KIRKLAND & ELLIS

Blog Post

How Will the CARES Act Impact Energy and Infrastructure?

27 March 2020

At 4:00 p.m. ET today, President Trump signed the $2.2 trillion Coronavirus Aid, Relief, and Economic Security Act (**"CARES Act"**). This post explores the implications of this massive legislation for the energy and infrastructure market.

Are any provisions of the CARES Act targeted toward energy and infrastructure?

For the energy sector, the answer appears to be no. Despite lobbying efforts by renewable energy industry groups and oil & gas producers, the CARES Act does not provide targeted programs for either subsector. As we discussed in a March 23 blog post, certain renewables trade groups had been advocating for extensions to looming tax credit deadlines and also the implementation of a cash grant or direct payment option to offset potential demand reduction in the tax equity market. In a March 19 blog post, we detailed an announcement by the Department of Energy that it intended to purchase $3 billion of American crude oil to fill the Strategic Petroleum Reserve. That initiative is contingent on the availability of funds from Congress. None of these proposals made it into the final CARES Act, which led to, among other items, the Department of Energy abandoning the March 19 solicitation to fill the Strategic Petroleum Reserve. Still, there is much that businesses operating in the energy sector should understand about the new bill.

There are certain specific programs under the CARES Act directed towards the transportation infrastructure subsector. In addition to the Air Carrier Working Support program providing for grants of $25 billion to passenger air carriers, $4 billion to cargo air carriers and $3 billion to contractors, in each case, for the continuation of employee wages, salaries and benefits, the CARES Act includes $10 billion of grants to airports under the FAA’s Airport Improvement Program; $492 million and $526 million of grants to the National Railroad Passenger Corporation for activities relating to the Northeast Corridor and National Network, respectively; and $25 billion of grants for public transit to tribal, state and local authorities, and other operators of public transportation that receive federal transit program grants.

Separately, we expect that businesses operating in the energy and infrastructure sectors may be able to avail themselves of industry-agnostic relief available to companies operating in distressed sectors of the economy under certain other provisions of the CARES Act, including the economic stabilization targeted lending program and the expansion of the small business loans under the "Paycheck Protection Program" (each discussed further below).

Please reach out directly to request more detailed information (including presentations that we have prepared on the CARES Act) or with questions as to whether these programs or requirements may apply to a particular business.

Economic Stabilization — $500 Billion of Loans, Loan Guarantees and Other Investments by the U.S. Treasury (Section 4003)

Likely the most relevant element of the CARES Act for businesses operating in the energy and infrastructure sectors is the creation of a program to provide up to $500 billion in the form of loans, loan guarantees and other investments by the U.S. Treasury, $454 billion of which may be allocated to Eligible Businesses operating in any sector. (“*Eligible Businesses*” is defined as an air carrier or any U.S. business that has not otherwise received adequate economic relief in the form of loans or loan guarantees provided under the CARES Act). However, because most of the procedures and requirements of this program are to be published within 10 days of the enactment of the CARES Act, applicants — including businesses operating in the energy and infrastructure sectors — will need to wait until publication of these procedures and requirements to determine whether and under what additional conditions they will qualify.

Section 4003 of the CARES Act provides for emergency relief through loans, loan guarantees and investments, including: (i) $25 billion for (x) passenger air carriers and (y) “Eligible Businesses” certified under part 145 of title 14, Code of Federal Regulations, and approved to perform inspection, repair, replace or overhaul services, and ticket agents; (ii) $4 billion for cargo air carriers; (iii) $17 billion for businesses critical to national security; and (iv) $454 billion plus unused amounts above for other Eligible Businesses, states and municipalities.

To effect the lending program pursuant to clause (iv), the Treasury will guarantee or backstop $454 billion of loans to be made by the Federal Reserve. Since the Federal Reserve does not require dollar-for-dollar support from Treasury to make loans, the Federal Reserve is likely to make loans in an aggregate amount exceeding $454 billion. It has been reported that one of Secretary Mnuchin's favorite talking points is that, with the Federal Reserve's help, the government will turn this approximately $454 billion dollar program into a $4 trillion "booster shot" for the U.S. economy.

There are no required terms specified in the statute — loans and guarantees are to be made on "such terms and conditions, and contain such covenants, representations, warranties, and requirements (including requirements for audits) as the Secretary determines appropriate." Interest rates will be determined by Treasury based on the risk and the current average yield on outstanding U.S. Treasury bills with a comparable maturity. There is also no specified limit on the amount one business may receive under the program.

As one component, the Treasury will establish a program to provide financing for banks and other lenders to make direct loans to mid-size businesses with 500–10,000 employees, with interest rates no higher than 2% per year, and for the first six months after such direct loan is made (or for such longer period as Treasury may determine in its discretion), no principal or interest shall be due and payable. A borrower receiving a direct loan under this program will need to make certain certifications, including with regards to retention of workforce and restrictions on outsourcing or offshoring jobs.

As another component of the $454 billion program, the Federal Reserve has discretion to establish a "Main Street Lending Program" or similar program supporting lending to small and mid-sized businesses on such terms and conditions set by the Federal Reserve, including any program in which the Secretary makes a loan, guarantee or investment.

Companies interested in receiving direct loans under the lending program should note certain other important restrictions:

- There will be no loan forgiveness;
- Participating obligors will be subject to certain limits on compensation for highly paid employees; and

- Participating obligors will be subject to restrictions on stock buybacks and payments of dividends on common stock and other capital distributions.

