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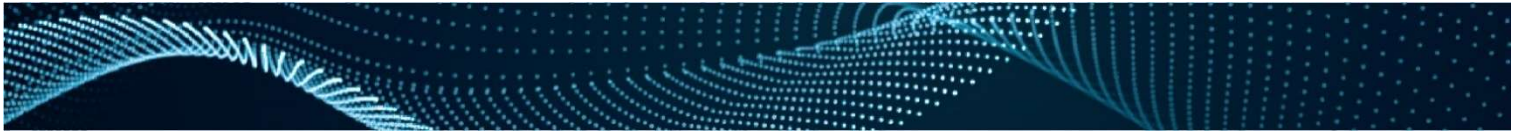
Last Update: May 27, 2020

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# COVID-19 Resources

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# Clients & Friends Memo

## **COVID-19 Update: Updated FAQs and MLSA Released by the Federal Reserve Provides Additional Details on Eligible ABS, Eligible Borrowers and Financing Terms under TALF**

**May 27, 2020**

On Wednesday, May 20, 2020, the Federal Reserve announced the first loan subscription date for the Term Asset-Backed Securities Loan Facility (“TALF”) and published the Master Loan and Security Agreement (the “MLSA”) and an expanded set of Frequently Asked Questions, providing further details on the terms and conditions that will apply to borrowings under TALF.<sup>1</sup> On Tuesday, May 26, 2020, the Federal Reserve released another updated set of Frequently Asked Questions with additional clarifications applicable to TALF<sup>2</sup> and an updated form of issuer and sponsor certification.<sup>3</sup> The Updated FAQs follow the release on May 12, 2020 by the Federal Reserve of its initial set of Frequently Asked Questions for the TALF program (the “Initial FAQs”).<sup>4</sup>

TALF's first subscription date for loans backed by eligible asset-backed securities (“Eligible ABS”) will be June 17, 2020, and the first loan closing date will be June 25, 2020.

For a discussion of the Initial FAQs, see our Clients & Friends Memo dated May 15, 2020 titled “*COVID-19 Update: Federal Reserve Issues New TALF Term Sheet and Responses to Frequently Asked Questions*”<sup>5</sup> and our Clients & Friends Memo dated May 13, 2020 titled “*COVID-19*

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<sup>1</sup> <https://www.newyorkfed.org/newsevents/news/markets/2020/20200520>

<sup>2</sup> The cumulative updates contained in the Frequently Asked Questions relating to TALF released on May 20, 2020 and the Frequently Asked Questions relating to TALF released on May 26, 2020 <https://www.newyorkfed.org/markets/term-asset-backed-securities-loan-facility/term-asset-backed-securities-loan-facility-faq> are collectively referred to herein as the “Updated FAQs”.

<sup>3</sup> <https://www.newyorkfed.org/medialibrary/media/markets/talfdocs/talf-issuer-sponsor-certification.pdf>

<sup>4</sup> <https://www.newyorkfed.org/newsevents/news/markets/2020/20200512>

<sup>5</sup> <https://www.cadwalader.com/resources/clients-friends-memos/covid-19-update-federal-reserve-issues-new-talf-term-sheet-and-responses-to-frequently-asked-questions>

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*Update: Federal Reserve Provides Additional Guidance on Inclusion of CLOs in New TALF Term Sheet and Responses to Frequently Asked Questions.”<sup>6</sup>*

The additional details and clarifications provided by the Updated FAQs generally relate to: (i) collateral eligibility, (ii) borrower eligibility, (iii) financing terms, (iv) borrowing procedures, and (v) the role, responsibilities and protections of TALF Agents. This memorandum summarizes certain of the additional details and clarifications relating to collateral eligibility, borrower eligibility and financing terms described in the Updated FAQs.

## Eligible ABS

Additional details and/or clarifications relating to Eligible ABS:

- Eligible NRSROs. The list of eligible NRSROs under TALF has been expanded to include DBRS, Inc. and Kroll Bond Rating Agency. However an Eligible ABS must also have a qualifying rating from one of Fitch Ratings, Inc., Moody’s Investors Service, Inc. or S&P Global Ratings.
- Unsolicited Ratings. Unsolicited ratings will not be considered in determining whether collateral constitutes Eligible ABS.
- SBA ABS. The expanded description of small business ABS (“SBA ABS”) that may be pledged as collateral for a TALF loan clarifies that the SBA ABS (rather than the underlying assets as provided in the Initial FAQs) must be fully guaranteed by the full faith and credit of the U.S. government and that the underlying assets consist of loans made pursuant to (i) section 7(a) of the Small Business Act and (ii) the Certified Development Company/504 loan program of the U.S. Small Business Administration.
- Junior Triple-A ABS Are Not Eligible ABS. ABS tranches that are junior to any other class of securities backed by the same pool of assets are not Eligible ABS under TALF.

*Note:* This restriction raises the question of whether, as a technical matter, triple-A CLO notes (commonly designated as Class A Notes or Class A-1 Notes) that would otherwise qualify as Eligible ABS would be ineligible if the CLO issuer also issued “Class X Notes” that amortize during the term of the TALF loan, even though there is no express subordination.

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<sup>6</sup> <https://www.cadwalader.com/resources/clients-friends-memos/covid-19-update-federal-reserve-provides-additional-guidance-on-inclusion-of-clos-in-new-talf-term-sheet-and-responses-to-frequently-asked-questions>

- Issuer Disclosure and Documentation.

- Eligible ABS issued on or after March 23, 2020 and before May 22, 2020 are excluded from the requirement (described in the Initial FAQs) that the offering document for such Eligible ABS disclose whether the deal is prime or subprime.
- Issuers of Eligible ABS will be required to submit the final credit rating letters from each eligible NRSRO no later than 10:00 a.m. (New York time) on the applicable TALF loan settlement date.
- Sponsors or issuers of ABS proposed as Eligible ABS must provide to the Federal Reserve Bank of New York (the “FRBNY”) all data on the ABS or its underlying exposures that the issuer has provided to any NRSRO no later than 5:00 p.m. (New York time) three weeks in advance of the applicable TALF subscription date.
- Sponsors or issuers of ABS proposed as Eligible ABS must also provide a written waiver or consent to any such NRSRO, permitting such NRSRO to share its view of the credit quality of the ABS and its underlying exposures with the FRBNY.
- Sponsors and issuers of Eligible ABS (other than SBA ABS) are required to ensure that the information included in the offering document contains a certification that, among other things, (i) the ABS is “eligible collateral” and (ii) the sponsor (or, if the sponsor is a special purpose vehicle, the sponsor’s direct or indirect ultimate parent) has executed and delivered an indemnity in favor of the TALF SPV and the FRBNY indemnifying each of them from any losses they may suffer if such certifications are untrue.

*Note:* The “sponsor” for purposes of the issuer and sponsor certification and the sponsor indemnity undertaking, in both public and private offerings for Eligible ABS, will be the legal entity that is the sponsor of the ABS issuance. The sponsor is the entity that organizes and initiates an ABS transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity. For CLOs, the collateral manager will be the “sponsor” for these purposes even if the collateral manager is not the “sponsor” for purposes of the risk retention rules.<sup>7</sup> If the sponsor is a special purpose vehicle, the sponsor’s direct or indirect ultimate parent must execute the certification and indemnity undertaking.

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<sup>7</sup> The United States federal interagency credit risk retention requirements of Section 15G of the Exchange Act, as added by Section 941 of the Dodd-Frank Act, and promulgated at 17 C.F.R. Part 246, became effective with respect to CLOs on December 24, 2016. Subsequently, the U.S. Court of Appeals for the District of Columbia Circuit ruled, in *The Loan Syndications & Trading Ass’n v. SEC*, No. 17-5004 (D.C. Cir. Feb. 9, 2018), that managers of “open-market CLOs” are not securitizers under Section 941 of the Dodd-Frank Act and, consequently, are not subject to the credit risk retention requirements in respect of the CLOs they manage.

- As a condition to the disbursement of a TALF loan secured by newly-issued ABS, an accounting firm retained by the issuer must provide to the FRBNY: (i) an auditor attestation regarding the issuer and sponsor's certification that the ABS is TALF eligible ("Auditor Attestation") or (ii) in the case of CLOs, an agreed upon procedures report with respect to factual matters related to various TALF eligibility criteria for the leveraged loans underlying such CLO ("AUP Report (TALF)"). If available, the accounting firm must also provide the FRBNY a copy of the report on agreed upon procedures that it delivers to the sponsor and the underwriter or initial purchaser, including any updates to such report, in connection with CLOs ("AUP Report (Industry)").<sup>8</sup>
- Timing Considerations. While the Updated FAQs address some timing issues relating to Eligible ABS, some ambiguity remains with respect to Eligible ABS issued on dates *prior* to the disbursement of the related TALF loan proceeds.
- Eligible ABS expressly includes:
  - (i) ABS purchased by the borrower on the same day as the extension of the related TALF loan (*i.e.*, primary transactions that coincide with a TALF loan disbursement date); and
  - (ii) ABS issued within the 30-day period immediately preceding the applicable TALF subscription date if such ABS has been acquired in an arm's length secondary market transaction (*i.e.*, secondary transactions that occurred not more than 30 days prior to the applicable TALF subscription date).

*Note:* It remains unclear whether ABS purchased by a proposed TALF borrower in a primary transaction not more than 30 days prior to the applicable TALF subscription date would qualify as Eligible ABS.

## Eligible Borrowers

Additional details and/or clarifications relating to eligible borrowers under TALF:

- Borrower Certification. A TALF borrower may rely on "ABS spreads that are elevated relative to normal market conditions" to make the required certification that it is unable to secure adequate credit accommodations from other banking institutions.
- Regulatory Capital Treatment. The regulatory capital requirements for securities financed by a TALF loan are the same as those for securities that are not financed by a TALF loan.

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<sup>8</sup> The Auditor Attestation or AUP Report (TALF), as applicable, and, if available, the AUP Report (Industry) must be submitted to the FRBNY no later than 5:00 p.m. (New York time) on the same day the issuer furnishes such reports on Form ABS-15G.

- *CARES Act Restrictions.* The compensation, stock repurchase, and capital distribution restrictions that apply to direct loan programs under section 4003(c)(3)(A)(ii) of the Coronavirus Aid Relief and Economic Security Act do not apply to TALF.
- *CMBS and CLO Borrowers.* The aggregate of any mortgage loans (in the case of CMBS) or leveraged loans (in the case of CLOs) made to a TALF borrower and any of its affiliates (rather than just the TALF borrower's affiliates, as described in the Initial FAQs) may not constitute more than a minimum percentage<sup>9</sup> of the underlying collateral pool securing the Eligible ABS pledged by such TALF borrower.

## Financing Terms

Additional details and/or clarifications relating to TALF loan terms:

- *Term.* Each TALF loan will have a three year maturity.
- *Prepayment.* A TALF borrower may prepay a TALF loan in full or in part (subject to the terms and procedures set forth in the MLSA, including the restrictions on permitted repayment dates) by delivering a prepayment notice to the FRBNY. There are no prepayment penalties.
- *Loan Amounts.* The loan amount for an Eligible ABS issued on or after March 23, 2020 and purchased no more than 30 days before the proposed subscription date will be equal to: (i) the base value<sup>10</sup> minus (ii) the base dollar haircut.<sup>11</sup> If the base value is less than the base dollar haircut, the ABS is not eligible collateral for TALF.
- *Substitution of Eligible ABS.* TALF borrowers are not permitted to substitute Eligible ABS under a TALF loan.
- *Assignment of TALF Loans.* A TALF borrower may assign all of its obligations with respect to a TALF loan to another eligible TALF borrower in accordance with the terms and procedures set forth in the MLSA, including that the related ABS constitutes Eligible ABS as of the date of the assumption, and with the prior consent of the FRBNY by delivering an Assignment and Assumption.
- *Payment at Maturity.* At the maturity of a TALF loan, the TALF borrower may: (i) repay the TALF loan with same day funds, at which time the TALF SPV will deliver the collateral free of payment; (ii) arrange for the sale of the collateral and instruct the TALF SPV to deliver the pledged ABS to

<sup>9</sup> Four percent of the aggregate principal balance of mortgage loans in the portfolio, in the case of CMBS, and five percent of the aggregate principal balance of leveraged loans in the portfolio, in the case of CLOs.

<sup>10</sup> "Base value is equal to the least of: (i) the dollar purchase price on the applicable trade date, (ii) the market value as of the subscription date, and (iii) a value based on the [FRBNY's] review, provided, however, that, other than SBA ABS, the base value may not be greater than par.

<sup>11</sup> Base dollar haircut varies with the asset class and average life of the ABS. See CWT Clients & Friends Memo, *supra* note 5.

the counterparty versus payment in an amount sufficient for the repayment of the TALF loan; or (iii) deliver a Collateral Surrender and Acceptance Notice and surrender the collateral to the TALF SPV by the TALF loan maturity date, in lieu of repaying the outstanding principal or interest on a TALF loan.

- Principal Losses on Eligible ABS. If a TALF-financed ABS incurs a principal loss during the term of the related TALF loan, the TALF borrower is responsible for all interest and principal payments on such TALF loan. If the TALF borrower does not make such payments, the FRBNY will enforce its rights over the collateral and the borrower will forfeit its haircut amount.
- Interest Shortfall; Grace Period. A TALF borrower has a grace period of 30 days to pay any interest shortfall on a TALF loan if the interest received on the pledged ABS is not sufficient to cover the interest payment on the TALF loan. After the grace period, if the loan remains delinquent, the FRBNY will enforce its rights over the related TALF loan collateral. Where the interest shortfall relates solely to a timing difference between the interest payments on the pledged ABS and the interest payments on the TALF loan (and the pledged ABS continue to pay in accordance with their terms), that timing differential is not considered a delinquency.

### Additional Resources

Cadwalader Clients & Friends Memo, "[COVID-19 Update: Federal Reserve Launches TALF \(Again\)](#)," March 23, 2020.

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# Clients & Friends Memo

## COVID-19 Update: NYSE and Nasdaq Adopt Temporary Exceptions to Certain Shareholder Approval Requirements

May 22, 2020

The NYSE and Nasdaq continue to provide temporary relief from certain of their listing and corporate governance requirements amid the market disruption caused by COVID-19. In March and April, the NYSE suspended its minimum market capitalization requirement and provided relief from its shareholder approval requirements for 20% issuances and for transactions with related persons, in each case through June 30, 2020. In March, Nasdaq announced that it would consider the effects of COVID-19 in its review of requests for financial viability exceptions to Nasdaq's shareholder approval requirements.<sup>1</sup> Both exchanges have since adopted new rules that create broader temporary exceptions to certain shareholder approval requirements. On May 1, 2020, Nasdaq filed a proposed rule change with the SEC to adopt a new listing rule for shareholder approval of 20% issuances and insider participation in certain financings. On May 14, 2020, the NYSE followed by filing a proposed rule change that was largely the same.<sup>2</sup> Both temporary rules have been approved by the SEC and are effective through June 30, 2020.

The purpose of the temporary rules is to support the urgent liquidity needs of companies caused by severe limitations on the ability to operate their businesses, significant market declines, volatility in the U.S. and global equity markets, and severe disruption in the credit markets. The exchanges responded to these needs by providing a straightforward set of criteria that streamline their listed companies' access to capital.

### 20% Issuances

The NYSE and Nasdaq require shareholder approval of certain transactions (other than public offerings) that involve the issuance of 20% or more of a company's outstanding common stock or voting power before the transaction.

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1 The relief measures taken by the exchanges in March and April are discussed in our previous COVID-19 Updates, which are available [here](#) and [here](#).

2 See Nasdaq Listing Rule 5636T and Section 312.03T of the NYSE Listed Company Manual.

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The temporary rules provide an exception to this stockholder approval requirement if certain conditions are met. Under the rules, a company may issue securities without shareholder approval upon submitting an application to the listing exchange that demonstrates that the transaction satisfies the following requirements:

- the need for the transaction is due to circumstances related to COVID-19;
- the delay in securing shareholder approval would (a) have a material adverse impact on the company's ability to maintain operations under its pre-COVID-19 business plan, (b) result in workforce reductions, (c) adversely impact the company's ability to undertake new initiatives in response to COVID-19 or (d) seriously jeopardize the financial viability of the enterprise;
- the company undertook a process designed to ensure that the proposed transaction represents the best terms available to the company; and
- the company's audit committee or a comparable committee comprised solely of independent, disinterested directors expressly approved reliance on this exception and determined that the transaction is in the best interest of shareholders.

The NYSE rule also includes a condition that proceeds of the transaction will not be used to fund an acquisition. The supplemental listing application submitted to the listing exchange for the transaction must include a certification that details how the transaction complies with the applicable exception.

In order for the exception to apply, the company must execute a binding agreement for the issuance prior to June 30, 2020. The issuance of the securities governed by the agreement in reliance on the exception may occur after June 30, 2020, provided it takes place no longer than 30 calendar days following the date of the agreement.

Under the NYSE rule, the exchange must also approve a company's reliance on the exception prior to the company making the issuance. Under the Nasdaq rule, no approval is required for issuances of less than 25% of the company's common stock or voting power if the maximum discount at which shares could be issued is 15% of the lower of (1) the Nasdaq Official Closing Price (as reflected on Nasdaq.com) immediately preceding the signing of the binding agreement; or (2) the average Nasdaq Official Closing Price of the common stock for the five trading days immediately preceding the signing of the binding agreement. In all other cases, Nasdaq must approve a company's reliance on the exception prior to the company making the issuance.

Issuances of stock in reliance on these temporary rules will be aggregated with any subsequent issuances by the company (not including public offerings) at a discount to the minimum price if the binding agreement governing the subsequent issuances is executed within 90 days of the prior issuance. If following the subsequent issuance, the aggregate issuance (including any shares issued in reliance on the exception) equals or exceeds 20% of the total shares or voting power

outstanding before the initial issuance, then shareholder approval will be required prior to the subsequent issuance.

### **Insider Participation and Equity Compensation**

Nasdaq requires shareholder approval for certain issuances of securities when an equity compensation plan or arrangement pursuant to which stock may be acquired by officers, directors, employees or consultants is to be established or materially amended. This has long been interpreted to require shareholder approval for certain sales to officers, directors, employees, or consultants when such issuance could be considered a form of “equity compensation.” The NYSE also requires shareholder approval for equity compensation plans, including material revisions to existing compensation plans, with limited exceptions. In addition, the NYSE has a separate requirement for shareholder approval prior to the issuance of common stock, or of securities convertible into or exercisable for common stock, in any transaction or series of related transactions to a related party, a subsidiary, affiliate or other closely related person to a related party, or any company or entity in which a related party has a substantial direct or indirect interest. A “related party” is defined as a director, officer or substantial securityholder of the company. The temporary rules provide an exception to these requirements provided:

- the participation of any affiliate is less than 5% of the transaction;
- the participation of all affiliates are collectively less than 10% of the transaction;
- the participation of any affiliate was specifically required by unaffiliated investors; and
- the affiliates did not participate in negotiating the economic terms of the transaction.

This narrow exception only applies to situations where an unaffiliated investor requires a company’s senior management to put their personal capital at risk and participate in a capital raising transaction alongside the unaffiliated investors. The exchanges believe that listed companies seeking to raise capital may face such requests as a result of uncertainty related to the ongoing spread of COVID-19.

### **Public Disclosure Requirements**

The temporary rules require the company relying on these exceptions to make a public announcement by filing a Form 8-K, where required by the SEC, or issue a press release as promptly as possible, but no later than two business days before the issuance of securities. This public announcement must disclose:

- the terms of the transaction (including the number of shares of common stock that could be issued and the consideration received);
- that shareholder approval would ordinarily be required under the applicable exchange rules but for the fact that the company is relying on the temporary exception; and

- that the audit committee or a comparable body of the board of directors comprised solely of independent, disinterested directors expressly approved reliance on the temporary exception and determined that the transaction is in the best interest of shareholders.

\* \* \*

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# Clients & Friends Memo

## COVID-19 Update: An End to Temporary Restrictions on Short Selling in the European Union

19 May 2020

Further to our [Clients and Friends Memorandum of 22 April 2020](#), on 18 May 2020 the European Securities and Markets Authority (“**ESMA**”) issued a [press release](#) on the non-renewal of and termination of short selling bans by the following national competent authorities (“**NCAs**”): Austria’s Finanzmarktaufsicht (FMA) Belgium’s Financial Securities and Markets Authority (FSMA); France’s Autorité des Marchés Financiers (AMF); Greece’s Hellenic Capital Market Commission (HCMC); Italy’s Commissione Nazionale per le Società e la Borsa; and Spain’s Comisión Nacional del Mercado de Valores (CNMV).

The NCAs referred to above previously announced temporary short selling bans (permitted under the EU Short Selling Regulation’s emergency provisions) in mid-March 2020, which were subsequently renewed in April 2020. These bans are now no longer in effect. The non-renewal and termination measures come as a result of the reduction in the market volatility in the financial markets that had been caused by the onset of the COVID-19 pandemic.

The press release also highlighted that the net short position reporting threshold under the EU Short Selling Regulation remains at the lowered level of 0.1% per the ESMA decision on 16 March 2020.

\* \* \*

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# Clients & Friends Memo

## Crime in the Time of Covid-19: The Progress of UK White-Collar Investigations and Trials During Lockdown

19 May 2020

Regulators and enforcement agencies in the United Kingdom, while not immune to the effects of the Covid-19 pandemic, have proved to be relatively adaptable with a continued appetite for enforcement. As their counterparts in the [United States](#), there is an emphasis on facilitating the government's efforts to stabilise the market, and provide guidance for businesses and individuals while being vocal about a zero-tolerance policy for any pandemic-related fraud. There has been a unanimous emphasis on companies reviewing their compliance measures to ensure they effectively ward against new risks that may be brought by market conditions or operational changes. While there is no cohesive policy regarding enforcement, and delays are likely to plague all ongoing investigations, there does not seem to be a sizeable discontinuance of matters or a change in expectations. Depending on the regulatory or enforcement body involved, this may be a window of opportunity for companies and individuals to gain some clarity in relation to their role in and the overall direction of any investigation. Included below is a roundup of current enforcement actions by a number of agencies enforcing against economic crime, and potential areas of future scrutiny.

### Financial Conduct Authority

The FCA has been at the forefront of responding effectively to the current crisis, publishing guidelines and advice in relation to a number of matters to instruct businesses and protect consumers. While the focus will be on the short-term functioning of the market and the treatment of customers, the FCA has taken every opportunity to reiterate that it will continue to investigate compliance issues and that enforcement actions should be expected to continue as usual. The [Business Plan 2020-21](#) acknowledges the effects of the crisis, but also it reiterates that fraud will continue to be an enforcement priority.

A number of statements confirm that compliance expectations will not be lowered; instead, firms will be required to adapt their systems and controls to adequately address the new risks. The FCA has [warned](#) that it is “*actively reviewing the contingency plans of a wide range of firms*,” including

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an assessment of “*operational risks*,” with an expectation that “*firms [are] to take all reasonable steps to meet their regulatory obligations*”.

The FCA has amended some of its rules to enable firms to try to help businesses and consumers affected by the pandemic, but has also reminded firms at every turn that failure to adhere to its guidance in relation to Principle 6 of the Principles for Businesses (“*A firm must pay due regard to the interests of its customers and treat them fairly.*”) may well result in enforcement action. For example, in the consumer credit and SME loan space, it is expected that the regulator will apply particular scrutiny to the treatment of borrowers experiencing financial difficulty as a result of the pandemic.

While no one senior manager at a regulated firm is required to oversee the coronavirus response, firms are [expected](#) to allocate responsibilities in a way that effectively manages risks. Responsibilities are likely to be mapped back to the Senior Managers Regime [(see also our [Clients & Friends memo](#) regarding lending to small and medium-sized enterprises and responsibilities for senior managers)]. The FCA has highlighted market abuse as a continuing high-risk area and [requires](#) firms to “*take all steps to prevent [against] market abuse*,” which may include paying more attention to compliance measures with “*enhanced monitoring, or retrospective reviews.*” Finally, anti-money laundering compliance is also [expected](#) to continue as normal with some innovative suggestions for verifying a client’s identity, including requesting they submit “*selfies*” or videos, or seek verification by a third party such as a lawyer. This guidance has been supported by the issuance of direct requests to banks for continued improvement and action.

