at least pari passu with any existing secured debt, if any, and may otherwise be unsecured. No Main Street Lending Program facility is permitted to be contractually subordinated to any unsecured debt of the borrower.

Further, an important additional clarification now expressly permits borrowers with split collateral structures to incur debt under MSPLF and MSELF. The latest FAQs make clear that MSPLF and MSELF debt can be incurred pari passu with one of multiple tranches of secured debt and need not share in all collateral that secures a borrower's other debt.

Solely under the MSPLF, the latest FAQs impose an additional requirement where an MSPLF loan will be secured. The so-called "Collateral Coverage Ratio" requires that pro forma for incurrence of the MSPLF loan, the ratio of collateral to debt is either (i) at least 2:1 (i.e., collateral value 200 percent of loans secured by such collateral) or (ii) not less than the ratio of collateral to debt for all of a borrower's other secured debt at origination (except debt secured by real estate, which is disregarded for this purpose).

5. Lender Registration, Reliance, and Certainty of Participation

The latest pre-launch update includes the first significant details on how lenders will establish eligibility and receive funds for participations. Eligibility is established by relatively simple certifications as to (i) meeting the Main Street Lending Program's definition of "Eligible Lender," (ii) solvency, and (iii) satisfying the CARES Act's conflict of interest prohibition. As is the case for borrowers, knowing material misrepresentation is punishable under criminal and/or civil law, so we urge lenders to consult with counsel.

Although it takes at least seven and as many as nine documents for a lender to establish eligibility and participation under the Main Street Lending Program, the latest FAQs provide lenders with two helpful accommodations to encourage participation. First, although lenders must collect specific certifications and include certain covenants applicable to borrowers, lenders are expressly permitted to rely on all borrower certification and covenants, as well as subsequent self-reporting by borrowers, and are not expected to independently verify borrower's certifications or actively monitor ongoing compliance. Second, lenders are granted the option to either (i) make loans more quickly, prior to binding approval by the Main

Street SPV to purchase its participation (with documentation submitted for approval after the loan is made, with risk on the lender to have complied with all program terms) or (ii) provide a loan commitment to a borrower, contingent upon receiving a binding commitment from the Main Street SPV to purchase its participation (with documentation submitted for approval in advance of making the loan). If the contingent commitment option is selected, lenders are obligated to fund within three business days of the Main Street SPV's binding commitment.

Also of note, lenders are now able to see the form of participation agreement provided by the Federal Reserve Board for participation purchases, which includes, among other provisions, the circumstances under which the Main Street SPV will elevate its participation to an assignment and general parameters for the Main Street SPV's involvement after any default, acceleration, and/or bankruptcy. Generally, the Federal Reserve Board has signaled that it does not expect to elevate its participation to an assignment (and will expect the lender to manage market-standard workout processes with a distressed borrower) unless its interests and the lender's interests are misaligned or if the loan amount involved with a distressed borrower is relatively large.

Closing Thoughts

Certain borrowers and lenders may view the imminent launch of the program with optimism and excitement; for cash-strapped eligible borrowers, the latest guidance gives certainty to the process and specific covenants and certifications that will apply. For those on the fence as to eligibility and/or desirability of participation, the latest guidance may provide certainty as to their best path forward. Others may be pushed out of participation in a Main Street Lending Program due to its apparent hostility to private equity funds and businesses that are part of affiliated groups, and still others may find the loan terms to not be sufficiently generous to justify program restrictions. For lenders considering making loans and selling participations to the Main Street SPVs, we expect that the latest guidance is useful to make final determination on participation and, if desired, prepare loan documentation to be ready at launch.

For those interested borrowers whose eligibility cannot be established under the current rules, there remains some hope that the Federal Reserve Board continues to be receptive to commentary and willing to provide additional accommodations in the future. However, we are

also seeing in this latest guidance the impact of mandatory provisions applicable for the Federal Reserve Board to limit risky lending and protect taxpayer dollars.

Whether the needs of borrowers and lenders lend themselves to immediate participation in the Main Street Lending Program or to a wait-and-see approach, we remain ready to assist with determination of eligibility and with negotiation of program-compliant loan documentation for participants. At this point, the only way the Main Street Lending Program

could surprise us—in particular, in light of the events around the SBA's Paycheck Protection Program—would be if it did not continue to evolve and adapt in the weeks and months to come.

To see our other material related to the pandemic, please visit the Coronavirus/COVID-19: Facts, Insights & Resources page of our website by clicking [here](#).

Contacts

Please contact the listed attorneys for further information on the matters discussed herein.

LOWELL A. CITRON

Partner

Chair, Debt Financing

T: 646.414.6819

lcitron@lowenstein.com

BRYAN D. LAPLANT

Counsel

T: 646.414.6884

blaplant@lowenstein.com

NEW YORK

PALO ALTO

NEW JERSEY

UTAH

WASHINGTON, D.C.

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