Small Business Administration “Paycheck Protection Program” (Section 1102)

The “Paycheck Protection Program” under Section 1102 will provide funds to qualifying businesses through June 30, 2020, that may be used for payroll costs, rent, utilities, certain health care benefits and interest on debt incurred prior to February 15, 2020. Applications will need to be submitted to Small Business Administration (**“SBA”**)-approved lenders. Application forms, required certifications and an outline of the application process should be forthcoming from the SBA in the next few weeks. Most private-equity-backed portfolio companies will likely not be able to avail themselves of the Paycheck Protection Program because the size test (discussed below) takes into account a broad definition of affiliates.

While the CARES Act authorizes up to $349 billion of commitments for the Paycheck Protection Program, the amounts of the individual loans to be provided under the Paycheck Protection Program are small — limited to the lesser of (i) 2.5x trailing 12 months average monthly qualifying payroll costs (plus any outstanding amount under a pre-existing economic injury disaster loan made on or after January 31, 2020, and before the Payment Protection Program loans are available); and (ii) $10 million. There are alternate measurement periods for new and seasonal businesses. Loans under this program are subject to a maximum interest rate of 4%, and do not include collateral or any personal guaranty requirements. Loan principal is expected to be forgivable so long as proceeds are used for qualifying expenses (e.g., rent, payroll, utilities) except to the extent of workforce reduction. To the extent not forgiven, loans will have a maximum maturity of 10 years.

Eligibility is determined based on the size of a business, together with all its affiliates (subject to three narrow exclusions in which affiliates are not included in the size test). The size test is as follows: (i) a business must have 500 employees or fewer, unless a higher number of employees is assigned to its primary industry North American Industry Classification System (“**NAICS**”) code by the SBA; (ii) a business that falls within NAICS Code 72 (accommodation and food services) cannot have 500 or more employees per physical location; or (iii) a business that does not meet the employee test can still meet any revenue test that has been assigned for its industry NAICS code by the SBA. The SBA publishes the size standards per NAICS code on its website at www.sba.gov. Employee limits for certain energy and infrastructure-related NAICS codes are as follows:

- “Crude Petroleum and Natural Gas Extraction” — 1,250;
- “Natural Gas Liquid Extraction” — 750;
- “Fossil Fuel Electric Power Generation and “Nuclear Electric Power Generation” — 750; and
- “Electric Power Distribution” and “Natural Gas Distribution” — 1,000

Loan Modifications (Section 4013)

Section 4013, in combination with the regulatory guidance that was issued by the federal banking regulators on March 23, 2020, facilitates the modification of loans to borrowers that were “current” (i.e., not more than 30 days past due) as of December 31, 2019, and permits banks to avoid treating such modifications as “troubled debt restructurings” (**“TDRs”**) under U.S. GAAP, including for impairment testing and reserve requirements.

This relief will permit banks to enter into modifications (including forbearance arrangements, interest rate modifications, repayment plans, and other similar arrangements that defer or delay the payment of principal or interest) without the adverse financial accounting impact that would apply if the terms of the modification, absent the Section 4013 relief, would have required the bank to treat the modification as a TDR under conventional U.S. GAAP accounting. Qualifying modifications need to be made prior to the earlier of December 31, 2020, or 60 days after the termination of the national emergency declaration and may only relate to loans that were not more than 30 days past due as of December 31, 2019, and borrowers suffering an adverse impact that is related to the coronavirus disease 2019 (COVID–19) pandemic.

Additionally, Section 4013 requires federal banking regulators to respect the decision of the bank to invoke the relief from TDR accounting and the related impact on the bank’s reserve requirements. Thus, while helpful, Section 4013 does not require banks to provide modifications or any specific relief.

Tax Changes (Sections 2303 and 2306)

There are two tax provisions in the bill that should benefit companies in the energy and infrastructure market generally, though they are not likely to spur new investment on their own. The provisions give temporary relief for certain revenue-raising measures that were enacted as part of the Tax Cuts and Jobs Act in 2017 to help pay for a reduction in the corporate tax rate.

The first provision relaxes the limitation on net operating losses (**"NOLs"**). NOLs generally refer to deductions and losses that exceed a taxpayer's income and gain in a particular year. NOLs from 2018 and later are currently permitted to be carried forward indefinitely to future tax years, but cannot be carried back to offset taxable income in prior years. Further, post-2017 NOL carryforwards may only offset 80% of taxable income in future tax years. The CARES Act permits NOLs from 2018, 2019 or 2020 to be carried back for up to five years (i.e., potentially back to 2013, in the case of 2018 NOLs), and repeals the 80% income limitation for NOLs generated before 2021. Companies that have accrued significant NOLs over the past several years could potentially unlock additional cash flow by amending their tax returns and applying those NOLs to receive tax refunds from years in which they may have previously paid taxes (including under the pre-2018 35% corporate tax rate).

The second provision temporarily increases the cap on business interest expense deductions. Business interest expense is generally limited under current law to 30% of a taxpayer's taxable income (calculated similarly to EBITDA before 2021, but calculated after taking depreciation, depletion and amortization into account after 2021). The CARES Act increases the limit to 50% for 2019 and 2020.

Looking Ahead

While the CARES Act did not include the kinds of proposals for which many in the energy industry had advocated, it will have impacts on many energy and infrastructure businesses. Additionally, much of the impact will depend on the requirements for the economic stabilization targeted lending program that are to be published in the next 10 days.

At the same time, energy and infrastructure trade associations are not giving up their fight for more sector-specific relief. Depending on the length of the pandemic and the country's developing economic outlook, there may be a subsequent tax bill over the coming weeks that will be more focused on long-term economic stimulus packages. It is also possible that special provisions for renewables and other energy and infrastructure subsectors may be included in the next stimulus package, should it be necessary.

Read more insights from Kirkland's Energy & Infrastructure blog.

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