Other statements also have been backed up by action. A large investigation of 14 financial institutions and multiple individuals in relation to allegations of tax fraud, by dividend stripping trades, in a number of European jurisdictions is continuing. The cumulative value of the fraud is estimated to be in excess of €50 billion and, while the regulator has been relatively quiet about the issue, media reports indicate the matters are close to conclusion and decisions regarding action will be taken imminently. Additionally, the latest warning notice made against an individual alleged to have engaged in market abuse was [issued](#) as recently as 19 March 2020, indicating fair warning has been given for firms and individuals alike to expect increased scrutiny by the regulator in the near future.

### **Crown Prosecution Service**

As the key public agency conducting criminal prosecutions in England and Wales, the CPS has provided the [Covid-19 Interim CPS Charging Protocol](#) which acknowledges the difficulties a jury trial poses during this crisis and categorises large, complex investigations that have been ongoing as lower priority during the pandemic. The CPS has indicated that enforcement of Covid-19-related fraud will be a matter of priority; however, prosecution of other fraudulent activity will not decline but

instead may be referred directly to the Crown Court and, in order to clear up some of the backlog it may implement, “a virtual specialist fraud court,”

While criminal cases are on hold, in particular those dealing with complex fraud, matters affecting a defendant’s legal position are not, most recently through the Court of Appeal judgment in *Barton & Booth v The Queen* [2020] EWCA Crim 575, whereby the Court confirmed the test for criminal dishonesty from *Ivey v Genting Casinos (UK) Ltd t/a Crockfords* [2017] UKSC 67 leaving the *Ghosh* test to be considered a legal relic. *Ghosh* required that: (i) the conduct complained of be found dishonest by the objective standards of ordinary, reasonable and honest people; and (ii) the defendant *realise* that an ordinary honest person would regard the behaviour as dishonest. The Ivey test strips out the subjective second limb and replaces it by enquiring: (i) what the defendant’s actual state of knowledge or belief was, based on the facts; and (ii) whether the conduct was dishonest based on the standards of ordinary decent people. Subjective judgment in relation to the defendant’s experience and intelligence will now be considered to be wrapped up in the fact-finding, first limb of the test. It is unclear whether, and to what extent, previous defences such as market practice or other standards will be considered, therefore making it more straightforward to prosecute. Furthermore, the test for dishonesty is a crucial issue in a number of complex criminal investigations, particularly those with allegations of conspiracy to defraud, certain corporate criminal offences that consider the “failure to prevent” and the Fraud Act 2006. This change will therefore require corporations to implement more risk-based, preventative compliance policies with consideration given to changing public opinion as to what would constitute dishonesty.

### **Serious Fraud Office**

In contrast, the SFO has provided little public information regarding how ongoing matters will progress. Except for [stating](#) that it no longer will be able to engage with any paper correspondence, the SFO has yet to make any other announcements. It is, however, clear that investigations and related litigation will continue, albeit with some delay. ENRC’s High Court proceeding questioning the use of certain evidence by the SFO continued via a virtual hearing last week. Mr Justice Waksman ruled that the SFO would need to consider to what extent its investigation incorporated information that ENRC has alleged was disclosed to the regulator during unauthorised meetings with the company’s former lawyer at Dechert. Progress is also being made in other SFO investigations, including changing the status of individuals involved with an ongoing investigation. The SFO is not currently conducting compulsory section 2 interviews, and it has issued a handful of such notices demanding information during the lockdown. While the agency seems particularly affected by the lockdown, it will need to find a way to progress interviews and actively seek out new investigations. Defence counsel are therefore expected to be ready to progress all aspects of ongoing investigations.

Delays in the justice system have been highlighted by the adjournment of one of the biggest ongoing corruption trials at the end of March. The criminal trial of three Unaoil/SBM executives

brought by the SFO in relation to allegations of conspiring to make corrupt payments for certain Iraqi oil contracts was adjourned for almost two months. Evidence in the matter was concluded; however, closing submissions and jury deliberation were outstanding. The trial resumed this week at the London Central Criminal Court with social-distancing measures in place. A number of smaller court venues are also being assessed to determine whether it will be possible to resume other jury trials in the near future. Currently the courts are looking to conclude ongoing cases and adjourn all non-urgent work. While the Unaoil trial will go some way toward determining the feasibility of an ongoing trial being heard in the new environment, the challenge for the Court system will be whether complex new trials can be brought with social-distancing measures in place.

Other criminal proceedings that have been postponed include the three-week extradition hearing of Julian Assange, which was due to begin on 18 May 2020. The hearing is unlikely to be heard before September of this year at the earliest. Mr. Assange was deemed to be a flight risk and therefore was denied bail in March. Additionally, the 16-week fraud trial of Jonathan Denton, the former finance partner at a law firm alleged to be involved in running a fraudulent investment scheme valued at approximately £21 million, also has been postponed, after commencing in January this year, until January 2021.

This hiatus may be an opportunity to engage the SFO and get clarity on a case-by-case basis as to the position of individuals and companies and next steps that will allow for defence counsel to prepare for the flurry of future requests likely to be made when the lockdown is over.

### **National Crime Agency**

The NCA has echoed its commitment to work with other government and private-sector partners to enforce against fraud as criminals seek to capitalise on the pandemic.

Prior to the pandemic and up until last month, the NCA was actively pursuing and defending unexplained wealth orders (“UWOs”) to target the flow of “dirty money,” one of its strategic priorities per the [Annual Plan 2020-21](#). After [defending](#) an appeal in February of this year, the NCA saw a dismissal of three UWOs. The [judgement](#) by Justice Lang in *NCA v Baker* [2020] EWHC (Admin) reiterated that UWOs are only one instrument, with “*relatively limited purpose*”, that can be used by law enforcement to combat the proceeds of crime. This raised some debate as to the likelihood of future use.

The facts in *NCA v Baker* were unique in that after the UWOs were issued on an *ex parte* basis, “*extensive information about purchase and transfer of the properties, their registered owners, and the [ultimate beneficial owners]*” was provided by the respondent. The NCA did not consider the information adequate, which resulted in an appeal to discharge the orders. Justice Lang considered the information provided and made some significant findings that will likely guide future applications for UWOs. The judgement confirmed that UWOs were considerably intrusive as they required a

respondent to make statements and disclose potentially confidential financial matters, with criminal liability attaching to any false or misleading statements. There was therefore an increased need to limit situations in which UWOs were used. Justice Lang restated the need for a sound evidentiary basis, including the NCA being required to evaluate whether evidence provided was genuine and capable of being verified and, if so, to conduct a “*fair-minded evaluation*” of any new information. Additionally, in an unprecedented statement in the context of the proceeds of crime, the Court acknowledged that there were lawful reasons for using offshore vehicles, including “*privacy, security [and] tax mitigation*,” which should not be discounted in an investigation.

The NCA has announced that it will appeal the decision; however, no submissions have been made as of yet. Due to the exceptional circumstances in this dismissal, and with the current focus being on pandemic-related crime, UWOs may be used less frequently in the near term. However, it is unlikely that the agency will significantly curtail the use of its powers to apply for UWOs.

Another less publicized yet widely used tool to restrict the use of proceeds of crime is the Account Freezing Order (“**AFO**”). On 23 April 2020, the Metropolitan Police [announced](#) AFOs against 25 bank accounts holding in excess of €1.9 million. The investigation is said to have started in 2018 and centred around members of an organised crime network based in Italy using UK incorporated companies to launder money. After securing an AFO, law enforcement may then investigate and apply for a Forfeiture Order. This may be granted in the absence of a criminal conviction, but simply if, on the balance of probabilities, the account represents monies intended to be used in criminal conduct, or are the proceeds of crime.

Administrative proceedings in relation to proceeds of crime, including determining timetables, orders regarding disclosure of information, etc., may take place virtually. While it is not necessary for a defendant to be present at a confiscation hearing, it is desirable for this to be the case. The Coronavirus Act 2020, as it temporarily amends the Crime and Disorder Act 1998, allows for a defendant to attend confiscation hearings virtually. Furthermore, virtual hearings can be made public and not be in contravention of common law principles or Article 6 of the European Convention on Human Rights (“right to a fair trial”). It is therefore possible that prosecutions in relation to the proceeds of crime will be less affected than other criminal trials during this time.

### **Her Majesty’s Revenue and Customs**

HMRC has taken the strategic decision to concentrate its resources to help businesses and individuals through the current economic uncertainty. As a result, HMRC has written to a number of individuals and companies currently under investigation to inform them that it will not require further information or press for responses at this time. In some cases, investigations have been suspended. Some individuals have heard that their tax enquiries have been discontinued. HMRC, together with its counterparts in enforcement, has reiterated its commitment to fighting economic crime and it is unlikely this temporary hiatus will continue for the medium to long term.

Some investigations may be settled pursuant to Code of Practice 9. This is possible in certain circumstances where HMRC suspects a fraud has occurred but believes it would be more beneficial to resolve the issue as a civil rather than criminal matter. This will likely be limited to cases where there is little evidence and will remain a matter of discretion. However, given the current crisis, an immediate financial settlement may seem more attractive in certain cases as opposed to a resource-consuming complex criminal investigation.

HMRC is encouraging companies that are not under investigation to focus their resources on ensuring compliance, particularly on ensuring that books and records are kept accurate and up to date, and has indicated this is a likely area to come under significant scrutiny at a later date. In particular losses will need to be accounted for and financial institutions will need to consider how they account for non-performing assets. The risk for corporations also has been heightened since the introduction of corporate liability pursuant to the Criminal Finances Act 2017.

#### Office of Sanctions Implementation

While OFSI was not known previously for its imposition of large monetary penalties, it would seem the fourth time is a charm, as OFSI recently [announced](#) a financial penalty of £20.47 million to be levied against Standard Chartered Bank for breaching sectoral sanctions imposed against Russia by the EU that, in turn, are applicable in the UK. The sanctions were in place since 2014 and prohibit EU persons from making loans or credit available to certain Russian banks and associated entities. Standard Chartered Bank voluntarily disclosed a series of 102 loans made to Denizbank, which was a majority-owned subsidiary of Sberbank (a sanctioned entity). There was a slim exemption for 32 of the transactions; however, the remaining loans with an estimated value of over £266 million were in breach, and 21 of those (accounting for approximately £97 million) were issued after HM Treasury received its powers to issue monetary penalties. These were considered the “*most serious*” used in the assessment of the final penalty. The fine was reduced for a cooperation and voluntary disclosure, and further reduced upon ministerial review. The main takeaways from the enforcement action include the value OFSI places on “*prompt and complete voluntary disclosure*,” a requirement for firms to understand the details of different types of sanctions, including the scope of any exemptions, and the need for a compliance program to be effective in practice. It would also seem that firms will benefit from applying for ministerial review, as this is the second matter where it has been requested and was proven successful in reducing the overall penalty.

\* \* \*

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# Clients & Friends Memo

## **The Law's Long Reach: Recent Actions Show Federal Enforcement Agencies Are Not "Locked Down" by Social-Distancing and Quarantine Orders**

**May 19, 2020**

For federal law enforcement agencies – like the rest of government and society at large – the COVID-19 pandemic has ushered in a host of interrupted routines, unforeseen challenges, and new priorities. For businesses, understanding how these agencies are adapting and focusing their resources is critical to navigating a fast-changing regulatory environment. This article examines the response to COVID-19 of three key federal agencies: the Department of Justice ("DOJ"), the Securities and Exchange Commission ("SEC"), and the Office of Foreign Assets Control ("OFAC"). The record of these agencies over the last two months reflects a commitment to combating fraud and other abuses in connection with the public health response to COVID-19, while also pushing forward existing cases and providing guidance to help companies and individuals stay compliant during trying times. Cadwalader has [observed](#) a similar dynamic with respect to antitrust enforcement, and the same vigor on the part of enforcement agencies is apparent across the pond, as our colleagues in the United Kingdom write [here](#).

### ***Department of Justice***

The DOJ responded to COVID-19 almost immediately as opportunities for fraud sprouted nearly as fast as public concern over the virus. In a March 16 [letter](#) to all U.S. Attorneys, Attorney General William P. Barr noted that "[t]he pandemic is dangerous enough without wrongdoers seeking to profit from public panic." The letter specifically warned against fake cures, phishing emails from persons claiming to represent the World Health Organization, and malicious software embedded in mobile apps claiming to track the spread of the coronavirus.

The DOJ's COVID-19 response [website](#) encourages the reporting of hoarding and price gouging, warns against criminals posing as Internal Revenue Service ("IRS") employees, and highlights the risk of cryptocurrency frauds involving blackmail and investment scams. And the DOJ has designated the National Center for Disaster Fraud ("NCDF") – a national coordinating agency

within the DOJ's Criminal Division – to receive [complaints](#) from the public related to the coronavirus.

Law enforcement has wasted no time responding to the Attorney General's directives, as evidenced by a growing wave of arrests and charges. For example, on May 5 the DOJ [announced](#) that two men were charged in the District of Rhode Island with seeking a fraudulent loan of over \$500,000, which would have been forgivable under the Small Business Administration's Paycheck Protection Program ("PPP") and the Coronavirus Aid, Relief, and Economic Security ("CARES") Act. The DOJ alleged that the men falsely claimed to have dozens of employees, whose wages would have been safeguarded by the loan, when in fact these employees did not exist. Based on the allegations against these defendants, this appears to be a case of brazen fraud – and there may be many more such cases, given the hundreds of billions of dollars made available under the PPP. It remains to be seen how aggressively the DOJ will pursue more borderline cases involving legitimate businesses that may run afoul of rules requiring that loans be "necessary," among other requirements. (Cadwalader has covered the PPP and the potential for related audits and criminal enforcement, including with respect to the concept of "necessity," [here](#), [here](#), and [here](#).)

In addition, the U.S. Attorney's Office for the Eastern District of New York [announced](#) on April 28 that two individuals were arrested in connection with an alleged scheme to sell protective masks in New York City at a 50 percent mark-up. According to the criminal complaint, this conduct violated the Defense Production Act ("DPA") and executive orders invoking the President's authority under that law to make it illegal to hoard, or sell at excessive prices, medical supplies and devices designated by the Secretary of Health and Human Services ("HHS") as scarce. Also in the Eastern District of New York, a third individual was [charged](#) in a similar scheme to hoard personal protective equipment ("PPE") and price-gouge customers at his retail store, and another man was [arrested](#) for stealing COVID-19 government stimulus checks from the mail.

And on May 15, the DOJ [announced](#) charges against a woman accused of attempting to defraud Medicare, a federally funded health care benefit program. The defendant, who lives in Georgia, was under investigation for a number of years for her role in submitting false and fraudulent claims for genetic testing. Of late, however, she allegedly expanded her scheme to include paying and receiving kickbacks from COVID-19 testing laboratories, in violation of the Anti-Kickback Statute and health care fraud statutes.

The DOJ has been joined by a number of other federal agencies in rooting out COVID-19-related fraud. Since the start of the pandemic, the Food and Drug Administration ("FDA") and the Federal Trade Commission ("FTC") have issued dozens of "Warning Letters" to companies accused of marketing unapproved treatments and cures. Typically, these letters demand corrective actions within 48 hours, and threaten legal action if recipients do not comply. In at least one case, the FDA worked with the U.S. Attorney's Office in the District of Utah to institute such legal action,

[requesting](#) and [obtaining](#) a temporary restraining order and other relief against an individual and two companies accused of promoting “ingestible silver products” as protection against the coronavirus. Other enforcement actions evidence a similarly high level of cooperation with an array of agencies, including the Internal Revenue Service (“IRS”), the U.S. Postal Inspection Service, and local law enforcement authorities.

Notwithstanding remote working adaptations and reliance on electronic processes, there has undoubtedly been some disruption to the DOJ’s normal investigative and prosecutorial functions. Many courts have instituted prohibitions on in-person hearings, extended filing deadlines, and delayed jury trials, including in criminal cases (discussed [here](#) and [here](#)). Similarly, grand jury activities have been curtailed, impacting federal prosecutors’ ability to return indictments. However, procedural changes and technology allow some activities to continue – especially through the use of videoconferencing and teleconferencing. Indeed, the defendants accused of selling protective masks at inflated prices in New York City, discussed above, each made their initial appearance in federal court via teleconference.

### ***Securities and Exchange Commission***

The SEC has been active in its response to the COVID-19 crisis and has taken a number of actions to make sure the U.S. markets stay open and function well. The Commission is emphasizing its monitoring of market functions and system risks, providing regulatory relief and guidance to those impacted by COVID-19, and maintaining its enforcement efforts. The SEC has provided exemptive relief and/or guidance to market participants in a wide range of areas, including: shareholder meetings and certain public company filing deadlines (discussed [here](#)); registered investment advisers’ ability to borrow funds; broker-dealer financial responsibility rules; crowdfunding; and issues of concern to business development companies, registered investment companies, transfer agents, registered municipal advisors, and others. A summary of the actions taken by the SEC in response to the crisis is available on its website [here](#).

On the enforcement front, the SEC has reassured the public that its commitment to investor protection is unwavering and that it will maintain its enforcement efforts during the crisis. In a recent speech given on May 12, 2020, SEC Division of Enforcement Co-Director Steven Peikin discussed recent efforts made by the Division to address the heightened risk and protect investors during the COVID-19 pandemic. One of these efforts is the formation of the Coronavirus Steering Committee to coordinate the Division’s response to the crisis. The mandate of the committee is “to proactively identify and monitor areas of potential misconduct, ensure appropriate allocation of our resources, avoid duplication of efforts, coordinate responses as appropriate with other state and federal agencies, and ensure consistency in the manner in which the women and men of the Division address coronavirus-related matters.” The Coronavirus Steering Committee is focused on:

- coordinating with the Division's Microcap Task Force and the Office of Market Intelligence to analyze the microcap market and "triage" matters for action;
- collaborating with the Division's Market Abuse Unit to watch trading activity for potential market manipulation, especially relating to issuer announcements that are from industries heavily affected by the coronavirus;
- developing a system to rapidly review public filings of highly impacted industries "with a focus on identifying disclosures that appear to be significantly out of step with others in the same industry";
- working with the Division's specialty units such as the Asset Management Unit and Complex Financial Instruments Unit to monitor the impact of the crisis on various industries for potential issues; and
- communicating with other regulators to coordinate efforts to protect investors.

The Division has also worked to communicate with investors and keep market participants updated on the coronavirus' impact on the market and the Division's response.

The SEC's recent enforcement actions have been laser-focused on COVID-19-related misconduct that could harm main street investors. Towards this end, it has used its authority to suspend trading in the securities of more than thirty companies since the onset of the crisis due to issues with the adequacy and accuracy of information in the market related to COVID-19. In particular, the SEC has cited concerns with companies' claims regarding the availability of personal protective equipment, tests, treatments, and vaccines for COVID-19.<sup>1</sup> In its first enforcement action related to the crisis, the SEC [charged](#) one of these companies and its CEO with securities fraud for falsely claiming that the company had acquired for sale a large number of N95 masks and had established a "direct pipeline from manufacturers and suppliers to buyers" when it had done neither. The SEC also recently [charged](#) two more companies (one along with its CEO) for misleading claims about COVID-19. We expect that these are the first wave in what will likely be a significant number of SEC enforcement actions for false statements related to COVID-19.

The SEC has also emphasized the importance of maintaining market integrity and following corporate controls and procedures during the crisis. This includes the prohibitions on illegal insider trading and the proper treatment of material nonpublic information. In a [statement](#) issued on March 23, 2020, the Co-Directors of the Division of Enforcement stressed that material nonpublic information available to corporate insiders may be even more valuable during the COVID-19 crisis and cautioned people with access to material non-public information – including "directors, officers, employees, consultants and other outside professions" – to be "mindful of their obligations to keep this information confidential and comply with the prohibitions on illegal securities trading." They

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<sup>1</sup> More information about the SEC's trading suspensions related to COVID-19 can be found [here](#).

urged public companies to be aware of their disclosure obligations, including “established disclosure controls and procedures, insider trading prohibitions, codes of ethics, and Regulation FD and selective disclosure prohibitions[.]” The Co-Directors also reminded investment professionals that they must comply with policies and procedures designed to prevent misuse of material nonpublic information. We expect that the SEC will be watching the markets closely for unusual trading patterns and will investigate when it identifies outliers that look suspicious.

Public companies’ disclosures and public statements will likely draw enforcement scrutiny from the SEC in the coming months. This includes public companies’ disclosures and statements about the impact of the crisis on their businesses as well as pre-existing accounting or disclosure improprieties. In particular, the SEC is looking for disclosures “that may attempt to disguise previously undisclosed problems or weaknesses as coronavirus-related.” While it is important for companies to be careful about any public statements made about the crisis and its impact, the SEC has tried to provide some comfort for companies making good faith disclosures in this uncertain environment. In a [joint statement](#) issued on April 8, 2020, Chairman Jay Clayton and the Director of the Division of Corporate Finance provided guidance on what kind of disclosures the SEC wants to see from public companies during the crisis, encouraged companies to make robust forward-looking disclosures, and assured companies that the SEC “would not expect to second guess good faith attempts to provide investors and the other market participants appropriately framed forward-looking information.”

The SEC is also looking closely at aspects of the investment management industry. In addition to statements made by investment advisers to their clients about COVID-19’s impact on their businesses, the SEC has indicated that it is particularly interested in failures to honor redemptions by private funds and investment companies and the improper marketing and sale of structured products to retail investors.

As the SEC works to maintain its enforcement efforts, COVID-19 is impacting the way the SEC is investigating and litigating these cases. Of course, just like the DOJ, the SEC’s cases in active litigation are being impacted by the various court closures and related delays throughout the country. COVID-19 is also changing the way the SEC can conduct investigations. Social distancing guidelines are preventing the SEC from conducting many routine investigative steps in person. This includes important events such as investigative testimony, Wells and pre-Wells meetings, evidence reviews, and attorney proffers. As a result, SEC staff are now requesting that testimony and other in-person meetings take place telephonically, by videoconference, or via web-based programs. While the staff has agreed to accept informal phone interviews or attorney proffers in lieu of official sworn testimony in some situations, entities and individuals who are involved in ongoing investigations should expect requests of this nature to continue going forward.

**Office of Foreign Assets Control**

While much of the country has been sheltering at home, OFAC – like the DOJ and SEC – has continued to carry out its mission.

Of particular importance, OFAC has issued two important pieces of COVID-19-related guidance. First, on April 16 OFAC published a [Fact Sheet](#) explaining the applicability of existing OFAC exemptions, exceptions, and authorizations related to the provision of humanitarian assistance to combat COVID-19, even where certain sanctioned persons or jurisdictions are involved. In the Fact Sheet, OFAC stated that it “encourages those interested in providing such assistance during the COVID-19 crisis to avail themselves” of these authorities.

Second, on April 20 OFAC [urged](#) financial institutions and other businesses to notify the agency of any anticipated delays in meeting certain regulatory reporting requirements and deadlines, including those related to blocked and rejected transaction reports. OFAC also recognized that, consistent with a risk-based approach to sanctions compliance, companies may need to respond to COVID-19-related technical and resource challenges by “temporarily reallocating sanctions compliance resources” to other areas. OFAC suggested that it would view such challenges as a mitigating factor in future enforcement actions related to violations that may occur during the pandemic.

OFAC has also remained active on non-COVID-19 related matters. For example, the agency has announced two enforcement actions, [here](#) and [here](#). While this represents a decrease compared to the same period last year – when six actions were announced – there is no indication that the reduction is related to the effects of COVID-19, or that it portends a longer-term trend. The agency also has made significant sanctions designations, including the imposition of blocking measures against the [subsidiary](#) of Russia's largest oil company, as well as [entities](#) involved in the sale of Iranian oil and petrochemicals. In addition, OFAC has found time to: extend General Licenses related to its [Nicaragua-](#), [Ukraine-](#), and [Venezuela-](#)related sanctions programs; publish [amendments](#) to the North Korea Sanctions Regulations; and, along with other agencies, issue two detailed advisories regarding sanctions risk in the [maritime industry](#) and North Korea's “[malicious cyber activities](#).”

**Conclusion**

For federal enforcement agencies, the COVID-19 pandemic has been a time of change, but by no means a time of inactivity. As agencies (and the courts) continue to adapt with increased reliance on remote work and electronic processes, and as steps are taken towards re-opening offices across the country, companies should expect that enforcement activity will proceed with fewer disruptions than in the earliest days of the crisis. In addition, we are certain to see a focus on investigations stemming from potential fraud and other misconduct in the response to the

pandemic, underscoring the need for businesses to prioritize their compliance efforts – even as they grapple with the unprecedented uncertainty that is the universal hallmark of this COVID-19 era.

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# Clients & Friends Memo

## COVID-19 Update: Federal Reserve Issues New TALF Term Sheet and Responses to Frequently Asked Questions

May 15, 2020

As part of a number of liquidity measures announced in response to the COVID-19 pandemic, the Federal Reserve re-established the Term Asset-Backed Securities Loan Facility ("TALF")<sup>1</sup> on March 23, 2020.<sup>2</sup> On April 9, 2020, the Federal Reserve released a term sheet (the "April Term Sheet") that expanded the range of "eligible collateral" to include certain commercial mortgage-backed securities ("CMBS") and collateralized loan obligations ("CLOs") and clarified which businesses would qualify as "eligible borrowers."<sup>3</sup>

On May 12, 2020, the Federal Reserve released an updated term sheet (the "May Term Sheet") for the TALF program.<sup>4</sup> In addition, the Federal Reserve issued guidance in response to frequently asked questions ("FAQs").<sup>5</sup> This memorandum reviews the changes contained in the May Term Sheet and summarizes some of the key take-aways from the FAQs regarding certain aspects of TALF (which, as of the date of this memo, is not yet operational).

Unless otherwise indicated herein, this memorandum does not address the inclusion of CLOs in TALF. For a detailed discussion of the inclusion of CLOs in TALF, please see our May 13, 2020 Clients & Friends Memo, "COVID-19 Update: Federal Reserve Provides Additional Guidance on Inclusion of CLOs in New TALF Term Sheet and Responses to Frequently Asked Questions" (the "CWT TALF CLO Memo").<sup>6</sup>

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<sup>1</sup> The version of TALF in effect in 2008-2010 is referred to herein as "TALF 1.0". The current version of TALF is referred to herein as "TALF" or "TALF 2.0".

<sup>2</sup> See the Federal Reserve's term sheet dated March 23, 2020, available at <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200323b3.pdf>

<sup>3</sup> Available at <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200409a1.pdf>

<sup>4</sup> Available at <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200512a1.pdf>

<sup>5</sup> Available at <https://www.newyorkfed.org/markets/term-asset-backed-securities-loan-facility/term-asset-backed-securities-loan-facility-faq>

<sup>6</sup> Available at <https://www.cadwalader.com/uploads/cfmemos/e57dfa009d44066ae307fcaed9c82a2b.pdf>

**Borrower Eligibility**

Investment Funds. The FAQs clarify that an investment fund could qualify as an “Eligible Borrower” and, accordingly, participate in TALF. Eligible Borrowers must (a) be created or organized in the United States or under the laws of the United States, (b) have significant operations in and majority of their employees based in the United States, and (c) maintain an account relationship with a primary dealer. As in TALF 1.0, both the investment fund and its investment manager that must be considered for eligibility. To satisfy prong (b) of the Eligible Borrower criteria, investment funds may look through to the investment manager to have “significant operations in and a majority of its employees based in the United States.”<sup>7</sup> Note that in TALF 1.0, the Federal Reserve used a “principal place of business” criterion for the investment manager.

**Note:** *Investment funds would not have been able to qualify as Eligible Borrowers due to their inability to satisfy prong (b) of the Eligible Borrower criteria if the Federal Reserve had not clarified that they are permitted to look through to the investment manager.*

Certain features of “investment funds” remain the same as in TALF 1.0:

- Investment funds include (1) any type of pooled investment vehicle that is organized as a business entity or institution, including without limitation a hedge fund, a private equity fund, and a mutual fund, and (2) any type of single-investor vehicle that is organized as a business entity or institution.
- Investment funds can be newly formed and can take the form of limited liability companies or partnerships.<sup>8</sup>
- The investment fund's strategy need not be limited to investing only in TALF eligible assets; rather, the investment fund may be multi-strategy, investing in a mix of TALF-eligible assets and other assets.

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<sup>7</sup> The meaning of “significant operations in the United States” includes a borrower (or an investment manager in the case of investment funds) with greater than 50% of its consolidated assets in, annual consolidated net income generated in, annual consolidated net operating revenues generated in, or annual consolidated operating expenses (excluding interest expense and any other expenses associated with debt service) generated in the United States as reflected in its most recent audited financial statements.

<sup>8</sup> The full definition of eligible business entities or institutions includes entities organized as limited liability companies, partnerships, banks, corporations, and business or other non-personal trusts.

In addition, neither an investment fund nor its investment manager may have any “Material Investors” that are foreign governments<sup>9</sup>, and the investment fund and its investment manager will be obligated, on an ongoing basis, to monitor relevant thresholds for compliance.<sup>10</sup>

Adequate Credit Accommodations. Each TALF borrower, including any eligible investment fund, will be required to certify that it is unable to secure adequate credit accommodations from other banking institutions and is not insolvent. This certification may be based on unusual economic conditions in the market or markets that are intended to be addressed by TALF 2.0. The FAQs make it clear that a borrower need not show that no credit is available, but rather, that lending is only available at prices or conditions that are inconsistent with a normal, well-functioning market. What is not clear is whether TALF borrowers will have an affirmative obligation to try to find alternative financing or whether it will be sufficient to argue that none would be available.

### **Collateral Eligibility**

The May Term Sheet and the FAQs also provide additional clarification around the characteristics of the asset classes (and their related underlying exposures) that are eligible to be collateral under a TALF loan.<sup>11</sup> Although no new asset classes were added to TALF 2.0 in the May Term Sheet<sup>12</sup>, there are a few notable changes for existing asset classes. This section provides an overview of certain selected eligibility requirements that have changed from those described in the April Term Sheet or from similar eligibility requirements in TALF 1.0. Selected requirements for CMBS and student loan ABS are described in subsections below.

***Note:*** *Notwithstanding industry lobbying, the list of eligible ABS still does not include residential mortgage-backed ABS, servicing advance receivables, new issue CMBS, single-asset single borrower (“SASB”) CMBS or commercial real estate collateralized loan obligations (“CRE CLOs”).*

Connection of Underlying Exposures to the U.S. The requirement in the April Term Sheet that all or substantially all of the credit exposures underlying eligible ABS must have been originated by a U.S. company has been replaced in the May Term Sheet with requirements that:

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<sup>9</sup> Neither the May Term Sheet nor the FAQs provide a definition of “foreign government.”

<sup>10</sup> A “Material Investor” is a person who owns, directly or indirectly, 10% or more of any outstanding class of securities of an entity; i.e., the investment fund or the investment manager.

<sup>11</sup> The only change to the list of underlying exposures that may back eligible ABS (that is, compared with the April Term Sheet) is a clarification that the only type of eligible “Insurance premium loans” are “Premium finance loans for property and casualty insurance.” This change is consistent with the FAQs from TALF 1.0.

<sup>12</sup> The FAQs indicate that the set of permissible underlying assets of eligible ABS may be expanded later to other asset classes.

- All or substantially all of the credit exposures underlying the eligible ABS must:
  - for newly issued ABS (except for CLOs) be originated by U.S.-organized entities (including U.S. branches or agencies of foreign banks),
  - for CLOs, have a lead or a co-lead arranger that is a U.S.-organized entity (including a U.S. branch or agency of a foreign bank), and
  - for all ABS (including CLOs and CMBS), be to U.S.-domiciled obligors or with respect to real property located in the United States or one of its territories.
- With respect to each of the requirements in the bullets above, the FAQs clarify that “all or substantially all” means that 95% or more of the dollar amount of the assets or loans must have the characteristics described above.

Domicile of Issuer. The requirement in the April Term Sheet that the issuer of eligible collateral must be a U.S. company has been removed.

**Note:** *Most ABS issuers would not have satisfied the proposed definition of U.S. company in the April Term Sheet. This change will also allow CLOs to continue to use offshore issuers so long as their collateral managers meet certain requirements, as described in the CWT TALF CLO Memo.*

Newly-Issued Requirements. Other than CMBS, SBA Pool Certificates or Development Company Participation Certificates, eligible ABS must be issued on or after March 23, 2020. CMBS must be issued prior to March 23, 2020, and SBA Pool Certificates or Development Company Participation Certificates must be issued on or after January 1, 2019.

In order for an ABS to constitute eligible collateral, all or substantially all of the underlying credit exposures must be newly-issued or originated, except for CMBS. The FAQs clarify the requirements around timing of origination and issuance with respect to each type of underlying exposure, as set forth in the following table:

Asset Type	Requirement
Auto loan ABS (non-revolving trust)	All or substantially all of the underlying assets must have been originated on or after January 1, 2019
Auto loan ABS (existing revolving (or master) trust)	No specific origination restriction for underlying assets, although eligible ABS must be issued to refinance existing auto ABS maturing prior to September 30, 2020, and may not be in amounts greater than the amount of the maturing auto ABS

Asset Type	Requirement
Auto loan ABS (master trust established on or after March 23, 2020)	All or substantially all of the underlying assets must have been originated on or after January 1, 2020
Credit card ABS (existing revolving (or master trust))	No specific origination restriction for underlying assets, although eligible ABS must be issued to refinance existing auto ABS maturing prior to September 30, 2020, and may not be in amounts greater than the amount of the maturing auto ABS
Credit card ABS (master trust established on or after March 23, 2020)	All or substantially all of the underlying assets must have been originated on or after January 1, 2020
Student loan ABS	All or substantially all of the underlying assets must have had a first disbursement date on or after January 1, 2019
SBA Pool Certificates and Development Company Participation Certificates	No specific origination restriction for underlying loans or debentures as long as the SBA Pool Certificates and Development Company Participation Certificates were issued on or after January 1, 2019
Equipment receivables ABS	All or substantially all of the underlying assets must have been originated on or after January 1, 2019
Floorplan ABS (existing revolving (or master trust))	No specific origination restriction for underlying assets, although eligible ABS must be issued to refinance existing floorplan ABS maturing prior to September 30, 2020, and may not be in amounts greater than the amount of the maturing ABS
Floorplan ABS (master trust established on or after March 23, 2020)	All or substantially all of the underlying assets must have been originated on or after January 1, 2020
Premium finance ABS (existing revolving (or master) trust)	No specific origination restriction for underlying assets, although eligible ABS must be issued to refinance existing premium finance ABS maturing prior to September 30, 2020, and may not be in amounts greater than the amount of the maturing ABS
Premium finance ABS (master trust established on or after March 23, 2020)	All or substantially all of the underlying assets must have been originated on or after January 1, 2020
CLOs	All or substantially all of the leveraged loans underlying CLOs must have been originated (or been refinanced) on or after January 1, 2019

Asset Type	Requirement
CMBS	No specific origination restriction for underlying mortgage loans, although CMBS must be issued before March 23, 2020

Additionally, the FAQs clarify that the requirement that “all or substantially all” of the underlying exposures be “newly issued” means 95% or more of the principal balance of the underlying assets in the eligible ABS. By contrast, in TALF 1.0, the threshold was 85%.

Rating Agencies. At this time, the Federal Reserve has designated only S&P Global Ratings, Moody’s Investors Service Inc., and Fitch Ratings, Inc. as eligible NRSROs to rate eligible ABS in TALF 2.0. The Federal Reserve explicitly noted in the FAQs that it may consider including other NRSROs. Under TALF 1.0, other rating agencies were permitted, but only with respect to certain asset classes.

LIBOR. Floating rate ABS that references LIBOR will be eligible collateral for TALF loans. However, the Federal Reserve expects that any ABS benchmarked to LIBOR will include adequate fallback language, such as that recommended by the Alternative Reference Rates Committee (“ARRC”) or substantially similar fallback language. For additional information on LIBOR and leveraged loans underlying eligible CLOs, please see our CWT TALF CLO Memo.

Acquisition of Eligible ABS. If eligible ABS is not issued on the same day that an investor borrows a TALF loan, the eligible ABS must have been acquired in arms-length secondary market transactions within 30 days prior to the relevant TALF loan subscription date.<sup>13</sup>

Optional Redemption. The FAQs clarify that newly issued eligible ABS may not include a redemption option that is exercisable prior to three years after the disbursement date of any TALF loan secured by the pledge of such ABS, other than pursuant to a “customary clean-up call” (a definition of which is included in the FAQs). Additionally, newly issued ABS may not permit a redemption option at any time when such ABS is owned by the New York Fed or by the TALF SPV.

**Note:** *Under TALF 1.0, TALF borrowers had the option of surrendering eligible collateral in lieu of repayment of the TALF loan. While the TALF 2.0 term sheets and FAQs are silent on collateral surrender, if it remains an option, eligible newly issued ABS may need to have a prohibition on exercise of redemption options (other than clean-up calls) for longer than three years. Additionally, under TALF 1.0, the FAQs indicated that the Federal Reserve might permit certain newly*

<sup>13</sup> While not explicitly stated, eligible ABS acquired by a TALF borrower in the primary market should also be eligible collateral for a TALF loan, if they satisfy all other eligibility criteria.

*issued ABS with optional redemption features on a case-by-case basis. The TALF 2.0 FAQs do not contemplate such flexibility.*

Weighted Average Life and Prepayment Assumptions. Under the May Term Sheet and the FAQs, the weighted average life of auto, credit card, equipment, floorplan, and premium finance ABS must be five years or less. The average life for SBA Pool Certificates and private student loan ABS cannot be greater than seven years. No securitization may have an average life beyond ten years.

The FAQs provide guidance for determining the average life of eligible ABS with methodologies consistent with TALF 1.0. For amortizing ABS, average life is defined as the weighted average life to maturity based on the prepayment assumptions and market conventions listed in the FAQs. While most of the prepayment assumptions used for calculating the weighted average lives of eligible ABS are consistent with the prepayment assumptions used in TALF 1.0, the FAQs do include changes to three prepayment assumptions. Specifically:

- For Prime Auto Lease ABS, average life is determined by the weighted average life to maturity based on the prepayment assumption of 100% of the prepayment curve (as opposed to 75% in TALF 1.0);
- For SBA 504 loan ABS, average life is determined by the weighted average life to maturity based on the prepayment assumption of 7% Conditional Prepayment Rate (“CPR”)<sup>14</sup> (as opposed to 5% in TALF 1.0); and
- For amortizing eligible student loan ABS, average life is determined by the weighted average life to maturity based on the prepayment assumption of 8% CPR (as opposed to 4% in TALF 1.0).

The FAQs note that prepayment assumptions may be updated periodically for future TALF subscriptions and may be adjusted on a deal-specific basis.

Student Loan ABS. The May Term Sheet and FAQs have set forth certain requirements for student loan ABS that are different from the eligibility requirements for student loan ABS under TALF 1.0. Notably:

- All or substantially all of the assets underlying eligible student loan ABS must have had a first disbursement date on or after January 1, 2019.<sup>15</sup>

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<sup>14</sup> CPR represents the proportion of the principal of a pool of loans that is assumed to be paid off prematurely in each period.

<sup>15</sup> See “*Collateral Eligibility—Newly-Issued Requirements*” above.

- Private student loans, and private student loans that are for the purpose of refinancing existing private student loans or loans guaranteed by the federal government, if the refinanced loan disbursement date is on or after January 1, 2019, are eligible collateral.
- The average life for private student loan ABS cannot be greater than seven years.
- For amortizing eligible student loan ABS, the average life is determined by the weighted average life to maturity based on the prepayment assumption of 8% CPR. See “*Collateral Eligibility—Weighted Average Life and Prepayment Assumptions*” above.

CMBS. The May Term Sheet and the FAQs address eligibility requirements for CMBS, as described below.

*Eligible Collateral Remains Limited to Pooled Legacy CMBS.* The May Term Sheet did not expand (as industry participants had hoped) the scope of CMBS that qualifies as eligible collateral or extend eligibility to CRE CLOs. Eligible CMBS collateral remains limited to CMBS that:

- was issued on or before March 23, 2020;
- is not backed by only a single asset or obligations of only a single borrower (i.e., is not a SASB CMBS);
- has credit exposure that is “all or substantially all” with respect to U.S. domiciled obligors or real property located in the United States or one of its territories; and
- has an average life no greater than 10 years.

*Additional Clarity on CMBS Eligibility.* The FAQs did identify additional requisite characteristics specific to eligible CMBS. To qualify as eligible collateral under the TALF program, CMBS must:

- entitle its holder to payments of principal and interest (i.e., interest-only and principal-only CMBS do not qualify);
- bear interest at a fixed pass-through rate or a rate based upon the weighted average of underlying fixed-rate mortgage loans (i.e., floating rate CMBS do not qualify);
- not be junior to other securities with claims to the same pool of mortgage loans; and
- evidence an interest in a trust fund consisting of fully-funded mortgage loans the security for which must be evidenced by a mortgage or similar instrument on a fee or leasehold interest in one or more income-generating commercial properties.

*Prohibition on Eligibility of Borrower-Affiliated CMBS.* Consistent with the provisions of TALF 1.0, the FAQs also make clear that otherwise eligible CMBS will nonetheless be ineligible collateral for

TALF loans as to a particular borrower where the borrower (or an “affiliate”<sup>16</sup>) is the borrower under a mortgage loan or mortgage loans that constitute more than 5% of the aggregate principal balance of the pool of mortgage loans in the related trust fund on the subscription date.

### **Terms of TALF Loans**

#### Loan Size and Haircuts

*Market Value and Loan Size.* Under the FAQs, for all ABS other than SBA ABS, the market value must be no greater than par. For such assets, the New York Fed will lend to each borrower an amount equal to the market value of the pledged collateral, minus a haircut. For SBA ABS with a market value above par, the New York Fed will lend an amount equal to the market value, subject to a cap of 105% of par value, minus a haircut, and the borrower will periodically prepay a portion of the loan. The prepayments will be calculated to adjust for the expected reversion of market value toward par value as such ABS mature.

*Haircuts.* The haircuts for eligible ABS used to determine TALF loan size are consistent with the haircut levels set forth in TALF 1.0, other than for CLOs, which were not eligible collateral in TALF 1.0.

Interest Rates. The May Term Sheet made only small changes to the interest rates applicable to TALF loans. The TALF loan rate is determined by the type of collateral securing the loan. The rates for TALF loans are as follows:

- For CLOs, the interest rate will be 150 basis points over the 30-day average Secured Overnight Financing (“SOFR”) rate (30-day average SOFR);
- For SBA Pool Certificates (7(a) loans), the interest rate will be the top of the federal funds target range plus 75 basis points;
- For Development Company Participation Certificates (504 loans), the interest rate will be 75 basis points over the 3-year fed funds overnight index swap (“OIS”) rate; and
- For all other eligible ABS, the interest rate will be 125 basis points over the 2-year OIS rate for securities with a weighted average life less than two years, or 125 basis points over the 3-year OIS rate for securities with a weighted average life of two years or greater.

Interest rates will be set one day prior to the applicable loan subscription date.

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<sup>16</sup> The term “affiliate” will have the meaning set forth in the Master Loan and Security Agreement (the “MLSA”). The TALF 2.0 MLSA has not yet been released.

Interest on TALF loans financing ABS (other than CLOs) will be payable monthly; interest on TALF loans financing CLOs will be payable quarterly.

Fees. On each loan settlement date, the borrower must pay to the TALF SPV's settlement account an administrative fee equal to 10 basis points of the loan amount, which will cover the fees associated with the facility. Unlike TALF 1.0, the FAQ does not contemplate a higher fee payable for TALF loans collateralized by CMBS.

#### **Additional Information Expected From the Federal Reserve**

The FAQs acknowledge that open questions remain regarding the operation of TALF 2.0. The FAQs expressly provide that further information will be forthcoming on a variety of relevant topics, including borrower certifications, collateral review, issuer certifications, auditor assurances, SBA documentation and loan subscription and closing mechanics. Also, many terms of the program, including the definition of "affiliate", are expected to be provided in the MLSA for TALF 2.0, which has not yet been released.

#### **Additional Resources**

Cadwalader "[TALF 2.0: Overview and Opportunities](#)" webinar, April 30, 2020

Cadwalader Clients & Friends Memo, "[COVID-19 Update: Federal Reserve Launches TALF \(Again\)](#)," March 23, 2020

Cadwalader Clients & Friends Memo, "[COVID-19 Update: Federal Reserve Provides Additional Guidance on Inclusion of CLOs in New TALF Term Sheet and Responses to Frequently Asked Questions](#)," May 13, 2020

\* \* \*

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# Clients & Friends Memo

## COVID-19 Update: Federal Reserve Provides Additional Guidance on Inclusion of CLOs in New TALF Term Sheet and Responses to Frequently Asked Questions

May 13, 2020

As part of a number of liquidity measures announced in response to the COVID-19 pandemic, the Federal Reserve re-established the Term Asset-Backed Securities Loan Facility (“TALF”) on March 23, 2020. On April 9, 2020, the Federal Reserve released an updated term sheet that expanded the range of “eligible collateral” to include certain legacy commercial mortgage-backed securities and newly-issued, static collateralized loan obligations (“CLOs”) and clarified which businesses would qualify as “eligible borrowers.”<sup>1</sup>

On May 12, 2020, the Federal Reserve released another update to the term sheet for the TALF program.<sup>2</sup> In addition, the Federal Reserve issued guidance in response to frequently asked questions (“FAQs”).<sup>3</sup> This memorandum reviews the changes contained in the new term sheet and summarizes some of the key takeaways from the FAQs regarding the inclusion of CLOs as “eligible collateral” for TALF loans.

### Eligible CLO Securities

U.S. dollar-denominated securities issued by static CLOs that are collateralized by leveraged loans<sup>4</sup> must satisfy the following criteria in order to qualify as eligible collateral for a TALF loan:

Static CLOs. TALF-eligible CLOs must be backed by a fully-ramped, static pool of leveraged loans. A static CLO for purposes of TALF has the following characteristics:

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<sup>1</sup> Available at <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200409a1.pdf>

<sup>2</sup> Available at <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200512a1.pdf>

<sup>3</sup> Available at <https://www.newyorkfed.org/markets/term-asset-backed-securities-loan-facility/term-asset-backed-securities-loan-facility-faq>

<sup>4</sup> CLOs backed by commercial real estate are not eligible collateral under TALF.

- Limited Reinvestment. TALF-eligible CLOs will be required to limit the reinvestment of any proceeds (interest, principal, sale, prepayments, etc.) in additional leveraged loans (a) unless such reinvestment occurs at least three years after the disbursement date of the related TALF financing and (b) at any time when the senior ABS of such CLO is owned<sup>5</sup> by the Federal Reserve Bank of New York (“FRBNY”) or the TALF SPV.<sup>6</sup>
- Sales Restrictions. TALF-eligible CLOs will be required to restrict the sale of underlying loans other than loans:
  - (a) that have defaulted in payment of principal and interest<sup>7</sup> or
  - (b) that are sold “to a sponsor”<sup>8</sup> for an amount at least equal to par plus accrued.

**Note:** *The concept of a defaulted underlying loan for purposes of TALF is significantly narrower than a typical CLO definition of “Defaulted Loan,” which may be solved by using different defined terms to distinguish between defaulted assets for the purposes of permitted sales and applying haircuts.*

**Note:** *Some uncertainty exists, based on the current language in the FAQ, whether sales of defaulted loans must also be sold “to a sponsor” for an amount at least equal to par, which, as a practical matter, would be problematic.*

**Note:** *As currently proposed, TALF-eligible CLOs would not be permitted to sell “Credit Risk Loans” unless sold to a sponsor for an amount at least equal to par plus accrued.*

Issue Date. TALF-eligible CLO securities must be issued on or after March 23, 2020 and, unless the Board and the Secretary of the Treasury extend the facility, on or before September 30, 2020.<sup>9</sup>

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<sup>5</sup> Note that such ownership would not be expected to occur absent foreclosure by the FRBNY or the TALF SPV or, if applicable, collateral surrender by the borrower.

<sup>6</sup> Combined with the requirement that the portfolio of underlying collateral be fully-ramped, this effectively means that a TALF-eligible CLO will be restricted from purchasing any additional loans following the date of issuance until the termination of the related TALF financing.

<sup>7</sup> Note that, as currently proposed in the FAQs, the sale of a loan that has defaulted in payment of interest would not be permitted by a TALF-eligible CLO issuer until the maturity of the loan had been accelerated.

<sup>8</sup> The term “sponsor” is not defined in the FAQs.

<sup>9</sup> In addition, the FAQs state that if the ABS securing the financing is not issued on the same day as the financing, such ABS must have been acquired in an arms-length secondary market transaction within 30 days prior to the relevant loan subscription date. While not explicitly stated, ABS acquired by a TALF borrower in the primary market should also be eligible collateral for a TALF loan subscribed for within 30 days of the ABS issuance, if the ABS satisfies all other eligibility criteria.

Rating. TALF-eligible CLO securities must be triple-A rated by at least two of S&P, Moody's and/or Fitch.<sup>10,11</sup>

CLO Manager. The manager of a TALF-eligible CLO must have its principal place of business in the U.S.

Interest Payments. Interest payments of TALF-eligible CLO securities:

- may not step-up or step-down; and
- may be benchmarked to LIBOR, but then must include adequate fallback provisions (such as the recommended Alternative Reference Rates Committee ("ARRC") fallback language or substantially similar fallback language).

Maturity. There is no minimum or maximum maturity limit for TALF-eligible CLO securities.

Average Life. The average life of TALF-eligible CLO securities cannot be greater than ten years.

**Note:** *The average life will be determined based on the weighted average life to maturity assuming a 10% conditional prepayment rate.*

**Note:** *Issuers of TALF-eligible CLO securities will be expected to disclose the average life of the ABS in the offering document. The FAQs state such disclosure is material to and will be relied on by the FRBNY, introducing potential liability to the CLO issuer.*

Redemptions. TALF-eligible CLO securities may not be callable by the CLO issuer prior to the three year anniversary of the disbursement date of the related TALF loan (and never when the ABS is owned by the FRBNY or the TALF SPV),<sup>12</sup> other than pursuant to a customary clean-up call.<sup>13</sup>

**Note:** *The limit on redemptions of TALF-eligible CLO securities appears to prohibit (a) a non-call period of less than 3 years and (b) tax redemptions inside the 3-year non-call period. The FAQs*

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<sup>10</sup> "Eligible collateral (eligible ABS) include U.S. dollar-denominated cash (that is, not synthetic) ABS that (i) have a credit rating in the highest long-term or, if no long-term rating is available, the highest short-term investment-grade rating category from at least two eligible ("NRSROs") and (ii) do not have a credit rating below the highest investment-grade rating category from an eligible NRSRO."

<sup>11</sup> The Fed may consider including other NRSROs under the TALF.

<sup>12</sup> Note that such ownership would not be expected to occur absent foreclosure by the FRBNY or the TALF SPV or, if applicable and permitted, collateral surrender by the borrower.

<sup>13</sup> "A "customary clean-up call" with respect to a sponsor and its securitization refers to the clean-up call which is exercisable by the servicer or the depositor when the remaining balance of the assets or the liabilities of the issuer is not more than 10% (or a higher percentage customarily used by the sponsor in its securitizations that were offered before the TALF program was established) of the original balance of such assets or liabilities." Relying on the alternative contained in the parenthetical, a 15% clean-up call may be permissible for TALF-eligible CLO securities.

*do, however, permit clean-up call redemptions and appear to permit partial redemptions by refinancing of CLO tranches that are not otherwise TALF-eligible. TALF-eligible CLO securities may not be re-priceable prior to the end of the 3-year non-call period, because the issuer's customary right to compel a holder that doesn't agree to a re-pricing to sell its ABS seems incompatible with the restrictions on redemptions of TALF-eligible ABS.*

Overcollateralization Test. TALF-eligible CLOs must include at least one overcollateralization test redirecting cashflow from the equity and subordinated tranches to the TALF-eligible senior tranche in the event of deterioration in the underlying loan portfolio.

DTC Clearance Required. TALF-eligible CLOs must be cleared through the Depository Trust Company.

### Underlying Portfolio Requirements

#### Collateral Composition.

- U.S. Origination. For TALF-eligible CLOs, at least 95 percent of the dollar amount of the underlying loans of such CLO must be exposures that are (1) arranged by a lead or a co-lead arranger that is a U.S.-organized entity (including a U.S. branch or agency of a foreign bank) and (2) made to U.S.-domiciled obligors.

**Note:** *The inclusion of U.S. branches or agencies of foreign banks appears to be responsive to industry feedback.*

- Newly-Originated. Not less than 95% of the eligible leveraged loans underlying a TALF-eligible CLO must have been newly-originated or refinanced on or after January 1, 2019.

**Note:** *The origination date requirement appears to be responsive to industry feedback and should, subject to the satisfaction of the other eligibility criteria, make it possible to securitize certain legacy warehouse assets in TALF-eligible CLOs.*

- Senior Secured. All eligible leveraged loans underlying a TALF-eligible CLO must be senior secured (meaning first-lien, or subject to the limitation below, second-lien) and current on interest and principal.
- Concentration Limitations. TALF-eligible CLOs must satisfy the following portfolio limitations as of the financing subscription date:
  - not more than 10% may consist of second lien loans;

- not more than 7.5% may consist of debtor-in-possession (DIP) loans;
- not more than 65% of the underlying loans of a broadly syndicated CLO<sup>14</sup> and not more than 10% of the underlying loans of a middle-market CLO<sup>15</sup> may consist of covenant lite loans; and
- not more than 4% may consist of the obligations of a single obligor.

**Note:** *The bifurcated limit on covenant lite loans, combined with the definitions of “broadly syndicated CLO” and “middle market CLO,” effectively restricts TALF-eligible broadly syndicated CLOs from purchasing small obligor loans (less than \$150,000,000 total potential indebtedness).*

- Delayed Draw Loans. Eligible leveraged loans do not appear to include delayed draw loans.

**Note:** *The FAQs separately (a) restrict the retention of issuance proceeds in anticipation of application to the purchase of additional receivables and (b) clarify that the origination date of loans “drawn under an existing arrangement to extend credit” is the date on which the loan was drawn or funded and not the date on which the arrangement was put in place.*

- TALF Borrower Affiliated Loans. TALF-eligible CLO securities may not be backed by loans originated or securitized by the borrower or an affiliate<sup>16</sup> of the borrower.

**Note:** *This is a particularly noteworthy limitation on manager/originators of middle market CLOs.*

#### Other Underlying Portfolio Requirements and Restrictions.

- Eligible leveraged loans underlying a TALF-eligible CLO that bear interest “tied to LIBOR are generally expected to have adequate fallback language” (such as the ARRC-recommended fallback language or substantially similar fallback language as prevailing in the relevant market when the loan was originated).

<sup>14</sup> “A broadly syndicated CLO is a CLO that **does not** include leveraged loans of obligors with potential indebtedness of less than \$150,000,000 and permits no more than 10% of the portfolio to be comprised of leveraged loans to obligors with total potential indebtedness of \$150,000,000 to \$250,000,000.” (emphasis added)

<sup>15</sup> “A middle market CLO is a CLO that is composed of leveraged loans of obligors, **all or substantially all of which** have potential indebtedness of less than \$250,000,000 but does not permit the portfolio to include leveraged loans of obligors with EBITDA (as calculated in accordance with the underlying instrument) of less than \$10,000,000.” (emphasis added)

<sup>16</sup> The term “affiliate” will have the meaning set forth in the Master Loan Security Agreement (“MLSA”). The MLSA relating to the current TALF program has not yet been published.

**TALF Financing Terms**

Financing of TALF-eligible CLO securities will be made on the following terms:

- Haircuts.<sup>17</sup> 20% if the average life of the CLO is five years or fewer;  
21% if the average life of the CLO is between five and six years;  
22% if the average life of the CLO is between six and seven years;  
23% if the average life of the CLO is between seven and eight years;  
24% if the average life of the CLO is between eight and nine years;  
25% if the average life of the CLO is between nine and ten years;
- Financing Interest Rate. For CLOs, the interest rate will be 150 basis points over the 30-day average Secured Overnight Financing rate (30-day average SOFR), payable quarterly.

**Note:** *Tying the TALF financing interest rate to 30-day average SOFR creates some basis risk for TALF borrowers, both at the outset and following the eventual transition from LIBOR.*

**Additional Resources**

Cadwalader [“TALF 2.0: Overview and Opportunities”](#) webinar, April 30, 2020

Cadwalader Clients & Friends Memo, [“COVID-19 Update: Federal Reserve Launches TALF \(Again\),”](#) March 23, 2020

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<sup>17</sup> Haircuts are subject to revision should market conditions change materially.

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# Clients & Friends Memo

## **COVID-19 Update: Governor Cuomo Extends Eviction and Foreclosure Moratorium and Allows Tenants to Apply Security Deposits to the Payment of Rent**

**May 13, 2020**

On May 7, 2020, New York State Governor Andrew Cuomo issued Executive Order 202.28<sup>1</sup> (the “New Order”) to provide additional relief to renters impacted by the COVID-19 pandemic and extended the time periods for certain other protections that had been previously granted to renters and property owners pursuant to Executive Order 202.8<sup>2</sup> (the “March 20 Order”).

The March 20 Order provided for a moratorium on evictions of residential and commercial tenants and foreclosures of residential and commercial properties for 90 days. The New Order extends the moratorium on evictions and foreclosures for an additional 60 days beginning on June 20, 2020, if the basis of the eviction or foreclosure is the nonpayment of rent or the mortgage, as applicable, and the tenant or owner, as applicable, is eligible for unemployment insurance or benefits under state or federal law or is otherwise facing financial hardship due to the COVID-19 pandemic. This is a slight modification from the March 20 Order, which contained a flat prohibition on the enforcement of evictions and foreclosures regardless of the basis, employment state or impact of COVID-19.

The New Order also allows landlords and tenants of residential properties, upon the consent of the tenant, to enter in an agreement by which a security deposit, and any accrued interest thereon, may be used to pay rent. The New Order requires that landlords provide such relief to tenants who request such relief and are eligible for unemployment insurance or benefits under state or federal law or are otherwise facing financial hardship due to the COVID-19 pandemic. While the New Order permits security deposits to be applied to rent, tenants are not ultimately relieved from the obligation to maintain security deposits. Any security deposit that is used to pay rent is required to be replenished by the tenant by paying 1/12 of the amount of the security deposit used as rent each month beginning no later than 90 days from the date the security deposit is used. In lieu of

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<sup>1</sup> Executive Order 202.28, available [here](#).

<sup>2</sup> Executive Order 202.8, available [here](#).

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the monthly security deposit replenishment, the tenant may, at their option, retain insurance that provides relief for the landlord.

Additionally, pursuant to the New Order, residential landlords may not demand or be entitled to any payment, fee or charge for late payment of rent occurring between March 20, 2020 and August 20, 2020.

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# Clients & Friends Memo

## COVID-19 Update: Antitrust Enforcement Remains Robust Despite COVID-19

May 7, 2020

Many clients have asked about the state of federal antitrust enforcement during the current pandemic. We can tell you this: the Agencies are taking longer to clear or challenge deals, but the level of antitrust enforcement, for both merger and conduct cases, remains robust despite the investigating staff operating from home offices and kitchen tables.

Our progressive-minded friends at the American Antitrust Institute and the leaders of the FTC and DOJ have been locked in a public feud over the level of rigor in the Trump Administration's antitrust enforcement programs generally. We come down squarely on the side of the FTC/DOJ that the AAI has cherry-picked and manipulated data to support its assertion that enforcement productivity is down. Instead, we see evidence that enforcement during the current regime is comparable to previous Democratic and Republican administrations for the past several decades. Moreover, and despite a call by some progressive FTC Commissioners and Congressional leaders for a COVID-19 moratorium on most mergers, the FTC and DOJ continue apace at investigating and clearing deals and investigating civil and criminal conduct for antitrust violations.

To make the point that enforcement remains robust, we thought it would be useful to collect reports about all enforcement actions from March 1, 2020 to date. The reports below that contain a link are linked to official FTC or DOJ press releases, except for the final category on merger-related action from the Hill, which are linked to media sources. Other reports without a link were drawn from various media sources.

### Merger Enforcement

- AbbVie/Allergan deal cleared with conditions. AbbVie announced on May 5 that the FTC accepted a proposed consent order requiring divestitures.
- [Cengage and McGraw-Hill terminated their merger agreement in response to DOJ concerns](#) (May 4).

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- [Bankrupt dairy company Dean Foods and the Dairy Farmers of America reached an agreement with DOJ allowing the parties to merge with conditions](#) (May 1). The companies must divest Dean dairy plants in Illinois, Wisconsin and Massachusetts.
- [DOJ closed its investigation into Prairie Farms' proposed acquisition of fluid milk processing plants from Dean Foods in the South and Midwest](#) (May 1). DOJ concluded that the plants at issue likely would be shut down if not purchased by Prairie Farms due to Dean's distressed financial condition and the lack of alternate operators who could buy the plants in time.
- Willis Towers Watson's CEO on April 30 downplayed the pandemic's impact on the regulatory approval process for its acquisition by Aon. The deal would combine the world's second- and third-largest insurance brokers by sales.
- Stryker CEO on April 30 stated that the companies expect to close their merger at the end of October. The parties are in the market to divest their STAR ankle reconstructive-joint business and toe-joint products to address FTC concerns. The FTC reportedly still is reviewing the companies' products and services for additional overlapping products.
- As of late April, DOJ's review of Anheuser-Busch's proposed acquisition of Craft Brew Alliance reportedly is limited to potential effects in Hawaii, where Kona is a leading brand and one of Hawaii's largest craft breweries.
- Eldorado entered into a definitive agreement on April 23 to divest two casino properties to Twin River to address FTC concerns regarding its acquisition of Caesars Entertainment.
- [FTC approved a final order settling charges that FXI Holdings, Inc./Innocor, Inc. merger was anticompetitive](#) (April 21). The polyurethane foam producers will divest certain plants in order to preserve competition in three regional markets for the low-density conventional polyurethane that is used in home furnishings.
- Thermo Fisher Scientific and Qiagen received a Second Request from the FTC on April 20 regarding their proposed deal.
- Morgan Stanley/E\*Trade deal cleared. Morgan Stanley told investors during its quarterly earnings call on April 16.
- Press reports indicate that DOJ is evaluating Liberty Media's potential acquisition of iHeartMedia, prompting a group of consumer and artist advocacy organizations to send a letter to DOJ opposing the deal on April 15. DOJ reportedly is looking at competition for advertisements between the two parties.
- Brazil's Administrative Council for Economic Defense, or CADE, approved the International Airlines Group/Air Europa deal on April 13. CADE stated that the transaction also has been approved by DOJ, but the approval date has not been disclosed.

- Under pressure from the FTC and European enforcers, Johnson & Johnson abandoned its acquisition of TachoSil Fibrin Sealant Patch from Takeda Pharmaceuticals on April 10. [The FTC then closed its investigation of the proposed acquisition](#) (April 10).
- [FTC approved final order imposing conditions on Compassion First/National Veterinary Associates deal](#) (April 10). The parties must divest three clinics in order to preserve competition in three local geographic markets for various specialty and emergency veterinary services.
- [FTC imposed conditions on Össur Hf's acquisition of College Park Industries, Inc.](#) (April 7). The conditions aim to remedy competition loss in the U.S. market for myoelectric devices.
- Constellation Brands announced on April 3 that the FTC is vetting potential buyers for divestiture assets related to Constellation's sale of more than 30 wine and spirits brands to E. & J. Gallo.
- Novartis announced on April 2 its mutual agreement with Aurobindo Pharma USA Inc. to terminate the agreement to sell Aurobindo its Sandoz US generic oral solids and dermatology business because FTC approval was not obtained within anticipated timelines.
- [DOJ required divestitures in UTC/Raytheon merger to address vertical and horizontal concerns](#) (March 26). Divestitures will preserve competition in the U.S. for military airborne radios, military GPS systems and reconnaissance components.
- [FTC approved Danaher Corporation's acquisition of GE Biopharma with conditions](#) (March 19). Danaher agreed to divest 10 products in markets where the company competed head-to-head with GE's biopharma business.
- [DOJ won historic arbitration of Novelis Inc./Aleris Corporation merger dispute](#) (March 9). DOJ succeeded in its first attempt to resolve a key dispute in a merger challenge through arbitration. Novelis must divest assets in order to consummate transaction with Aleris.
- There also have been 125 early terminations since March 1, with 89 being granted since the FTC resumed issuing early terminations on March 30 after a brief pause of about two weeks due to COVID-19.

#### Litigation

- The FTC asked a Fifth Circuit panel on May 4 to unfreeze the FTC's enforcement action targeting Louisiana Real Estate Appraisers Board fee rules, arguing that the board must first go through the FTC administrative process. The FTC is appealing a lower court's ruling that paused its in-house administrative examination of the fee rules, which the agency says are illegally restraining trade.
- [Former VieVu parent Safariland reached an agreement with the FTC to settle charges that it entered into anticompetitive agreements with body-worn camera systems seller Axon](#) (April 17).

The settlement is part of the FTC's larger case challenging Axon's consummated acquisition of former competitor VieVu.

- The FTC filed an amended complaint on April 14 in a case accusing Vyera Pharmaceuticals and two of its owners of illegally preventing generic competition for the drug Daraprim. The case was originally filed by the FTC and New York. [The amended complaint adds six additional states as plaintiffs.](#)
- On April 13, the FTC pushed back timing in its administrative court in four deals: Altria-Juul, Axon-VieVu, Jefferson Health-Einstein and Peabody-Arch Coal. The challenges have been stayed an additional 45 days due to the COVID-19 crisis and comes after previous extensions in each case. The FTC's effort to block the Peabody/Arch Coal joint venture in federal court also will be extended by three weeks.
- Related to the FTC's efforts to unwind Axon's acquisition of police body camera rival VieVu in its administrative court, on April 8, Axon's challenge to the constitutionality of the FTC's administrative court proceedings was dismissed. Axon asked the Ninth Circuit for an expedited briefing and hearing on its challenge on April 17, and filed a brief on May 1 stating that it should be allowed to challenge the constitutionality of the FTC's merger review process and administrative court prior to the administrative court ruling.
- [DOJ agreed to civil settlement with last known Korean oil company accused in military bid rigging conspiracy that targeted Defense Department fuel supply contracts for U.S. military bases in South Korea](#) (April 8). Five other companies previously settled charges that the companies' scheme violated antitrust law and defrauded American taxpayers.
- [A Delaware federal judge denied DOJ's request to block the merger of Sabre Corporation and Farelogix, Inc. on April 7](#) (April 8). DOJ filed a protective notice to appeal on April 9, and the deal was blocked by the United Kingdom's Competition & Markets Authority on April 9. The parties abandoned the deal on May 1, leading [DOJ to consider whether to move to vacate the district court decision approving the merger](#) (May 1).
- [DOJ announced final judgment in the T-Mobile/Sprint transaction](#) (April 1). The federal district court order gives effect to the settlement that the DOJ and numerous states reached with the merging parties and Dish Network to allow the deal to proceed, subject to substantial divestitures and other remedies.
- DOJ filed a statement of interest on March 21 asking the district judge to grant Fortress Investment Group's motion to dismiss the claims by Apple and Intel challenging Fortress' allegedly illegal patent-licensing business. DOJ stepped in because of its "particular interest" in the intersection between antitrust and intellectual property law. Apple and Intel filed a brief on April 14 rebutting the DOJ's opposition to their antitrust claims, and DOJ filed a reply brief on April 23.

**Criminal Enforcement**

- [Florida Cancer Specialists and Research Institute, a leading cancer treatment center, agreed to pay \\$100 million and enter a deferred prosecution agreement to resolve market allocation charge by DOJ](#) (April 30).
- In-home health care services companies reportedly are facing scrutiny from DOJ relating to potential anticompetitive conduct involving no-poach agreements and other potential anticompetitive conduct. The investigation began last year by DOJ staff in San Francisco.
- Fair Isaac Corp. disclosed that it was notified on March 13 that DOJ has opened a civil investigation into potential exclusionary conduct by FICO (March 15).
- [Two commercial flooring executives pleaded guilty to rigging bids](#) (March 9). These were the fourth and fifth guilty pleas in the government's continuing investigation.
- [A fugitive for nearly five years, a former automotive parts executive was extradited to the U.S. and pleaded guilty to antitrust conspiracy](#) (March 3).
- [Pharmaceutical company Sandoz Inc. agreed to pay a \\$195 million criminal penalty, the largest for a domestic antitrust case, to settle charges for conspiring to allocate customers, rig bids and fix prices for generic drugs](#) (March 2). This is the third pharmaceutical company to admit to criminal charges in DOJ's ongoing investigation.

**Business Review Letters**

- [AmerisourceBergen received expedited approval to collaborate with other medical supply wholesalers and the federal government to distribute critical medicine and other supplies to communities fighting the COVID-19 pandemic](#) (April 20).
- [DOJ stated it will not challenge a proposal by the Association of Independent Commercial Producers to operate an online platform for advertisers to solicit bids from companies that provide production services for commercial advertisements](#) (April 16).
- [Project Airbridge medical supplies distributors received expedited approval for collaborative efforts to expedite and increase manufacturing, sourcing and distribution of personal protective equipment \(PPE\) and coronavirus-treatment-related medication](#) (April 4).

**Joint Actions**

- [DOJ and FTC issued a joint statement announcing they are closely monitoring employer collusion to disadvantage workers in the wake of COVID-19](#) (April 13).
- [DOJ and FTC issued guidance for businesses seeking to collaborate on COVID-19 response and set forth expedited review procedures for such collaborations](#) (March 24).
- [DOJ and FTC issued a joint letter raising concerns that a proposed California law would disadvantage small brewers](#) (March 23).

**Merger-Related Actions from The Hill**

- Antitrust Subcommittee Chairman David N. Cicilline (RI-01) led House lawmakers on May 5 in urging that the next COVID-19 relief package include language prohibiting corporate mergers that do not involve the purchase of a severely distressed company. [The letter sent to Speaker Nancy Pelosi and Republican Leader Kevin McCarthy was signed by eleven additional House representatives.](#)
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- Senator Elizabeth Warren (D-Mass) and Representative Alexandria Ocasio-Cortez (D-NY-14) announced on April 28 plans to introduce the [Pandemic Anti-Monopoly Act](#) to impose a moratorium on mergers and acquisitions involving large companies until the FTC unanimously determines that small businesses, workers and consumers are no longer under severe financial distress. The Act also would pause all waiting periods and deadlines imposed on antitrust agencies during the moratorium.
- FTC member Rohit Chopra has expressed support for Cicilline's proposal, whereas his fellow [FTC commissioner Noah Phillips harshly criticized both Cicilline's proposal and the proposed Pandemic Anti-Monopoly Act](#) in an essay for the *Truth on the Market* blog.
- [Fifteen senators, led by Amy Klobuchar \(D-Minn\), ranking member of the Senate antitrust committee, on May 1 sent a letter to the heads of the FTC and DOJ](#) urging the agencies to remain vigilant against anticompetitive mergers and conduct as the country continues to suffer the effects of the COVID-19 pandemic. The letter also asks the agencies questions relating to the effect of COVID-19 on their enforcement abilities, how they are accounting for economic uncertainty during their reviews, whether they have been able to meet HSR deadlines, and if they will commit to conducting retrospective reviews of mergers that were allowed to proceed during the pandemic.

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If you have any questions, please feel free to contact either of the following Cadwalader attorneys.

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# Clients & Friends Memo

## COVID-19 Urgent Update: SBA Extends Safe Harbor Date to Return PPP Loans to May 14 and Other Guidance

May 6, 2020

The Small Business Administration (“**SBA**”), in consultation with the Treasury Department, issued FAQ #43 on May 5, 2020 **extending by a week** the time within which a borrower has to repay a previously issued SBA loan under the Paycheck Protection Program (“**PPP**”) in order to take advantage of a presumption that a borrower certified necessity for the loan in good faith at the time of the loan application.<sup>1</sup> This memo updates Cadwalader’s recent Clients & Friends Memo<sup>2</sup> that provided the guidance below outlining criteria that a borrower should consider in deciding whether to return PPP funds as well as proactive steps that borrowers can take to document analysis performed in making the necessity certification whether or not funds are returned by the safe harbor deadline.

In addition to extending the safe harbor date until May 14, 2020, the SBA confirmed the general understanding that, in determining PPP eligibility under the 500 employee limit, a business must include all of its (and its affiliates’) employees wherever located (including overseas employees), even though the business’s calculation of “payroll costs” includes only those employees whose principal residence is in the U.S. Specifically, in FAQ #44,<sup>3</sup> the SBA and Treasury Department guidance clearly stated that “for purposes of the PPP’s 500 or fewer employee size standard, an applicant must count all of its employees and the employees of its U.S. and foreign affiliates, absent a waiver or specific exception to the affiliation rules.”

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<sup>1</sup> Paycheck Protection Program Loans: Frequently Asked Questions, FAQ #43 (May 5, 2020).

<sup>2</sup> See Cadwalader, Wickersham & Taft, COVID-19 Update: These Are Not the Droids You’re Looking For: The “Wrong” Type of PPP Borrowers May Need to Repay Their Loans or Prepare for an Audit, available at <https://www.cadwalader.com/resources/clients-friends-memos/covid-19-update-these-are-not-the-droids-youre-looking-for-the-wrong-type-of-ppp-borrowers-may-need-to-repay-their-loans-or-prepare-for-an-audit>

<sup>3</sup> Paycheck Protection Program Loans: Frequently Asked Questions, FAQ #44 (May 5, 2020).

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Here is our prior guidance with respect to the safe harbor certification:

Borrowers may be grappling with a difficult question: At the time of loan application, was the company the type of borrower to which the Small Business Administration (“SBA”) was looking to make PPP loans? Specifically, given that the Treasury Department’s prior guidance on the standards for obtaining a PPP loan were at best vague and at worst inconsistent with current guidance,<sup>4</sup> was the borrower’s certification that the PPP loan was “necessary” made in good faith? If not, a borrower has until May 14, 2020 to repay the loan and be deemed to have made the required “necessity” certification in good faith.<sup>5</sup> If the answer is yes, some borrowers should nonetheless prepare to be audited, as the SBA has announced plans to review “all loans in excess of \$2 million, in addition to other loans as appropriate.”<sup>6</sup> Borrowers seeking to navigate a middle way by keeping the loan proceeds but foregoing a request for forgiveness are unlikely to emerge unscathed if they do not meet the “necessity” requirements. Underlying the Trump Administration’s guidance on “necessity” is a requirement that PPP borrowers consider whether, at the time of application, they were able to access non-PPP funds “in a manner that is not significantly detrimental to the business.”<sup>7</sup> As a follow-up to Cadwalader’s recent Clients & Friends Memo, [The Paycheck Protection Program and the Concept of “Necessity”](#),<sup>8</sup> this article provides questions to consider when evaluating whether a PPP borrower’s loan was “necessary.”

### Forecasting and Modeling

As a necessary first step, a borrower should enlist either its outside accounting firm or professionals in a finance role to create a cash forecast for how COVID-19 will affect short-term cash inflows and outflows. In senior-level discussions, the company should then develop best- and worst-case scenarios to evaluate whether the company had, at the time of its loan application, access to non-PPP-funds in a manner that was “not significantly detrimental to the business.”<sup>9</sup> The senior-level considerations should be clearly documented and justified, taking into account a variety of quantitative and qualitative factors, including, but not limited to:

- Cash and cash equivalents

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<sup>4</sup> See Cadwalader, Wickersham & Taft, *COVID-19 Update: The Paycheck Protection Program and the Concept of “Necessity”* (Apr. 30, 2020), available at <https://www.cadwalader.com/resources/clients-friends-memos/covid-19-update-the-paycheck-protection-program-and-the-concept-of-necessity>.

<sup>5</sup> Paycheck Protection Program Loans: Frequently Asked Questions, FAQ #31 (Apr. 23, 2020).

<sup>6</sup> Paycheck Protection Program Loans: Frequently Asked Questions, FAQ #39 (Apr. 29, 2020).

<sup>7</sup> FAQ #31, *supra* note 2.

<sup>8</sup> *The Paycheck Protection Program and the Concept of “Necessity”*, *supra* note 1.

<sup>9</sup> FAQ #31, *supra* note 2.

A company, whether public or private, with sizeable and relatively liquid assets may not be able to make the necessity certification. On the other hand, if cash-on-hand is earmarked for a non-payroll critical use, the use of that cash to pay employees could be “significantly detrimental” to the business.

- Existing Sources of Funds

While the SBA Interim Final Regulations make clear that borrowers need not first seek credit elsewhere,<sup>10</sup> borrowers should evaluate their existing sources of funds. Existing lines of credit that were near exhaustion or unlikely to be renewed may support a necessity certification, but largely untapped lines of credit, even where the cost of borrowing is higher, may not. Similarly, businesses owned by companies with adequate sources of liquidity should carefully consider whether they had ready access to funds, through debt or even equity, that could support the business’s ongoing operations.<sup>11</sup>

- Industry Projections and Regional Differences

Borrowers should consider their specific needs in the context of their industry and the location of their operations, suppliers, and customers. Borrowers in industries hard-hit by COVID-19 are more likely to be able to certify necessity than borrowers experiencing increased demand. Likewise, borrowers with operations, suppliers, or customers in hard-hit regions may face operational and financial challenges that borrowers in other locations do not. Each business should evaluate the extent to which it is able to (1) procure the supplies, equipment, and labor it requires, and (2) sell goods or services to its particular customers. In particular, businesses should consider the impact of COVID-19 on the volume and timing of customer receipts, especially over the period between now and June 30, and whether any reduction in receipts will strain existing cash resources.

### **Are You a Public Company?**

Public companies certainly have access to the capital markets, but in many instances that capital may not be available readily enough to provide the needed cash infusion to sustain operations. Accordingly, public companies should consider documenting its consideration of the feasibility of securities offerings, including debt and equity, to fund ongoing operations without resort to the PPP program. Included in this calculus should be a review of the financial strength of the company, current analyst recommendations, the current stock price and outlook, and the time horizon for realizing cash through a debt or equity offering. In particular, the company should consider the costs and practicality of raising cash in the debt markets if the company does not currently have a shelf registration. More likely than not, a company facing a short-term liquidity need may be unable

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<sup>10</sup> Small Business Administration, Interim Final Regulation, *Business Loan Program Temporary Changes; Paycheck Protection Program* § 3(c), 85 Fed. Reg. 20811, 20815-16 (Apr. 15, 2020).

<sup>11</sup> Paycheck Protection Program Loans: Frequently Asked Questions, FAQ #37 (Apr. 28, 2020).

to generate cash through a new offering. Even though it is unlikely that fundraising through the capital markets would swiftly provide funds to support ongoing operations, the company should document a board-level discussion of that option.

### Public Scrutiny

Public companies in particular should also consider the risk of public scrutiny of any PPP borrowing. Generally, SBA loans are intended to benefit small businesses, and the intent of the PPP was no different. However, due to the CARES Act's easing of SBA eligibility criteria—particularly with respect to companies in the food service and accommodation industries that were partially exempted from the 500-employee limit—companies the public may perceive as “large” (and thus not the droids the SBA was looking for) were able to access the PPP funds.<sup>12</sup> Some of these companies have been criticized and several have voluntarily returned PPP loan proceeds in response to the public outcry. Given that the Pandemic Response Accountability Committee website (<https://pandemic.oversight.gov>) will soon publicly report details about PPP borrowers, loan recipients should consider whether they are willing and prepared to withstand the reputational hit of a Wall Street versus Main Street accusation. This is especially true given the SBA's plans to audit all PPP loans over \$2 million and the regulatory scrutiny—and plaintiffs' attorney trolling—that will likely follow.

### Preparing for Audits and Investigations

The analysis of whether a PPP loan was “necessary” under the Trump Administration's retroactive guidance in FAQ #31 and whether a company should take advantage of the limited safe harbor the FAQ offers to borrowers who repay their loans is highly fact-dependent. A company that carefully considers and thoroughly documents its analysis will be well-positioned to respond to the audits and investigations of borrowers that are certain to come. Attorneys across Cadwalader's finance, regulatory and investigations teams have combined together to assist borrowers in conducting the necessity analysis, either to assess potentially returning PPP loan proceeds, or to prepare for audits, or worse, down the road.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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<sup>12</sup> See e.g., *The Paycheck Protection Program and the Concept of “Necessity”*, *supra* note 1.

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# Clients & Friends Memo

## COVID-19 Update: Meet the Special Inspector General for Pandemic Recovery

May 6, 2020

The Senate Banking Committee reconvened in person and by video on Tuesday, May 5, 2020, to hold a hearing on President Trump's nomination of Brian D. Miller to serve as the Special Inspector General for Pandemic Recovery ("**SIGPR**"). Mr. Miller, a former prosecutor and Inspector General for the General Services Administration, has served as Senior Associate Counsel and Special Assistant to President Trump since December 2018. However, upon Senate confirmation, Mr. Miller will undertake an immense new role: providing independent oversight of more than \$500 billion in Treasury Department funding aimed at supporting businesses and municipalities impacted by the COVID-19 pandemic. As a follow-up to Cadwalader's recent Clients & Friends Memo, [Federal Investigators Prepare to Investigate and Prosecute Fraud in Emergency Loan Programs](https://www.cadwalader.com/resources/clients-friends-memos/covid-19-update-federal-investigators-prepare-to-investigate-and-prosecute-fraud-in-emergency-loan-programs),<sup>1</sup> which outlined the roles of federal inspectors general in detecting fraud and abuse in various pandemic relief programs, this article provides a more in-depth look at the SIGPR's role in overseeing relief provided under the Title IV of the CARES Act.

### The SIGPR's Oversight of Treasury Department Relief

The CARES Act created the SIGPR – a new, independent inspector general within the Treasury Department – to provide oversight of Treasury Department loans, loan guarantees and other investments made under Title IV of the CARES Act. Specifically, this encompasses oversight of (1) \$29 billion in Treasury Department loans or loan guarantees for air carriers and related businesses, (2) \$17 billion in Treasury Department loans or loan guarantees to businesses that are "critical to maintaining national security," and (3) \$454 billion in Treasury Department investments in emergency Federal Reserve facilities ("**13(3) facilities**") that support eligible businesses, States,

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<sup>1</sup> See Cadwalader, Wickersham & Taft, LLP *COVID-19 Update: Federal Investigators Prepare to Investigate and Prosecute Fraud in Emergency Loan Programs* (Apr. 24, 2020), available at <https://www.cadwalader.com/resources/clients-friends-memos/covid-19-update-federal-investigators-prepare-to-investigate-and-prosecute-fraud-in-emergency-loan-programs>.

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municipalities and Tribal governments. Treasury Department investments in 13(3) facilities, alone, could support more than \$6 trillion in loans and other liquidity.<sup>2</sup>

*Transparency of Treasury Department Spending*

The Coronavirus Aid, Relief, and Economic Security Act (the “**CARES Act**”) directs the SIGPR to collect and summarize information relating to the Treasury Department’s activities under Title IV. This responsibility includes (i) a description of the categories of loans, loan guarantees and other investments made by the Treasury Department, (ii) a listing of the businesses that receive support under each category, (iii) an explanation of the Treasury Department’s rationale for entering into each transaction, (iv) information associated with managers or servicers hired in connection with each transaction, and (v) an estimate of the amount outstanding and any loss or gain recognized from each transaction. The SIGPR is also directed to publish quarterly reports to Congress regarding the Treasury Department’s investments under Title IV. During the May 5, 2020 Senate confirmation hearing, Mr. Miller committed to work closely with the Pandemic Response Accountability Committee (“**PRAC**”), a committee of inspectors general established by the CARES Act to coordinate and support oversight of all federal pandemic relief programs.<sup>3</sup> The PRAC website (<https://pandemic.oversight.gov>) will soon include detailed information about recipients of pandemic relief in a user-friendly and searchable format, as required by the CARES Act. However, it is unclear at this time if the PRAC website or the SIGPR website will include all of the detailed information required to be collected about each Treasury Department investment.

*Recommendations to Prevent and Detect Fraud and Abuse*

The SIGPR is responsible for making recommendations to improve the administration and prevent fraud and abuse of Treasury Department loans, loan guarantees and other investments made under Title IV of the CARES Act, and for reporting out those recommendations to Congress on a semi-annual basis. The SIGPR’s recommendations will presumably highlight any weaknesses or failures of restrictions on Treasury Department investments – such as those relating to stock buybacks, dividend payments, executive compensation and maintaining employment levels. For example, the Special Inspector General of the Troubled Asset Relief Program (“**SIGTARP**”), on which the SIGPR is modeled, consistently published observations and recommendations relating to executive

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<sup>2</sup> Cadwalader has issued a series of Clients & Friends memo describing the CARES Act and other pandemic relief, including Federal Reserve 13(3) facilities. *See, e.g., COVID-19 Update: Federal Reserve Announces Main Street Lending Program* (Apr. 16, 2020), available at <https://www.cadwalader.com/resources/clients-friends-memos/covid-19-update-federal-reserve-announces-main-street-lending-program>. Cadwalader has developed a compendium of Clients & Friends memos related to the COVID-19 pandemic, available at <https://www.cadwalader.com/resources/covid-19-resources>.

<sup>3</sup> Both the Inspector General for the Federal Reserve Board of Governors and the Deputy Inspector General for the Treasury Department have been named to the PRAC. Michael Horowitz, Inspector General of the Department of Justice (“**DOJ**”) and a former Cadwalader partner, is currently serving as Acting Chair of the PRAC.

compensation paid by institutions that received federal support through the \$800 billion Troubled Asset Relief Program.<sup>4</sup>

*Audits, Investigations and Referrals of Criminal Activity*

The SIGPR is also directed by the CARES Act to supervise, conduct and coordinate audits and investigations of the Treasury Department's investments under Title IV. As described in [Federal Investigators Prepare to Investigate and Prosecute Fraud in Emergency Loan Programs](#),<sup>5</sup> the SIGPR is authorized to issue subpoenas and to obtain information or assistance upon request from any department, agency, or other entity of the federal government. Should any request be unreasonably refused or not provided, the SIGPR is required under the CARES Act to report to Congress. This reporting requirement to Congress, rather than an agency head as required of others inspectors general, is the subject of a signing statement by President Trump. Mr. Miller committed at the May 5, 2020 hearing to act independently and to notify Congress as required by the law, but it remains unclear at this time what impact, if any, the President's signing statement will have on the enforcement of SIGPR subpoenas and requests for information.

The SIGPR also has direct law enforcement authority reserved only to certain inspectors general, including independent authority to seek and execute search and arrest warrants; however, the SIGPR must expeditiously refer any criminal activity identified to the DOJ for prosecution. If the SIGTARP's activities since 2008 are any indication, the SIGPR is likely to pursue fraud investigations aggressively and refer hundreds of criminal investigations to the DOJ for prosecution. To date, SIGTARP investigations have resulted in over 430 criminal prosecutions by the DOJ and more than 370 convictions for bank fraud, securities fraud, money laundering, mortgage fraud, conspiracy and other criminal offenses.<sup>6</sup>

During the May 5, 2020 hearing, Mr. Miller stated that, if confirmed, his office will investigate potential fraud and abuse of the Treasury Department's investments to its fullest authority.

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<sup>4</sup> See, e.g., SIGTARP, *Extent of Federal Agencies' Oversight of AIG Compensation Varies, and Important Challenges Remain* (Oct. 14, 2009), available at [https://www.sigtar.gov/Audit%20Reports/Extent\\_of\\_Federal\\_Agencies%27\\_Oversight\\_of\\_AIG\\_Compensation\\_Varied\\_and\\_Important\\_Challenges\\_Remain\\_10\\_14\\_09.pdf](https://www.sigtar.gov/Audit%20Reports/Extent_of_Federal_Agencies%27_Oversight_of_AIG_Compensation_Varied_and_Important_Challenges_Remain_10_14_09.pdf); SIGTARP, *Treasury Continues to Approving Excessive Pay for Top Executives at Bailed-Out Companies* (Jan. 28, 2013), available at [https://www.sigtar.gov/Audit%20Reports/2013\\_SIGTARP\\_Bailout\\_Pay\\_Report.pdf](https://www.sigtar.gov/Audit%20Reports/2013_SIGTARP_Bailout_Pay_Report.pdf).

<sup>5</sup> *Federal Investigators Prepare to Investigate and Prosecute Fraud in Emergency Loan Programs*, *supra* note 1.

<sup>6</sup> See SIGTARP Semiannual Report to Congress (Oct. 30, 2019), available at [https://www.sigtar.gov/Quarterly%20Reports/October\\_30\\_2019\\_Report\\_to\\_Congress.pdf](https://www.sigtar.gov/Quarterly%20Reports/October_30_2019_Report_to_Congress.pdf); SIGTARP Financial Institution Crimes & Fines Database, available at <https://www.sigtar.gov/Pages/wd9er7g.aspx>.

If you have questions about your participation in an emergency program administered by the Treasury Department or the Federal Reserve under Title IV of the CARES Act, including the risk of investigation and liability, the attorneys listed below have experience defending allegations of fraud and would be happy to respond to your questions or concerns.

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# Clients & Friends Memo

## COVID-19 Update: Paycheck Protection Program – Secondary Market Restrictions on Whole Loan Transfers Partially Lifted

May 5, 2020

Last week, the federal government implemented two measures designed to facilitate the financing of Paycheck Protection Program (“PPP”) loans through whole loan sales. These two measures fall on the heels of guidance issued by the Small Business Administration (“SBA”) the week earlier, partially lifting existing SBA restrictions on participation transactions involving PPP loans. *See [COVID-19 Update: The Paycheck Protection Program – Loan Participation Transactions](#).*

As explained in our prior Clients & Friends Memos, PPP loans are a form of SBA Section 7(a) loan, a traditional form of SBA-guaranteed loan. Confusion has existed since the inception of the PPP due to the CARES Act’s statutory language and the effort to conform PPP loans to the existing 7(a) loan regulatory regime. Section 1102(a) of the CARES Act provides that PPP loans “shall be eligible to be sold in the secondary market consistent with this subsection.” This statement regarding sales in the secondary market was echoed in Treasury Department releases describing the PPP. “This subsection” refers to Section 7(a) of the Small Business Act.<sup>1</sup> On April 17, the SBA and the Treasury Department issued an FAQ reaffirming that “A PPP loan may be sold into the secondary market at any time after the loan is fully disbursed” and that “A secondary market sale of a PPP loan does not require SBA approval.”<sup>2</sup> Although not addressed in the CARES Act, the SBA’s existing regulations nonetheless impose some limitations on the ability of Section 7(a) loans to be transferred in the secondary market. With respect to whole loan sales, existing SBA Section 7(a) regulations require a prior approval for the sale of the loans, stipulate that such loans can be sold only to other SBA lenders, and allow such sales only if the selling lender has been determined by the SBA to meet certain good standing and performance criteria.<sup>3</sup>

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<sup>1</sup> 15 U.S.C. § 636.

<sup>2</sup> Paycheck Protection Program Loans Frequently Asked Questions, FAQ #30 (Apr. 17, 2020), <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>.

<sup>3</sup> 13 C.F.R. §§ 120.432(a) & 120.433.

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**The SBA's Procedural Notice on Whole Loan Sales**

In a Procedural Notice issued on May 1, 2020, the SBA announced that it was waiving certain of these requirements for whole loans sales.<sup>4</sup> The Procedural Notice waives the prior approval requirement, instead requiring the originating PPP lender to provide after-the-fact written notice to the SBA's Office of Credit Risk Management. The Notice deems all existing PPP lenders to satisfy the good standing and performance criteria applicable to sellers, but retains the requirement that PPP loans may be sold only to other SBA lenders (including lenders that have filed Forms 3506 or 3507 and therefore have the authority to originate PPP loans themselves). The Procedural Notice provides that the purchasing lender assumes responsibility for servicing, but can retain the originating lender as sub-servicer. Finally, the Notice states that "[t]he purchasing Lender acquires the PPP loan subject to SBA's existing rights, including its right to deny liability on its guarantee." This is consistent with the SBA's longstanding position that a purchaser of SBA loans "will assume all of the obligations and responsibilities of the selling Lender, including but not limited to, all obligations, responsibilities and liabilities resulting from the making, servicing, closing and liquidation of the selling Lenders' loans."<sup>5</sup>

**The Federal Reserve's Revised PPPLF Term Sheet to Facilitate PPP Whole Loan Sales and Non-Depository Institution Pledges**

Separately, the Board of Governors of the Federal Reserve System revised its term sheet governing the Paycheck Protection Program Loan Facility ("PPPLF") to allow depository institutions to pledge purchased PPP loans, and to allow non-depository institution PPP lenders to pledge both originated and purchased PPP loans directly to the Federal Reserve.<sup>6</sup> Previously, the PPPLF initial term sheet permitted depository institutions to pledge only those PPP loans originated by that depository institution, but did not allow the pledge of purchased PPP loans. The initial term sheet also advised that the Federal Reserve intended to allow non-depository institutions to pledge PPP loans to the Federal Reserve, but the term sheet provided no mechanism for doing so. As now revised, the PPPLF term sheet provides that (i) PPP lenders who are depository institutions should pledge PPP loans to their respective regional Federal Reserve Bank, (ii) PPP lenders who are community development financial institutions may pledge PPP loans to the Federal Reserve Bank of Boston, (iii) PPP lenders who are SBA-regulated "small business loan companies" or Farm Credit System members may pledge PPP loans to the Federal Reserve Bank of Minneapolis, and (iv) all other non-depository institution PPP lenders may pledge their loans to the Federal Reserve Bank of San Francisco. The Federal Reserve has now published the various documents that will be required for non-depository institutions to pledge their PPP loans.<sup>7</sup>

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<sup>4</sup> <https://www.sba.gov/sites/default/files/2020-05/5000-20024.pdf>.

<sup>5</sup> SBA Lender & Development Company Loan Program SOP 50-10-5(K) (Apr. 1, 2019), p. 257.

<sup>6</sup> <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200430b1.pdf>.

<sup>7</sup> [https://www.frbdiscountwindow.org/generalpages/nondi\\_ppplf](https://www.frbdiscountwindow.org/generalpages/nondi_ppplf).

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# Clients & Friends Memo

## COVID-19 Update: These Are Not the Droids You're Looking For: The "Wrong" Type of PPP Borrowers May Need to Repay Their Loans or Prepare for an Audit

May 4, 2020

On this May the Fourth (Be With You), many Paycheck Protection Program ("PPP") borrowers may be grappling with a difficult question: At the time of loan application, was the company the type of borrower the Small Business Administration ("SBA") was looking for? Specifically, given that the Treasury Department's prior guidance on the standards for obtaining a PPP loan were at best vague and at worst inconsistent with current guidance,<sup>1</sup> was the borrower's certification that the PPP loan was "necessary" made in good faith? If not, a borrower has until May 7, 2020 to repay the loan and be deemed to have made the required "necessity" certification in good faith.<sup>2</sup> If the answer is yes, some borrowers should nonetheless prepare to be audited, as the SBA has announced plans to review "all loans in excess of \$2 million, in addition to other loans as appropriate."<sup>3</sup> Borrowers seeking to navigate a middle way by keeping the loan proceeds but foregoing a request for forgiveness are unlikely to emerge unscathed if they do not meet the "necessity" requirements. Underlying the Trump Administration's guidance on "necessity" is a requirement that PPP borrowers consider whether, at the time of application, they were able to access non-PPP funds "in a manner that is not significantly detrimental to the business."<sup>4</sup> As a follow-up to Cadwalader's recent Clients & Friends Memo, [The Paycheck Protection Program and the Concept of "Necessity"](#),<sup>5</sup> this article provides questions to consider when evaluating whether a PPP borrower's loan was "necessary."

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<sup>1</sup> See Cadwalader, Wickersham & Taft, *COVID-19 Update: The Paycheck Protection Program and the Concept of "Necessity"* (Apr. 30, 2020), available at <https://www.cadwalader.com/resources/clients-friends-memos/covid-19-update-the-paycheck-protection-program-and-the-concept-of-necessity>.

<sup>2</sup> Paycheck Protection Program Loans: Frequently Asked Questions, FAQ #31 (Apr. 23, 2020).

<sup>3</sup> Paycheck Protection Program Loans: Frequently Asked Questions, FAQ #39 (Apr. 29, 2020).

<sup>4</sup> FAQ #31, *supra* note 2.

<sup>5</sup> *The Paycheck Protection Program and the Concept of "Necessity"*, *supra* note 1.

**Forecasting and Modeling**

As a necessary first step, a borrower should enlist either its outside accounting firm or professionals in a finance role to create a cash forecast for how COVID-19 will affect short-term cash inflows and outflows. In senior-level discussions, the company should then develop best- and worst-case scenarios to evaluate whether the company had, at the time of its loan application, access to non-PPP-funds in a manner that was “not significantly detrimental to the business.”<sup>6</sup> The senior-level considerations should be clearly documented and justified, taking into account a variety of quantitative and qualitative factors, including, but not limited to:

- Cash and cash equivalents

A company, whether public or private, with sizeable and relatively liquid assets may not be able to make the necessity certification. On the other hand, if cash-on-hand is earmarked for a non-payroll critical use, the use of that cash to pay employees could be “significantly detrimental” to the business.

- Existing Sources of Funds

While the SBA Interim Final Regulations make clear that borrowers need not first seek credit elsewhere,<sup>7</sup> borrowers should evaluate their existing sources of funds. Existing lines of credit that were near exhaustion or unlikely to be renewed may support a necessity certification, but largely untapped lines of credit, even where the cost of borrowing is higher, may not. Similarly, businesses owned by companies with adequate sources of liquidity should carefully consider whether they had ready access to funds, through debt or even equity, that could support the business’s ongoing operations.<sup>8</sup>

- Industry Projections and Regional Differences

Borrowers should consider their specific needs in the context of their industry and the location of their operations, suppliers, and customers. Borrowers in industries hard-hit by COVID-19 are more likely to be able to certify necessity than borrowers experiencing increased demand. Likewise, borrowers with operations, suppliers, or customers in hard-hit regions may face operational and financial challenges that borrowers in other locations do not. Each business should evaluate the extent to which it is able to (1) procure the supplies, equipment, and labor it requires, and (2) sell goods or services to its particular customers. In particular, businesses should consider the impact

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<sup>6</sup> FAQ #31, *supra* note 2.

<sup>7</sup> Small Business Administration, Interim Final Regulation, *Business Loan Program Temporary Changes; Paycheck Protection Program* § 3(c), 85 Fed. Reg. 20811, 20815-16 (Apr. 15, 2020).

<sup>8</sup> Paycheck Protection Program Loans: Frequently Asked Questions, FAQ #37 (Apr. 28, 2020).

of COVID-19 on the volume and timing of customer receipts, especially over the period between now and June 30, and whether any reduction in receipts will strain existing cash resources.

### **Are You a Public Company?**

Public companies certainly have access to the capital markets, but in many instances that capital may not be available readily enough to provide the needed cash infusion to sustain operations. Accordingly, public companies should consider documenting its consideration of the feasibility of securities offerings, including debt and equity, to fund ongoing operations without resort to the PPP program. Included in this calculus should be a review of the financial strength of the company, current analyst recommendations, the current stock price and outlook, and the time horizon for realizing cash through a debt or equity offering. In particular, the company should consider the costs and practicality of raising cash in the debt markets if the company does not currently have a shelf registration. More likely than not, a company facing a short-term liquidity need may be unable to generate cash through a new offering. Even though it is unlikely that fundraising through the capital markets would swiftly provide funds to support ongoing operations, the company should document a board-level discussion of that option.

### **Public Scrutiny**

Public companies in particular should also consider the risk of public scrutiny of any PPP borrowing. Generally, SBA loans are intended to benefit small businesses, and the intent of the PPP was no different. However, due to the CARES Act's easing of SBA eligibility criteria—particularly with respect to companies in the food service and accommodation industries that were partially exempted from the 500-employee limit—companies the public may perceive as “large” (and thus not the droids the SBA was looking for) were able to access the PPP funds.<sup>9</sup> Some of these companies have been criticized and several have voluntarily returned PPP loan proceeds in response to the public outcry. Given that the Pandemic Response Accountability Committee website (<https://pandemic.oversight.gov>) will soon publicly report details about PPP borrowers, loan recipients should consider whether they are willing and prepared to withstand the reputational hit of a Wall Street versus Main Street accusation. This is especially true given the SBA's plans to audit all PPP loans over \$2 million and the regulatory scrutiny – and plaintiffs' attorney trolling – that will likely follow.

### **Preparing for Audits and Investigations**

The analysis of whether a PPP loan was “necessary” under the Trump Administration's retroactive guidance in FAQ #31 and whether a company should take advantage of the limited safe harbor the FAQ offers to borrowers who repay their loans is highly fact-dependent. A company that carefully considers and thoroughly documents its analysis will be well-positioned to respond to the audits and investigations of borrowers that are certain to come. Attorneys across Cadwalader's finance,

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<sup>9</sup> See e.g., *The Paycheck Protection Program and the Concept of “Necessity”*, *supra* note 1.

regulatory and investigations teams have combined together to assist borrowers in conducting the necessity analysis, either to assess potential returning PPP loan proceeds, or to prepare for audits, or worse, down the road.

\* \* \*

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# Clients & Friends Memo

## COVID-19 Update: The European Commission Proposes Urgent Amendments to the EU Capital Requirements Regulation

May 4, 2020

On 28 April 2020, the European Commission (the “**Commission**”) [proposed](#) a new Regulation to make targeted amendments to the EU Capital Requirements Regulation (575/2013) (“**CRR**”) and the CRR II Regulation ((EU) 2019/876) (“**CRR II**”) in response to the COVID-19 pandemic. Subject to the EU legislative process operating as anticipated, it is expected that these changes will apply in the UK until the end of the Brexit transition period (currently scheduled to end on 31 December 2020), although these changes will also be reflected in the UK “onshored” version of CRR which will apply after the end of the transition period.

The legislative proposal is accompanied by a [Interpretative Communication](#) (the “**Communication**”), which sets out the Commission’s rationale for the changes and also provides guidance on the flexibility in the current EU accounting and prudential regimes during the COVID-19 pandemic. The Communication also sets out the Commission’s view that the EU’s existing prudential framework for banks contains sufficient flexibility for regulators to assist banks during the pandemic.

The Commission has, however, recognised that some further amendments to the CRR are required during the crisis. The proposed amendments are designed to improve banks’ capacity to lend and to absorb losses. They include the following proposals:

### IFRS 9 Transitional Measures

The Commission is concerned that the application of IFRS 9 during the COVID-19 pandemic may lead to a sudden significant increase in the Expected Credit Loss provisions of EU banks, which would result in an erosion of their capital. To counter this, the Commission has proposed an extension of the current transitional arrangements in the CRR by two years, in line with the international agreement of the Basel Committee on Banking Standards (announced on 3 April 2020). This would allow banks to add back to their regulatory capital any increase in new expected credit losses provisions that they recognise in 2020 and 2021 for their financial assets, which have not defaulted.

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**Calculation of the Leverage Ratio**

In line with the Basel III standards, CRR II amends CRR to introduce a capital requirement based on the leverage ratio that will become applicable on 28 June 2021. The CRR provides a discretion to temporarily exclude central bank reserves from a bank's leverage ratio calculation in exceptional circumstances, for a period of up to 1 year. Under the current rules, any exclusion is to be offset via a mechanism that increases a bank's individual leverage ratio requirement in a proportionate manner, through the calculation of an "adjusted leverage ratio". The Commission is concerned that the current rules, relating to the offsetting mechanism, would be too restrictive and that their application would actually not facilitate an effective transmission of central bank monetary policy and, ultimately, could force a bank to deleverage by selling assets or reducing the level of its lending. The Commission is therefore proposing a modification so that a bank would only be required to calculate the adjusted leverage ratio once, at the time the discretion is exercised. The adjusted leverage ratio would not change throughout the full period during which the discretion is exercised.

**Leverage Ratio Buffer**

The Commission proposes to delay the implementation of the leverage ratio buffer for global systemically-important institutions from 1 January 2022 to 1 January 2023. This revised timetable for implementation of the Basel III standards has been agreed with the Basel Committee on Banking Standards.

**Treatment of Publicly Guaranteed Loans Under the NPL Prudential Backstop**

CRR requires a minimum loss coverage requirement for non-performing loans ("NPLs") (the so-called "NPL backstop") to ensure that banks set aside sufficient funds to cover the risks associated with loans that have become non-performing. NPLs guaranteed by official export credit agencies currently receive a preferential treatment under the NPL backstop under CRR; the Commission proposes to temporarily extend this preferential treatment to exposures guaranteed by a wider range of public sector agencies which have provided guarantees in order to alleviate the economic impact of the COVID-19 pandemic.

**Acceleration of CRR II Measures**

The proposal also calls for measures in CRR II, due to apply from June 2021, to be brought forward in response to the pandemic. These measures include the favourable prudential treatment of loans backed by an employee's salary or pension and the "SME supporting factor" and the "infrastructure supporting factor" (CRR II will amend CRR to provide for a reduction in the amount of capital that banks need to hold in respect of loans they grant to SMEs and separately for exposures to entities that operate or finance physical structures or facilities, systems and networks that provide or support essential public services).

**Legislative Timetable**

These proposals now have to make their way through the EU legislative process, involving consideration and approval by the Council of the EU (representing the individual member states) and the European Parliament. It should be noted that the previous iteration of the CRR/CRD package took a number of years to be finalised. In this crisis situation, however, the Commission has called upon the legislators to finalise and approve these changes by the end of June 2020, citing the targeted nature of these amendments and informal engagement with member states prior to the announcement of the proposals. It is plausible, therefore, that these measures could become applicable from the beginning of July 2020.

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# Clients & Friends Memo

## COVID-19 Update: Prudential Regulatory Treatment of UK Business Interruption Loan Schemes (CBILS & CLBILS)

1 May 2020

On 27 April 2020, the UK Prudential Regulation Authority (“**PRA**”) published a statement (the “**statement**”) on whether the guarantees provided by the UK Government (through the British Business Bank) under the Coronavirus Business Interruption Loan Scheme (“**CBILS**”) and the Coronavirus Large Business Interruption Loan Scheme (“**CLBILS**”) are eligible for recognition as unfunded credit risk mitigation (“**CRM**”) under the EU Capital Requirements Regulation (the “**CRR**”). The CRR continues to apply in the UK until the end of the Brexit transition period (currently scheduled to end on 31 December 2020).

### Unfunded Credit Protection Under the Capital Requirements Regulation

A guarantee is one form of unfunded credit protection which, where it meets the conditions in Articles 194 and 213-215 CRR, may allow a firm to adjust risk weights and expected loss amounts. The statement reminds firms that they should review relevant articles of the CRR, and any relevant PRA rules and guidance (including expectations set out in the PRA’s Supervisory Statement on credit risk mitigation – SS17/13 ‘Credit risk mitigation’), when determining the risk weighted exposure amounts, and seek independent advice where necessary.

The PRA considers that the terms of the guarantees provided by the Government under CBILS and CLBILS do not contain features that would render these guarantees ineligible for recognition as unfunded credit risk protection, and the effects of these guarantees would appear to justify such treatment under the relevant provisions of the CRR. The statement also notes that some of the CBILS guarantees exclude cover for interest and fees. In accordance with the CRR, the PRA considers that firms recognising the CBILS guarantees as eligible unfunded protection in relation to an exposure are required to adjust the exposure amount to exclude elements not covered by the CBILS guarantees.

**Additional Guidance on Loan Underwriting**

The statement also provides some limited extra guidance for firms on their loan underwriting processes during the COVID-19 pandemic. The PRA recognises that it will be challenging for many businesses to provide forecast financial information with a high degree of confidence to support firms' loan underwriting processes. When lenders are making a credit decision, the statement reminds them that they should consider the full range of information available to them including (but not limited to):

- the performance of the proposed borrower business prior to the COVID-19 outbreak;
- a view of how the loan will be repaid in due course, relying on judgement in the absence of financial forecast information; and
- the general prospects for the sector in which the business operates once the effects of the pandemic have receded.

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# Clients & Friends Memo

## COVID-19 Update: The Paycheck Protection Program and the Concept of “Necessity”

April 30, 2020

In response to Cadwalader’s recent Clients & Friends Memo, *Federal Investigators Prepare to Investigate and Prosecute Fraud in Emergency Loan Programs*,<sup>1</sup> Cadwalader has heard from a number of borrowers under the CARES Act’s Paycheck Protection Program (PPP) who are now questioning whether the loan they took was “necessary.” This Clients & Friends Memo lays out the state of play regarding loan “necessity” under the PPP and steps companies can take to reduce their risk of audit and investigation.

In the past several weeks, there has been public backlash over reports that businesses not normally considered “small” (in the public’s mind) and that are otherwise seemingly financially healthy have submitted applications for, and received funding under, the PPP. Apart from isolated reports regarding certain applicants, as of yet we are not aware of any detailed public data available regarding individual applicants, so it is not clear to what extent this is actually true.<sup>2</sup> Nonetheless, media reports have led to the widespread belief that PPP funds were not being made available to the most needy of businesses. According to these reports, many eligible companies were unable to obtain PPP loans before the first round of the program’s funding was exhausted. These reports

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<sup>1</sup> Cadwalader, Wickersham & Taft, *COVID-19 Update: Federal Investigators Prepare to Investigate and Prosecute Fraud in Emergency Loan Programs* (Apr. 24, 2020), available at <https://www.cadwalader.com/resources/clients-friends-memos/covid-19-update-federal-investigators-prepare-to-investigate-and-prosecute-fraud-in-emergency-loan-programs>

<sup>2</sup> The Treasury Department’s PPP report issued on April 16 provides some insight regarding the loans that were approved under the first phase of the PPP involving \$349 billion of appropriated funds. In that phase, roughly two-thirds of the PPP dollars were disbursed in loan amounts of \$350,000 or more. This means that two-thirds of PPP dollars were disbursed to businesses with annual payrolls of roughly \$1.7 million (excluding highly compensated employees whose payroll costs were not eligible for PPP funding). More than a quarter of the PPP dollars were disbursed to companies with nearly \$10 million in annual payroll costs (again, excluding highly compensated employees). A partial list of PPP borrowers can be gleaned from public filings. See NBC News, *Which Companies Are Returning Their PPP Loans? Here’s the List* (April 28, 2020). Looking ahead, as required by the CARES Act, the Pandemic Response Accountability Committee website (<https://pandemic.oversight.gov/track-the-money>) will soon report more detailed information about individual recipients in a user-friendly and searchable format.

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state that other well-known and arguably larger companies like Shake Shack and Ruth's Chris Steak House *were* able to obtain financing, however.

In response to this backlash, on April 24, 2020, the Treasury Department and the Small Business Administration (SBA) issued FAQ #31, reminding businesses that, when submitting PPP application the business "must certify in good faith that their PPP loan request is necessary" and cautioning businesses that, when making this certification the business should "tak[e] into account their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business." The FAQ further states that "it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification." The FAQ then ominously states that "[a]ny borrower that applied for a PPP loan prior to the issuance of this guidance and repays the loan in full by May 7, 2020 will be deemed by SBA to have made the required certification in good faith"<sup>3</sup> – encouraging publicly traded companies and other companies with adequate liquidity to return their PPP loans by next week.

This uncertainty regarding which businesses are truly worthy of a PPP loan stems from the CARES Act itself. The CARES Act included an eligibility requirement for a PPP loan based on a business having an employee headcount of 500 or fewer employees.<sup>4</sup> This differs from the approach used by the SBA for its other small business programs, in which a business is determined to be "small" based alternatively on employee headcount or annual revenues, depending on the industry involved.<sup>5</sup> This in turn led to the possibility that some businesses with large revenue streams would be eligible for a PPP loan so long as its headcount was 500 or below – even though the business would not have been considered "small" by the SBA or eligible for other forms of SBA funding.

The CARES Act further waived the "affiliation" standards for entities in the Accommodation and Food Service Industry (NAICS code 72), allowing businesses in these industries to apply for a PPP loan if affiliated with, or even if a wholly owned subsidiary of, another otherwise healthy business.<sup>6</sup> In addition, the SBA issued new guidance on "affiliation" for PPP applicants generally, adopting objective standards based on majority control.<sup>7</sup> While this guidance was undoubtedly intended to speed the ability of applicants to complete PPP loan applications and obtain funding promptly, it

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<sup>3</sup> Paycheck Protection Program Loans: Frequently Asked Questions, FAQ #31 (Apr. 23, 2020).

<sup>4</sup> Public Law 116-136, § 1102 (2020).

<sup>5</sup> See 13 C.F.R. § 120.121.

<sup>6</sup> CARES Act, *supra* note 4, § 1102.

<sup>7</sup> U.S. Small Business Administration, *Affiliation Rules Applicable to U.S. Small Business Administration Paycheck Protection Program* (Apr. 3, 2020).

also may have led to the belief that applicants with financial links to other non-controlling entities were now able to apply.

The CARES Act did stipulate that “[a]ny eligible borrower applying for a [PPP loan] shall make a good-faith certification that ... the uncertainty of economic conditions as of the date of the application makes necessary the loan request to support the ongoing operations of the recipient.”<sup>8</sup> This certification requirement also appears in the application form (SBA Form 2483) used by lenders to originate PPP loans (and is a required disclosure in application forms for those lenders that choose to develop their own application):

The authorized representative of the Applicant must certify in good faith to all of the below by initialing next to each one:

...

\_\_\_\_\_ Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.<sup>9</sup>

However, in a somewhat inconsistent fashion, the CARES Act simultaneously waived the requirement applicable to all other SBA loans that the “small business concern is unable to obtain credit elsewhere.” The “credit-elsewhere” requirement is a statutory provision in the Small Business Act<sup>10</sup> and is reflected in SBA regulations.<sup>11</sup> As set forth in the Act, the credit-elsewhere requirement is a bar on SBA financing if the applicant can obtain credit elsewhere “on reasonable terms and conditions to the individual loan applicant from non-Federal, non-State, or non-local government sources.”<sup>12</sup> As implemented by the SBA, the credit-elsewhere requirement is a procedural requirement imposed on lenders; SBA lenders are required to certify to the SBA that the lender has determined that the applicant is unable to obtain credit elsewhere as required by the Act.

In its first PPP guidance issued to the public on March 31, 2020, the Treasury Department stressed to borrowers there was no need for the borrowers to determine whether other sources of funding were available to them:

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<sup>8</sup> CARES Act, *supra* note 4, § 1102.

<sup>9</sup> SBA Form 2483, p. 2.

<sup>10</sup> 15 U.S.C. § 636(a)(1)(A)(i).

<sup>11</sup> 13 C.F.R. § 120.101.

<sup>12</sup> 15 U.S.C. § 632(h).

***Do I need to first look for other funds before applying to this program?***

No. We are waiving the usual SBA requirement that you try to obtain some or all of the loan funds from other sources (i.e., we are waiving the Credit Elsewhere requirement).<sup>13</sup>

This undoubtedly led to the belief that businesses able to tap other sources of financing or liquidity would be permitted to obtain a PPP loan, because the applicant was under no obligation to look for other sources of funds.

The Interim Final Regulations released by the SBA three days later, on April 2, 2020, characterized the waiver of the credit-elsewhere requirement somewhat differently, though:

***c. Do lenders have to apply the “credit elsewhere test”?***

No. When evaluating an applicant’s eligibility lenders will not be required to apply the “credit elsewhere test” (as set forth in section 7(a)(1)(A) of the Small Business Act (15 USC 636) and SBA regulations at 13 CFR 120.101).<sup>14</sup>

The SBA’s regulation said nothing about whether or not *the borrower* needed to look for other sources of funding, but only that *the lender* did not need *to certify* that the lender had independently determined that, with respect to that particular borrower, credit was not available elsewhere.

Given the foregoing, the widespread confusion regarding PPP eligibility is understandable. Nonetheless, it is clear that the Treasury Department *now* believes that certain borrowers with ready access to financing are not eligible for PPP financing. While the Treasury Department has not gone so far as to state that PPP borrowers should have first sought to obtain credit from non-SBA sources, the Treasury Department *has* indicated that applicants with “the ability to access other sources of liquidity” may be ineligible if those sources can be accessed “in a manner that is not significantly detrimental to the business.” This apparently includes not only businesses that have access to the capital markets,<sup>15</sup> but also private companies “with adequate sources of liquidity,” perhaps including private companies with sufficient cash reserves or *existing* lines of credit.<sup>16</sup>

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<sup>13</sup> Treasury Department, Paycheck Protection Program (PPP) Information Sheet: Borrowers, p. 2 (Mar. 31, 2020).

<sup>14</sup> Small Business Administration, Interim Final Regulation, *Business Loan Program Temporary Changes; Paycheck Protection Program* § 3(c), 85 FED. REG. 20811, 20815-16 (Apr. 15, 2020).

<sup>15</sup> FAQ #31, *supra* note 3.

<sup>16</sup> Paycheck Protection Program Loans: Frequently Asked Questions, FAQ #37 (Apr. 28, 2020).

As described in Cadwalader's recent Clients & Friends memo,<sup>17</sup> a borrower under the PPP may be audited. According to PPP FAQ #39, SBA will "review all loans in excess of \$2 million, in addition to other loans as appropriate."<sup>18</sup> If a borrower's loan application and subsequent use of funds do not appear to comport with the PPP's regulatory requirements, the borrower could face civil and criminal investigations. Publicly traded companies and their affiliates, as well as private companies "with adequate sources of liquidity," should consult counsel to consider whether any previously borrowed PPP loan funds should be returned prior to May 7, 2020. If the decision is made not to return the funds, the business should fully document why the obtaining of PPP loan funds was "necessary" based on the particular circumstances faced by that business.

\* \* \*

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<sup>17</sup> Cadwalader, Wickersham & Taft, *COVID-19 Update: Federal Investigators Prepare to Investigate and Prosecute Fraud in Emergency Loan Programs* (Apr. 24, 2020), available at <https://www.cadwalader.com/resources/clients-friends-memos/covid-19-update-federal-investigators-prepare-to-investigate-and-prosecute-fraud-in-emergency-loan-programs>

<sup>18</sup> Paycheck Protection Program Loans: Frequently Asked Questions, FAQ #39 (Apr. 29, 2020).

# Clients & Friends Memo

## COVID-19 Update: The Paycheck Protection Program – Loan Participation Transactions

April 26, 2020

On Friday, April 24, 2020, the Small Business Administration (“SBA”) addressed some of the confusion regarding secondary market transactions involving Paycheck Protection Program (“PPP”) loans, at least with respect to participation transactions. In a Procedural Notice to SBA and PPP lenders, the SBA announced that it was lifting certain restrictions on participation transactions involving such PPP loans.<sup>1</sup>

As explained in our prior Clients & Friends memos, “[COVID-19 Update: The SBA's Paycheck Protection Program Explained](#)” and “[COVID-19 Update: The Paycheck Protection Program and the Secondary Market](#),” PPP loans are a form of SBA Section 7(a) loan, a traditional form of SBA guaranteed loan. Confusion has existed since the inception of the Program due to the CARES Act’s statutory language and the nature of the PPP loans and how they are regulated. Section 1102(a) of the CARES Act provides that PPP loans “shall be eligible to be sold in the secondary market consistent with this subsection.” This statement regarding sales in the secondary market was echoed in Treasury Department releases describing the PPP. “This subsection” refers to Section 7(a) of the Small Business Act.<sup>2</sup> On April 17, the SBA and the Treasury Department issued an FAQ reaffirming that “A PPP loan may be sold into the secondary market at any time after the loan is fully disbursed” and that “A secondary market sale of a PPP loan does not require SBA approval.”<sup>3</sup>

Although not addressed in the CARES Act, the SBA’s existing regulations nonetheless impose some limitations on the ability of Section 7(a) loans to be transferred in the secondary market. With respect to participations, existing SBA Section 7(a) regulations require a prior notice for participation transactions up to 90%, and prior consent for participations above 90%.

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<sup>1</sup> <https://content.sba.gov/sites/default/files/2020-04/Procedural%20Notice%20-%20PPP%20Loan%20Participations.pdf>

<sup>2</sup> 15 U.S.C. § 636.

<sup>3</sup> Paycheck Protection Program Loans Asked Questions, FAQ #30 (Apr. 17, 2020), <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>

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Participations can be made only to other SBA lenders. The SBA historically has required a formal Multiparty Agreement for participations above 90%.<sup>4</sup>

Regarding the “notice” concept, it is important to note that the notice concept refers to the transaction, not to the participants. SBA regulations provide that SBA originating lenders may participate away their loans only if pre-approved to do so; the SBA has to first determine that the originating SBA lender is sufficiently sound before it may participate away its loans.<sup>5</sup> Thus, although an SBA lender may enter into 90% (or less) participating transactions subject only to a notice requirement with respect to the transaction, the originating SBA 7(a) lender has to be a lender that has been approved by the SBA to enter into participations.

In the SBA’s Procedural Notice, the SBA announced that it is pre-approving all PPP originating lenders to participate away the PPP loans originated by that lender, effectively granting participation authority to all Section 7(a), Form 3506,<sup>6</sup> and Form 3507<sup>7</sup> PPP originating lenders. The SBA announced that it is maintaining the prior notice requirement, but that all PPP participations may go up to 100% – in effect, eliminating the prior consent requirement for participations above 90%. The SBA further made clear that servicing responsibilities must remain with the PPP originating lender, even in a 100% participation. This suggests that the entity responsible for submitting the PPP forgiveness and guarantee claims to the SBA will be the originating PPP lender.

Most notably, in the Procedural Notice, the SBA indicated that it is maintaining its requirement that the entity acquiring the participation interest must itself be an SBA-regulated entity – *i.e.*, either a Section 7(a) lender, or an entity that is authorized to originate PPP loans after having filed Form 3506 or Form 3507 with the SBA. This announcement by the SBA suggests that for other types of transactions – in particular, whole loan sales – the SBA will expect that the purchaser of the PPP loan also be an SBA-regulated entity (and possibly subject to existing SBA “secondary market” whole loan transfer protocols as well), frustrating some efforts by PPP lenders to sell whole PPP loans to non-SBA regulated entities.

The SBA’s Procedural Notice clears the way for PPP originating lenders to finance their originations by participating away the PPP loans to other SBA-regulated lenders, including most banks. This is

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<sup>4</sup> 13 C.F.R. § 120.432(b).

<sup>5</sup> 13 C.F.R. § 120.433(b).

<sup>6</sup> Form 3506 is the form submitted to the SBA by FDIC-insured depository institutions that do not currently have Section 7(a) loan authority. After submission of the notice, the depository institution is automatically permitted to begin originating PPP loans.

<sup>7</sup> Form 3507 is the form submitted to the SBA by entities other than FDIC-insured depository institutions that do not currently have Section 7(a) loan authority. Such entities may begin originating PPP loans only after the SBA approves.

critical, given the additional \$310 billion in PPP funding approved last week and the resumption of the origination of PPP loans as soon as April 27<sup>th</sup>.

\* \* \*

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# Clients & Friends Memo

## COVID-19 Update: Federal Investigators Prepare to Investigate and Prosecute Fraud in Emergency Loan Programs

April 24, 2020

Emergency COVID-19 relief legislation signed into law by President Trump, including the Coronavirus Aid, Recovery, and Economic Security Act ("**CARES Act**"), has allocated more than \$2 trillion in economic aid to individuals, businesses, non-profits and government entities adversely impacted by the pandemic.<sup>1</sup> Two primary components of the relief legislation are the Paycheck Protection Program ("**PPP**") and the Economic Injury Disaster Loan Program ("**EIDL**") administered by the Small Business Administration ("**SBA**"), which have already supported millions of forgivable and low-interest loans to eligible small businesses and non-profits. Another component is direct funding to the Treasury Department ("**Treasury**"), much of which has been invested in Federal Reserve facilities that will support another \$2 trillion to \$5 trillion in new financing to businesses and government entities facing liquidity issues. The size of these programs dwarfs any prior relief programs, including the \$700 billion Troubled Asset Relief Program ("**TARP**") signed into law by President Bush in 2008 and the \$787 billion American Recovery and Reinvestment Act ("**Recovery Act**") signed into law by President Obama in 2009.

These relief programs aim to prevent widespread economic collapse from the COVID-19 pandemic. But, if past is prologue, another reality looms: many lenders and borrowers of emergency financing will become targets of federal investigators looking to identify and punish fraud and abuse within the federal relief programs.

### Investigations of SBA Loan Fraud

Lenders and borrowers who participate in the PPP, EIDL and other SBA loan programs must comply with numerous rules and restrictions, including those described in guidance provided by the SBA on April 23, 2020,<sup>2</sup> and face potential investigations by the SBA Office of Inspector General

<sup>1</sup> *E.g.*, The Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020 (P.L. 116-123); the Families First Coronavirus Response Act (P.L. 116-127); the CARES Act (P.L. 116-136); and the Paycheck Protection Program and Health Care Enhancement Act (P.L. 116-139).

<sup>2</sup> Paycheck Protection Program Loan Frequently Asked Questions (FAQs) (Apr. 23, 2020), *available at* <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>.

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(“**SBA OIG**”) if their practices do not comply with the law. For instance, a small business owner who inflates average monthly payroll costs or employee headcount to qualify for a larger loan or to avoid repayment of a PPP loan could face criminal liability under the Small Business Act, the False Claims Act, and other federal fraud statutes.<sup>3</sup> Similarly, a business owner or executive who falsely certifies that a business meets the SBA’s applicable size and affiliation rules to qualify for a PPP loan could face criminal liability. The SBA has also warned that all PPP borrowers must certify *in good faith* that “[c]urrent economic uncertainty makes [the PPP] loan request necessary to support the ongoing operations of the [business].”<sup>4</sup>

Loans awarded through the PPP, EIDL and other SBA loan programs fall under the investigative authority of the SBA OIG. The SBA OIG maintains an active caseload of approximately 240 investigations of potential loan fraud, contracting fraud and other wrongdoing—many of which may result in administrative sanctions, civil penalties and even criminal prosecution.<sup>5</sup> Because emergency disaster loan programs like the PPP and EIDL are particularly vulnerable to fraud, the SBA OIG has dedicated resources for oversight.<sup>6</sup> Approximately 20 percent of the SBA OIG’s active caseload involves investigation of fraud in emergency disaster loan programs. These investigations have produced more than 165 criminal indictments and 163 convictions since 2006. Given that millions of emergency loans have been and will be extended through the PPP and EIDL, these numbers are likely to surge.

Like more than 70 other Offices of Inspectors General (“**OIGs**”) throughout the federal government, the SBA OIG holds broad investigative authority under the Inspector General Act (“**IG Act**”) to prevent and detect fraud and abuse in federal programs and operations.<sup>7</sup> The SBA OIG’s

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<sup>3</sup> *E.g.*, 18 U.S.C. § 371 (conspiracy to commit offense or to defraud United States); § 1001 (false statements); § 1341 (mail fraud); § 1343 (wire fraud); § 1344 (bank fraud); and § 1349 (conspiracy to commit fraud).

<sup>4</sup> SBA’s April 23, 2020 guidance states, “[f]or example, it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification.” However, “[a]ny borrower that applied for a PPP loan prior to the issuance of this guidance [on April 23, 2020] and repays the loan in full by May 7, 2020 will be deemed by SBA to have made the required certification in good faith.”

<sup>5</sup> During Fiscal Year 2019, SBA OIG actions resulted in 19 suspensions, 14 debarments and \$72.6 million in potential civil recoveries and fines. During the same period, SBA OIG investigations resulted in 49 criminal indictments by the DOJ and 36 convictions. *See* SBA OIG FY 2021 Congressional Budget Justification, *available at* <https://www.sba.gov/sites/default/files/2020-02/SBA-OIG-FY-2021-CBJ.pdf>.

<sup>6</sup> SBA OIG audits in the past have identified that SBA’s emergency disaster loans are vulnerable to fraud and losses because loan transactions are often expedited in order to provide quick relief and the volume of loan applications can quickly overwhelm SBA’s ability to exercise careful oversight of lending transactions. To combat this, additional funding has been allocated for SBA administration and oversight. For example, the CARES Act more than doubles SBA OIG’s budget request for fiscal year 2021, providing an additional \$25 million in funding.

<sup>7</sup> Congress enacted the IG Act in the wake of the Watergate scandal, creating 12 independent, Presidentially-appointed Inspectors General (“**IGs**”) tasked with preventing and detecting fraud and abuse within federal programs and operations.

investigative authority includes the power to issue subpoenas for documents and other records. The SBA OIG also has direct law enforcement authority under the IG Act, including independent authority to seek and execute search and arrest warrants. However, the IG Act requires the SBA OIG to “expeditiously” refer any criminal activity to the U.S. Department of Justice (“DOJ”), which has been directed to prioritize the investigation and prosecution of all criminal conduct relating to the COVID-19 pandemic.<sup>8</sup>

### Investigations of Treasury-Backed Loan and Securities Fraud

The CARES Act also creates new oversight mechanisms aimed to prevent and detect fraud and abuse of the emergency relief made available. In particular, the CARES Act creates a new Special Inspector General for Pandemic Recovery (“SIGPR”) that is responsible for investigating possible fraud and abuse associated with loans, loan guarantees, and other investments made by the Treasury. The SIGPR’s investigative authority extends to Federal Reserve programs and facilities funded by the Treasury under the CARES Act. For this reason, individuals employed by financial institutions, businesses and other entities that extend or receive financing through COVID-19 emergency facilities also face possible investigation by the SIGPR.

In most respects, the SIGPR resembles the Special Inspector General for the Troubled Asset Relief Program (“SIGTARP”), created in 2008 to investigate fraud and abuse associated with the \$700 billion emergency loan program administered through the Treasury. If the SIGTARP’s activities since 2008 are any indication, the SIGPR is likely to pursue fraud investigations aggressively and refer hundreds of criminal investigations to the DOJ for prosecution. To date, SIGTARP investigations have resulted in over 430 criminal prosecutions by the DOJ and more than 370 convictions for bank fraud, securities fraud, money laundering, mortgage fraud, conspiracy and other criminal offenses.<sup>9</sup> Of more than 290 defendants sentenced to serve time in prison from a SIGTARP investigation, approximately 25 percent were employed by financial institutions and approximately 60 percent were borrowers or homeowners who received assistance through various TARP facilities.

The SIGPR has the same investigative authorities provided to other OIGs under the IG Act, including the power to issue subpoenas and to seek and execute search and arrest warrants.

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Since then, Congress has expanded the number of statutory IGs to more than 70, including the SBA IG, and enhanced their authority to prevent and detect possible fraud.

<sup>8</sup> See Barr Memo to U.S. Attorneys (Mar. 16, 2020), available at <https://www.justice.gov/ag/page/file/1258676/download>; Press Release, Federal Bureau of Investigation, FBI and Secret Service Working Against COVID-19 Threats (Apr. 15, 2020), available at <https://www.fbi.gov/news/pressrel/press-releases/fbi-and-secret-service-working-against-covid-19-threats>; see also DOJ Fraud Alert, <https://www.justice.gov/coronavirus/combatingfraud>.

<sup>9</sup> See SIGTARP Semiannual Report to Congress (Oct. 30, 2019), available at [https://www.sig tarp.gov/Quarterly%20Reports/October\\_30\\_2019\\_Report\\_to\\_Congress.pdf](https://www.sig tarp.gov/Quarterly%20Reports/October_30_2019_Report_to_Congress.pdf); SIGTARP Financial Institution Crimes & Fines Database, available at <https://www.sig tarp.gov/Pages/wd9er7g.aspx>.

Additionally, the SIGPR has certain authorities and responsibilities conferred by the CARES Act. First, the SIGPR is authorized to obtain, upon request, information or assistance from “any department, agency, or other entity of the Federal Government.” Second, the SIGPR is required to report to Congress “without delay” whenever such information or assistance is, in the judgment of the SIGPR, “unreasonably refused or not provided.” This reporting requirement to Congress, rather than an agency head as required of others under the IG Act, is the subject of a signing statement by President Trump, but it is unclear at this time what impact, if any, the President’s signing statement will have on the enforcement of SIGPR subpoenas and requests for information.

### Inter-Agency COVID-19 Investigations

Anyone who extends or receives financing through a federal COVID-19 relief program should also be aware that the new emergency relief legislation directs federal investigators to coordinate their investigations of possible fraud and abuse. In particular, the CARES Act establishes a Pandemic Response Accountability Committee (“**PRAC**”) to coordinate and support oversight of federal spending through the various federal COVID-19 relief programs. The PRAC, housed within the existing Council of Inspectors General on Integrity and Efficiency (“**CIGIE**”),<sup>10</sup> is comprised of several federal IGs, including the SBA IG and the SIGPR, that oversee agencies that will disburse funds made available under the CARES Act or are otherwise involved in the federal response to the COVID-19 pandemic.<sup>11</sup>

The PRAC is largely modeled after the Recovery Accountability and Transparency Board (“**Recovery Board**”), which similarly consisted of federal IGs tasked with overseeing spending covered under the Recovery Act in 2009. The Recovery Board—largely known as the oversight body responsible for the tracking website [www.Recovery.gov](http://www.Recovery.gov)<sup>12</sup>—reportedly claimed in its final month a role in investigations that produced more than 1,665 criminal convictions, pleas and judgments.<sup>13</sup>

Like the Recovery Board before it, the PRAC holds the broad investigative authorities of the individual IGs. The PRAC and its staff are authorized to collaborate with or support any IG in conducting investigations or to conduct independent investigations, and are authorized under the IG Act to issue subpoenas for documents and other records. The PRAC also has authority under

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<sup>10</sup> The CIGIE, created by Congress in 2008 to coordinate and oversee the IG community, is an independent entity established within the executive branch. The CIGIE is comprised of all IGs whose offices are established under the IG Act, those that are Presidentially-appointed/Senate-confirmed and those that are appointed by agency heads.

<sup>11</sup> The IGs for the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation have also been named to the PRAC.

<sup>12</sup> The PRAC is similarly charged with establishing and maintaining a “user-friendly, public-facing website,” effectively deputizing millions of taxpayers to detect and report fraud and abuse of COVID-19 relief to federal investigators.

<sup>13</sup> Charles Clark, “Historic Effort to Track Stimulus Spending Wraps Up,” Government Executive (Sept. 28, 2015), *available at* <https://www.govexec.com/oversight/2015/09/historic-effort-track-stimulus-spending-wraps/122129>.

the CARES Act to issue and enforce subpoenas to compel the testimony of “persons who are not Federal officers or employees.”

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Millions of financial institutions, businesses and non-profits have already extended or borrowed emergency financing under a federal emergency loan program, and many more are expected to participate in the near future. Past experience has shown that when the dust settles, federal IGs will aggressively investigate and prosecute fraud and abuse. If you have questions about your participation in a federal emergency loan program, including the risk of investigation and liability, the attorneys listed below have experience defending allegations of fraud and would be happy to respond to your questions or concerns.

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# Clients & Friends Memo

## COVID-19 Update: Don't Be a Target: What Business Should Know about State Attorney General Reactions to COVID-19

April 24, 2020

In any time of crisis, there is heightened risk for fraud and scams. While United States Attorney General Barr has warned of scams and other illegal acts on the federal level,<sup>1</sup> it is with the state Attorneys General ("AGs") where the rubber hits the road in enforcing social distancing orders, investigating companies for alleged price gouging, continuing ongoing investigations, and overseeing lending relief efforts. As the economy begins to reopen on a state-by-state and sector-by-sector basis, companies must be vigilant in protecting themselves from the next wave of scrutiny by state AGs.

During normal times, state AGs rely upon their state's Consumer Protection Act and Unfair or Deceptive Acts or Practices (UDAP) statutes to fight against perceived fraud. During the COVID-19 crisis, state AGs have taken the additional step of issuing Civil Investigative Demands, mostly focused on the issue of price gouging, or an instance in which a company allegedly inflates prices above a perceived acceptable level based not solely on supply and demand, but also on leveraging, in this case, the COVID-19 pandemic to the detriment of the consumer. Allegations of price gouging often appear during or immediately following natural disasters, an example of which would be heightened prices for essential products such as generators and flashlights in historically hard-hit areas such as Florida or New Orleans during the Atlantic hurricane season. In the current environment, state AGs across the country are each receiving literally hundreds of consumer complaints alleging that companies are similarly raising prices on necessities.<sup>2</sup> Online platforms for third-party sellers are particularly vulnerable to state AGs in this environment, with most people sheltering in place and fulfilling the majority of their purchasing needs through online retail. In fact, 33 state AGs sent a letter to Amazon.com, Inc., Facebook, Inc., Craigslist, Inc. and eBay Inc. to request enhanced procedures to protect against price gouging on their respective platforms.<sup>3</sup> Ironically, companies such as Facebook, Google, Navient, and others that have been targeted by

<sup>1</sup> <https://www.justice.gov/opa/pr/attorney-general-william-p-barr-urges-american-public-report-covid-19-fraud>

<sup>2</sup> <https://www.cadwalader.com/state-attorney-general-insider/index.php?nid=6&eid=34>

<sup>3</sup> [https://www.attorneygeneral.gov/wp-content/uploads/2020/03/03\\_25\\_2020\\_Multistate-letter.pdf](https://www.attorneygeneral.gov/wp-content/uploads/2020/03/03_25_2020_Multistate-letter.pdf)

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state AGs, often on extremely flimsy legal grounds, are now being asked by those same regulators to continue their efforts to step up to assist in this pandemic. And those companies, and so many others, are doing just that.

However, there are indeed some bad actors. In one well-publicized example, two Tennessee men hoarded over 17,000 bottles of hand sanitizer with the intent to sell them for up to \$70 per bottle and was immediately met by an expedited investigation by Tennessee AG Herbert Slatery.<sup>4</sup> Other examples have abounded: Massachusetts AG Maura Healey unilaterally expanded her state's price gouging regulations, which had previously been limited to gasoline and petroleum products, to include "all goods or services necessary for the health, safety or welfare of the public";<sup>5</sup> New York AG Letitia James sent cease and desist letters to merchants that were allegedly engaging in price gouging related to the sale of hand sanitizer and disinfectant;<sup>6</sup> New Jersey AG Gurbir Grewal has sent over 80 cease and desist letters after receiving more than 600 complaints of COVID-19-related price gouging and other related consumer protection violations;<sup>7</sup> Florida AG Ashley Moody activated a "Price gouging Hotline" and opened an investigation into third-party sellers accused of price gouging on essential goods through accounts on Amazon;<sup>8</sup> and finally, 20 state AGs have implored 3M Company to create a database and accounting of the distribution and pricing of 3M's N95 respirator masks, including urging 3M to publish its policies prohibiting price gouging.

Businesses that remain open should be mindful of the additional steps taken to ensure compliance with social distancing regulations. For example, Vermont AG T.J. Donovan issued a directive for law enforcement outlining guidance for the enforcement of the state's COVID-19 Executive Order that, among other things, extended authority to the state Department of Public Safety to inspect the premises and records of any employer to ensure compliance with the Executive Order.<sup>9</sup> Other state AGs are enforcing their states' Executive Orders with similar diligence: New York AG James ordered over 70 medical transportation companies to stop providing group rides;<sup>10</sup> Michigan AG Dana Nessel sent a letter to home improvement store Menards in the wake of reports that the retailer had engaged in business practices that would endanger consumers and employees

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<sup>4</sup> On April 21, 2020, Tennessee AG Slatery announced that a settlement had been reached with the two men to resolve allegations of price gouging; all supplies were surrendered to a nonprofit organization in Tennessee and a portion of the supplies were distributed to officials in Kentucky, and the two men were prohibited from selling emergency or medical supplies grossly in excess of the price generally charged during any declared state of abnormal economic disruption related to the COVID-19 pandemic.

<sup>5</sup> <https://www.mass.gov/news/ag-healey-issues-emergency-regulation-prohibiting-price-gouging-of-critical-goods-and-services>

<sup>6</sup> <https://ag.ny.gov/press-release/2020/ag-james-price-gouging-will-not-be-tolerated>

<sup>7</sup> <https://www.njconsumeraffairs.gov/News/Pages/03172020.aspx>

<sup>8</sup> <http://www.myfloridalegal.com/newsrel.nsf/newsreleases/A32615BF3942B33E8525854300514289?Open&>

<sup>9</sup> [https://www.attorneygeneral.gov/wp-content/uploads/2020/03/03\\_25\\_2020\\_Multistate-letter.pdf](https://www.attorneygeneral.gov/wp-content/uploads/2020/03/03_25_2020_Multistate-letter.pdf)

<sup>10</sup> <https://ag.ny.gov/press-release/2020/attorney-general-james-orders-78-transport-providers-immediately-stop-endangering>

contrary to the Executive Order issued by Michigan Governor Gretchen Whitmer;<sup>11</sup> and Delaware law enforcement officials even issued cease and desist orders to a barber shop and a tobacco shop.<sup>12</sup>

As the economy begins to incrementally 'reopen' in the weeks and months to come, companies should document every step taken to protect their customers and employees as well as the rationale underlying those measures. The far-reaching effects of the COVID-19 pandemic are unlikely to subside until a vaccine becomes publicly available. Thus, state AGs are likely to continue to probe companies aggressively about safety measures taken to protect their customers and employees; adherence to government policies and interpretative guidance; their definition of essential employees; and whether the company contributed to the spread of the virus.

State AGs are the top law enforcement officers in their states and will continue to act to protect their citizens during, and long after, the COVID-19 crisis is over. Industry should be on the lookout for measures taken by state AGs to identify and prosecute fraud and perceived price gouging during the COVID-19 pandemic, and should comply with laws and Executive Orders as diligently as possible. What constitutes the requisite compliance with social distancing – both now and as the economy begins to reopen – and what constitutes an essential service are often somewhat subjective and may require the consult of counsel. Cadwalader's state AG practice is regularly in close communication with state AG offices and is well-positioned to provide guidance to clients that may be in receipt of an inquiry from a state AG, and we stand ready to continue to assist clients as they navigate the implications of the COVID-19 pandemic.

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<sup>11</sup> <https://www.michigan.gov/coronavirus/0,9753,7-406-98158-523976--,00.html>

<sup>12</sup> <https://www.delawarepublic.org/post/delaware-flagging-non-essential-businesses-open-during-shutdown>

# Clients & Friends Memo

## COVID-19 Update: Restrictions on Short Selling in the UK and European Union – An Update

22 April 2020

### Introduction

Five EU member states have extended their temporary bans on short selling imposed in line with the emergency process permitted by the EU Short Selling Regulation, despite increased pressure from hedge funds to remove the current restrictions.<sup>1</sup> Regulators in Austria, Belgium, France, Greece and Spain have now extended the bans (which were due to expire in the coming days) until mid-May, arguing that the restrictions are necessary to stabilise stock prices. Italy's ban will also continue until mid-June.

These are extensions to the temporary bans on the short selling of shares in response to the extreme volatility in equity markets caused by the COVID-19 pandemic described in our recent [memo](#).

### UK & U.S. Regulators – A Different Approach and Attitude to Short Selling

As noted previously, the UK (as well as Germany in the EU) have not banned short selling and appear disinclined to do so. The UK Financial Conduct Authority (“FCA”) continues to monitor market activity and has stated it will not rule out a ban if it considers such a prohibition necessary, but for the moment notes that “*net short selling activity [...] is low as a percentage of total market activity [and there is] no evidence that short selling has been the driver of recent market falls*”.<sup>2</sup>

In the U.S., the Securities and Exchange Commission (“SEC”) continues to push back against any suggestion that short selling should be banned during the COVID-19 crisis. Jay Clayton, the current SEC Chairman, recently stated that short selling is critical “*in order to facilitate ordinary*

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<sup>1</sup> European stocks dropped by around 30% in March, but a recovery of around 15% had led a number of funds to claim that further extensions would be damaging and push up the all-in costs of trading.

<sup>2</sup> See Financial Conduct Authority, ‘*Statement on UK Markets*’, accessible here: <https://www.fca.org.uk/news/statements/statement-uk-markets>.

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*market trading*".<sup>3</sup> While emergency orders were issued by the SEC during the 2008 financial crisis prohibiting short selling in a wide array of financial stocks (and requiring institutional money managers of a certain size to report short sales to the SEC on a weekly basis), the SEC stated that such orders were issued only because investors were aggressively short selling financial institution stocks which created sudden price declines in securities that were unrelated to true price valuation. Following the short sale ban, the former SEC Chairman, Christopher Cox, expressed regret with the decision, which would seem to indicate his scepticism that stock market prices had become disconnected from real values,<sup>4</sup> and noted that he believed the SEC would not ban short sales again as the costs "*appear to outweigh the benefits*".<sup>5</sup>

### Discussion

UK and U.S. market regulators have a different attitude towards short selling as compared to some EU countries. They believe the ability to take "long" and "short" positions is particularly important in many investment and risk management strategies and can benefit a wide range of investors (including pension funds for employees of companies and local government). In addition, a significant number of hedge fund investors maintain balanced long and short positions; if they are unable to increase or were required to reduce short position it would have a corresponding effect on their ability to increase or maintain long positions. Further, short selling is generally seen by UK and U.S. market regulators as a critical underpinning of the provision of liquidity by market makers,<sup>6</sup> the loss of which they will carefully balance before intervening to restrict or prevent. Consequently, it seems likely that regulators in both jurisdictions will resist the implementation of temporary bans on the short selling of shares in response to the COVID-19 crisis, despite the action taken (and extension of restrictions imposed) by other European countries. Both regulators have, however, confirmed their commitment to monitoring the situation and taking action if they deem necessary in the coming weeks.

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<sup>3</sup> See P. Kiernan, '*SEC Chairman: Government Shouldn't Ban Short Selling in Current Market*', Wall Street Journal, accessible here: <https://www.wsj.com/articles/sec-chairman-government-shouldnt-ban-short-selling-in-current-market-11585568341>.

<sup>4</sup> It is not in fact clear how one would demonstrate such a disconnect or if the disconnect really existed. While among major firms, only Lehman became insolvent, other firms were saved from failure only because of government intervention in one form or another.

<sup>5</sup> See R. Younglai, '*SEC chief has regrets over short-selling ban*', Reuters, 31 December, 2018.

<sup>6</sup> The SEC note, for example, that short selling "*contributes substantially to overall market quality through its positive effects on price efficiency and market liquidity*". See Division of Economic and Risk Analysis of the U.S. Securities and Exchange Commission, '*Short Sale Position and Transaction Reporting*', accessible here: <https://www.findknowdo.com/sites/default/files/2014/06/05/00/short-sale-position-and-transaction-reporting.pdf>

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# Clients & Friends Memo

## COVID-19 Update: UK Government Launches Convertible Loan Scheme for Start-Ups; Announces Additional Funding for Innovate UK

22 April 2020

### Introduction

On 20 April 2020, the UK Treasury [announced](#) a support package aimed at helping start-ups whose businesses are facing financial difficulties due to the COVID-19 pandemic. "Future Fund" is being created, pursuant to which the government will offer convertible bridging loans of £125,000 - £5 million to eligible high-growth companies, provided the government investment is matched by private money. The total size of the government's initial commitment to Future Fund is £250 million. It will initially be open from May until the end of September, and the scale of the fund will be kept under review. In addition, £750 million is being added to the existing Innovate UK program, which is a scheme providing grants and loans to small and medium-sized firms focused on R&D.

This follows pressure from many in the start-up community urging the government to focus on the needs of businesses in this important sector of the economy, many of whom have found themselves ineligible to participate in the COVID-related lending schemes previously announced in the UK (*see* our memo [here](#)).

### The Future Fund

The Future Fund is to comprise an initial £250 million of funding from the UK Government, with private investors (excluding angel investors), at least matching that commitment. The initial commitment will be open from May until the end of September. Certain details as to the mechanism for accessing the Future Fund are as yet unclear, but the Treasury has published a [partial term sheet](#), highlighting the following features of loans granted under the scheme:

**Eligibility.** To be eligible for a Future Fund bridging loan, a company must:

- a. be an unlisted UK registered company;
- b. have raised at least £250,000 in aggregate from private third party investors in previous funding rounds in the last five years; and
- c. have a substantive economic presence in the UK.

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Note that if a company is a member of a corporate group, only the ultimate parent company, if a UK registered company, is eligible to receive the loan. Further, the Government's guidance on the Future Fund (accessible [here](#)) provides that full eligibility criteria will be published shortly, and therefore additional criteria may apply.

**Loan Size.** The amount of the Bridge Funding provided by the Future Fund will be:

- a. a minimum of £125,000; and
- b. a maximum of £5 million.

The amount contributed by the Future Fund must be at least matched by private investors (the “**matched investors**”), though there is no upper limit on the amount that may be provided by private investors, so even larger bridge financings can take advantage of this scheme.

**Use of Proceeds.** The Bridge Funding must be used solely for working capital purposes and cannot be used by companies to repay any borrowings, make any dividends or bonus payments to staff, management, shareholders or consultants, or, in respect of the Government loan, pay any advisory or placement fees or bonuses to external advisers.

**Conversion.** The Bridge Funding will be convertible into equity in the following circumstances:

- a. *Automatic Conversion on a Qualifying Funding Round.* The Bridge Funding will automatically convert into equity in the debtor's next funding round equal to or exceeding the total amount of the Funding excluding shares issued on conversion of the Bridge Funding and any shares issued upon exercise of employees/consultants' options (a “**Qualifying Funding Round**”). The lenders will benefit from a conversion price for outstanding principal with at least a 20% discount (the “**Discount Rate**”) to the equity price set by that round (unless a higher discount rate is agreed). In all conversions, the Discount Rate will apply only to the conversion of principal, and any unpaid accrued interest will be converted without the Discount Rate.
- b. *Optional Conversion on a Non-Qualifying Funding Round.* The Bridge Funding may also be converted into equity on a funding round that does not meet the size test to be a Qualifying Funding Round, at the option of the holders of a majority in principal amount held by the matched investors. The conversion price will reflect the Discount Rate to the price set by that non-qualifying round.
- c. *Conversion or Repayment on a Sale or IPO.* If the Bridge Funding has not been converted prior to a sale or IPO, it will either:
  - i. convert into equity at the price set by the most recent non-qualifying funding round after the issuance of the Bridge Funding discounted by the Discount Rate<sup>1</sup>; or
  - ii. be repaid with a 100% redemption premium (being a premium equal to 100% of the

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<sup>1</sup> If no such funding round has occurred, the conversion price will not include a Discount Rate.

principal of the bridge funding) (the “**Redemption Premium**”),

whichever will provide the higher amount for the lenders.

- d. Conversion or Repayment on Maturity. At maturity, the Bridge Funding will either:
- i. convert into equity at the price set by the most recent non-qualifying funding round after the issuance of the Bridge Funding discounted by the Discount Rate<sup>2</sup>; or
  - ii. be repaid with a Redemption Premium,

at the option of the holders of a majority of the principal amount held by the matched investors.

**Interest Rate.** The interest rate on any loan will be 8% *per annum* (non-compounding) unless a higher rate is agreed upon between a company and matched investors.

**Term.** Each loan under the Future Fund will mature after a maximum of 36 months.

**Warranties.** Companies will provide limited, standard warranties (including those relating to title and ownership, capacity, loan eligibility in accordance with the Government eligibility criteria, compliance with laws, the borrowing facilities of said company, litigation and insolvency events to the lenders on closing of the loan).

**Covenants.** Companies will provide limited covenants to the Government during the term of the loan (and as a shareholder following conversion of the loan), including undertaking to treat the lenders and the holders of the conversion equity fairly and equally and to provide the Government with the same information rights as other investors in said company, and to comply with legal obligations.

**Most Favoured Nation.** Where a company issues further convertible loan instruments to investors (including any new or existing investors which are not matched investors) with more favourable terms, those terms will apply to the bridge funding provided under the Future Fund.

**Negative Pledge.** Companies will not be permitted to create any indebtedness that is senior to the Future Fund loan other than any *bona fide* senior indebtedness from a person that is not an existing shareholder or matched investor.

**Transfer Rights.** The Government will be entitled to transfer the loan and any conversion shares to any institutional investor which is acquiring a portfolio of the Government's interest in at least ten

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<sup>2</sup> If no such funding round has occurred, the conversion price will not include a Discount Rate.

companies owned in respect of the Future Fund. The Government will also be entitled to transfer any of its shares within the Government and to entities wholly owned by central government departments.

Note that the full terms of the Future Fund have yet to be finalised, and will be published by the Government in due course.

#### **Targeted Development Support**

In addition to the Future Fund convertible loan program, the Treasury have also announced £750 million will be available for grants and loans to R&D-intensive small and medium-sizes firms through Innovate UK.<sup>3</sup> Of that amount, £200 million will be used by Innovate UK to assist its 2,500 existing customers (on an opt-in basis), with the additional £550 million to be made available to fund R&D activity by additional businesses. It is understood that £175,000 of support will be offered to around 1,200 firms not currently in receipt of Innovate UK funding. The first payments under this scheme are anticipated to be made by mid-May.

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<sup>3</sup> Innovate UK is the UK's national innovation agency, a non-departmental public body operating at arm's-length from the Government as part of the United Kingdom Research and Innovation organisation.

# Clients & Friends Memo

## COVID-19 Update: The Impact of COVID-19 on Financial Contracts

April 20, 2020

The current market volatility arising from the restrictions imposed to reduce the risk of spread of COVID-19 has led many market participants to consider their position under existing contractual relationships, including, assessing their own obligations and whether any potential or actual event of default has occurred in respect of their counterparty. This memo illustrates practical issues to be taken into account by a counterparty to a financial contract in making these considerations using, as an example, a derivative transaction<sup>1</sup>.

### What do I Need to Diligence Under My Existing Financial Contracts Given Current Events?

*Do market closures affect my obligations?*

The impact of COVID-19 has led to unprecedented measures being put in place in many jurisdictions around the world which have, or may in the future have, the effect of closing markets in a variety of locations. These closures, and the location of the markets which are subject to closure, will need to be carefully considered to determine their impact on a party's position under a financial contract.

For example, the standard form ISDA Master Agreement (both the 1992 version and the 2002 version) contains a number of provisions which utilise the concept of Local Business Day or General Business Day which are defined, depending on their use, by reference to whether commercial banks or settlement systems are open in various places, locations or cities. These definitions are used to determine the due date for payment obligations, the calculation of interest, and whether a notice has been effectively served. Further, financial contracts may also contain product-specific provisions dealing with market closure, for example, the provisions relating to

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<sup>1</sup> The example of a derivative transaction is used as market volatility can immediately result in margin requirements in transactions with daily mark-to-market provisions. However, as the facts and specific provisions of each contractual relationship will vary from case to case, market participants should seek tailored legal advice.

Pricing Disruption Events and Settlement Disruption Events under ISDA's Equity Derivatives Definitions.

*Do any force majeure provisions affect my obligations?*

The expression “force majeure” clause refers to a provision that is commonly found in commercial agreements, by which one (or both) of the parties are entitled to cancel a contract, or are excused from performance of the contract (in whole or in part), or are entitled to suspend performance or to claim an extension of time for performance, upon the occurrence of a specified event (or events) beyond a party's control. The 2002 ISDA Master Agreement, for example, provides for the imposition of a “waiting period” following the occurrence of an Illegality or a Force Majeure Event, among other consequences.

A number of force majeure clauses have been tested before the English courts. The tendency of the courts has been to construe such provisions restrictively or to subject them to implied limitations. The onus is on the party seeking to rely on the force majeure clause to demonstrate that the facts in question fall within its scope, properly construed. Parties are not generally able to rely on a force majeure type provision where the impossibility is self-induced — in this context, compliance with governmental guidance following the outbreak of COVID-19 may be particularly relevant.

It can be crucial to identify any applicable force majeure clauses, and any other provisions dealing with supervening events such as impossibility or illegality, as the availability of protection provided by the clause may be contingent on correctly invoking it (i.e. by following a certain procedure, or by providing notice in a particular manner, within a stipulated time period). Depending on the particular contract, such procedures or formalities may be construed as strict conditions precedent, or merely as intermediate terms, the non-fulfilment of which does not necessarily deprive a party of the right to rely on the clause. Even the party who is not relying on the clause should act with care, for there is a risk it may be held to have waived, or to be estopped from asserting, any non-compliance with the contractual procedures for invoking the force majeure clause.

*Will the doctrine of “frustration” excuse non-performance?*

The English law doctrine of frustration operates (within narrow confines) to bring a contract prospectively to an end because of the effect of a supervening event. It has been said to arise in circumstances where a supervening event renders the performance of the bargain “radically different”, when compared to the considerations in play at the conclusion of the contract. The doctrine is narrow and cannot be lightly invoked before the English courts.

Where express provision has been made in the contract itself for the event which has actually occurred, the contract cannot be treated as frustrated. While boilerplate force majeure provisions in

some industry documents may expressly refer to pandemics, such express reference is unusual in ISDAs or other financial contracts. That said, the relevant force majeure event (or impossibility/illegality event) may not be COVID-19 itself, but rather the measures taken by governments to control its spread, and careful consideration is therefore necessary.

A key point to bear in mind is that the doctrine of frustration, if it operates, brings the contract to an end immediately, without more and automatically. It does not require an act by the parties to the contract. The essence of frustration is that it should not be due to the act or election of the party seeking to rely on it. Given that the consequence of frustration is to discharge and release the parties from all future obligations, its operation may adversely affect the position of an innocent party looking to rely on the future performance of close out provisions under an ISDA agreement. The remedies for frustration are usually restitutionary in nature, i.e. they aim to restore the parties to the position they would have been in had the transaction not been entered into.

### **My Counterparty is in Default - What Steps do I Need to Take?**

*What evidence of a cross-default do I have?*

Financial contracts may include cross-default provisions allowing a party to declare a default where, although the counterparty is complying with its other obligations under that contract, it is in default under another contract. In considering whether to take steps in respect of a potential cross-default, parties should first consider if they have clear evidence of the relevant cross- default according to the contractual criteria (i.e., not just market rumour - to avoid wrongful termination). For example, if the counterparty has listed debt, notifiable defaults may be discovered through announcements on the relevant stock exchange.

*Can I suspend my payment obligations to a defaulting party?*

If the contract allows it, the non-defaulting party will need to consider whether, and for how long, it can suspend its payment obligations to a defaulting party under the contract. Such clauses, under derivatives contracts, have been extensively litigated following the Lehman collapse<sup>2</sup>. The English courts ruled that a non-defaulting party under an ISDA Master Agreement can, under section 2(a)(iii), refuse to make payments to a defaulting party while a potential or actual event of default is continuing. Payment obligations remain suspended (potentially indefinitely), while the condition precedent (that no potential or actual event of default has occurred in respect of the other party) remains unfulfilled, and will revive once the default is cured or the non-defaulting party elects to terminate the transaction. Payment obligations are not extinguished by reason of maturity of the transaction (that is, the last date fixed for contractual performance), and amounts continue to accrue while the condition is unfulfilled. The English courts have refused to imply terms into the

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<sup>2</sup> For example, *Lomas and others v JFB Firth Rixson Inc and others* [2012] EWCA Civ 419

ISDA Master Agreement requiring the non-defaulting party to terminate the transaction and pay the defaulting party.

*Do I risk waiving a default if I do not enforce immediately?*

Subject to any express provisions to the contrary, if an event of default occurs under an ISDA Master Agreement, the non-defaulting party may, at any time while the event is continuing, and provided that it has not affirmed the agreement (for example, by continuing to perform it after becoming aware of the default) close out all the outstanding transactions under it.

It is a question of fact whether an affirmation or waiver has occurred following a breach of contract. If the non-defaulting party continues to perform without protest for a significant period after learning of an event of default, this may be construed as an election to abandon its right to terminate<sup>3</sup>, notwithstanding contractual provisions expressly providing that a party's delay in exercising its rights will not operate as a waiver or preclude it from subsequently exercising those rights.

In cases of implied affirmation there will usually need to be some sort of unequivocal act from which it may be inferred that the party intends to go on with the contract regardless of the breach. Mere inactivity after breach does not of itself amount to affirmation<sup>4</sup>. To avoid any suggestion that the contract has been affirmed during periods of negotiation and forbearance from enforcement, parties are advised (ideally with input from counsel) to make clear and express reservations of all rights under the contract and to consider the appropriateness of standstill agreements which could be put in place.

*How do I effectively deliver a termination/default notice?*

In current circumstances surrounding COVID-19, there may be practical difficulties and uncertainties surrounding the effective service of contractual notices, such as:

- If the address states a particular floor of a building, does putting a notice through a letter box, or leaving it with security, constitute valid delivery?
- If the recipient's office is closed, has a fax actually been delivered to a responsible employee?
- If registered mail is sent, is it enough that delivery is attempted?

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<sup>3</sup> See *Tele2 International Card Co SA v Post Office Ltd* [2009] EWCA Civ 9, where on the facts there was continued performance of the agreement for nearly a year without any protest or reserve of any kind.

<sup>4</sup> On the facts of *Edge Tools & Equipment Ltd v Greatstar Europe Ltd* [2018] EWHC 170 (QB) at 65 it was said that inaction over a 10-month period would have sufficed to amount to an affirmation of the contract by conduct.

- If it is impossible to deliver using any of the methods that the contract prescribes, how likely is the court to find an implied term in the contract that notice may be delivered in another way?
- What if the contractual methods for delivery are impracticable or inconvenient, but not impossible?
- If my contract provides that it terminates automatically upon certain events, should I still notify the counterparty, to avoid doubt about the date and time of termination?

When exercising a contractual right under English law that depends on service of a written notice (including the right to terminate), failure to strictly comply with any express formal requirements and/or pre-conditions in the contract will normally invalidate the notice. A prematurely issued notice to terminate a contract, for instance, may be found to be wrongful and constitute a renunciation of the contract. An incorrectly issued notice (to the wrong address or via the wrong method of communication), on the other hand, may be found to be invalid and ineffective altogether.

In the context of the ISDA Master Agreement, it has been held by the English High Court that the methods of service for notices and other communications are mandatory and the only means of effective service<sup>5</sup>. This means that any potential solutions to the practical difficulties in serving notices arising from office and other closures as a result of COVID-19 that rely on non-contractual methods of service, for example e-mail (which is expressly excluded as a method of service for notices of default under the ISDA Master Agreements) may be open to challenges. As witnessed during the Lehman crisis, issues surrounding whether a notice has been effectively served and the date of such service can quickly escalate into disputes either about the effectiveness of the termination, or about the correct day for subsequent valuations.

It is therefore paramount to check any information regarding addressees and addresses, as well as the specified method of delivery and date of effectiveness, provided for in the contract for notices of the particular kind in question. The golden rule in normal circumstances is to follow the contract to the letter, and to keep a solid evidentiary record.

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<sup>5</sup> Greenclose Ltd v National Westminster Bank Plc [2014] EWHC 1156 (Ch), 128

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# Clients & Friends Memo

## COVID-19 Update: Banking Agencies Issue Temporary Deferral of Appraisals and Evaluations for Real Estate Transactions

April 17, 2020

On April 14, 2020, the Federal Reserve, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation issued an interim final rule to temporarily defer real estate appraisals and evaluations under interagency appraisal rules.<sup>1</sup> The interim final rule provides a 120-day deferral of appraisal and evaluation requirements for all transactions secured by commercial or residential real estate during the COVID-19 pandemic (which for purposes of the interim final rule extends to December 31, 2020, unless extended by the federal banking agencies), other than transactions for acquisition, development, and construction of real estate. It does not revise any of the existing appraisal exceptions or any other requirements with respect to the performance of evaluations. Under the interim final rule, regulated institutions may close a real estate loan without a contemporaneous appraisal or evaluation, subject to the requirement that they obtain appraisals or evaluations within a grace period of 120 days after the closing of the transaction. Notwithstanding the interim final rule, the federal banking agencies expect institutions to use best efforts and available information to develop a credible, well-informed estimate of the collateral value of the subject property before the loan closing, and otherwise underwrite loans consistent with the principles contained in interagency standards. The deferral will expire on December 31, 2020, unless extended by the federal banking agencies.

In conjunction with the interim final rule, the federal banking agencies, together with the National Credit Union Administration and the Consumer Financial Protection Bureau, issued an interagency statement that outlines existing flexibilities in industry appraisal standards and federal appraisal regulations.<sup>2</sup> It also summarizes temporary changes to Fannie Mae and Freddie Mac appraisal standards that can assist lenders in light of the COVID-19 pandemic.

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<sup>1</sup> Interim Final Rule, Real Estate Appraisals (Apr. 13, 2020), available [here](#).

<sup>2</sup> Interagency Statement on Appraisals and Evaluations for Real Estate Related Financial Transactions Affected by the Coronavirus (Apr. 14, 2020), available [here](#).

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# Clients & Friends Memo

## COVID-19 Update: FCA Sends “Dear CEO” Letter to UK Banks on Lending to SMEs and Responsibilities of Senior Managers

April 17, 2020

On 15 April 2020, the UK Financial Conduct Authority (“**FCA**”) published a “Dear CEO” [letter](#) sent to the leaders of UK banks on lending to small and medium-sized enterprises (“**SMEs**”) during the COVID-19 pandemic.

The context for the letter is the package of measures announced by the UK Government and the UK regulators to support businesses and employees during the economic disruption caused by the COVID-19 pandemic. In particular, the letter references the critical role for the banking sector in providing support to SMEs through the Coronavirus Business Interruption Loan Scheme (“**CBILS**”)<sup>1</sup>. There has been some criticism from SMEs and industry bodies regarding the low level of approvals under the CBILS and the amount of time it has taken for banks to process applications.

In its letter, the FCA notes that the activity of lending to an SME generally falls outside of its regulatory jurisdiction, but that the Senior Managers and Certification Regime (“**SMCR**”) defines Senior Managers' responsibilities and accountability in a way that applies to unregulated activities (such as corporate lending) conducted by a bank.

The letter sets out the FCA's expectations of CEOs and bank boards in respect of SME lending, including the following key points:

- Each bank should have at least one Senior Manager (as defined in the SMCR) with clear responsibility for the activity of lending to SMEs.
- The FCA will take into account the Lending Standards Board's Standards of Lending Practice for business customers when considering how Senior Managers and other relevant employees, under the SMCR, discharge their duties in relation to SME lending.

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<sup>1</sup> For more details on CBILS, see our Clients & Friends memorandum dated 30 March 2020, available [here](#).

- Bank CEOs and boards should take reasonable steps to ensure that the Senior Manager with responsibility for small business lending is discharging their responsibilities suitably and effectively.
- The FCA will look for evidence that the CEOs and boards are collecting information on the banks' treatment of SME customers and, where appropriate, challenging the relevant Senior Manager(s) about that treatment.

The FCA warns that its objective is to ensure that that there must not be a repeat of "well documented historic issues" in banks' treatment of SMEs. The FCA strikes a more emollient tone, however, in that it states it will recognise that that banks may now be making different judgements, and adopting a different risk tolerance than they would before the COVID-19 pandemic to support SMEs. The FCA also recognises that controls in relation to the treatment of SMEs by regulated firms have strengthened in recent years.

The letter also notes that that the FCA has established a new small business unit, in operation from 15 April 2020, which will co-ordinate the activities of the FCA across small business issues, support regulated firms operating in this sector during the COVID-19 crisis and gather intelligence about the treatment of SMEs.

The letter serves as important reminder that the FCA's Principles for Businesses apply across the business of a regulated firm, even where some of the firm's activities fall outside the regulatory perimeter. In particular, the letter highlights the importance of CEOs, Boards and relevant Senior Managers receiving timely and accurate information about a bank's treatment of SME customers and the need to be able to demonstrate that SME customers have been treated fairly during the COVID-19 pandemic.

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# Clients & Friends Memo

## COVID-19 Update: Revisiting Pre-Negotiation Agreements in the Era of Covid-19

April 16, 2020

While the ramifications of the Covid-19 pandemic for real estate lenders and borrowers will unfold over time, at this point we know that lenders and borrowers will be communicating frequently and extensively regarding potential loan modifications and other accommodations. Lenders are well advised to insist on a pre-negotiation agreement, often referred to as a “PNA,” as a prerequisite to these communications.

A PNA is an agreement between a borrower and a lender intended to permit the lender to communicate with the borrower regarding a possible loan modification, waiver or other accommodations without prejudicing the lender’s ability to enforce the loan documents. The primary purpose of the agreement is to preserve the status quo over the course of negotiations and to prevent the borrower from using the negotiations as a basis for opposing any pending or potential enforcement efforts by the lender, or as a basis for bringing lender liability claims against the lender, by asserting that over the course of negotiations the lender committed to modify the loan documents, that correspondence exchanged during the negotiations itself constituted a loan modification, that the borrower justifiably relied on statements of the lender in forgoing refinancing opportunities and in incurring transaction costs, etc. Even if a borrower is ultimately unable to prevail on these claims, their potential use in opposing a lender’s motion for summary judgment and thereby prolonging an enforcement proceeding and increasing the borrower’s leverage should be of concern to the lender. The lender will typically require parties that entered into guaranties with respect to the loan to join in the PNA in order to prevent the guarantors from making similar claims, and to prevent the guarantors from asserting that the PNA itself precluded certain defenses and thereby increased the guarantors’ risk and raising so-called “surety defenses” on that basis.

It is advisable to enter into a PNA as soon as the lender anticipates negotiations with the borrower. In normal times, this would mean when a default occurs, when the borrower approaches the lender with a request to discuss a modification or waiver, or when a default is reasonably anticipated (e.g., when the lender has reason to believe that the borrower will be unable to refinance or satisfy the conditions to the exercise of an extension option on an approaching maturity date or to satisfy any

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other requirements under the loan documents, such as making a scheduled amortization payment or continuing to pay monthly debt service). Under current circumstances, the universe of loans for which these events can be anticipated has dramatically expanded.

From the lender's perspective, a PNA should at a minimum include those provisions necessary to preserve the status quo during the course of negotiations. These typically include agreements to the effect that (i) negotiations, which should be defined broadly to include all discussions, meetings, conferences, correspondence, e-mails, exchange of term sheets and draft documents and all other communications, are non-binding unless and until a binding written agreement has been executed and delivered, (ii) either party has the right to, at any time, terminate discussions in its sole discretion, for any or no reason, (iii) the borrower has no right to rely on the negotiations resulting in a settlement and should not forgo refinancing opportunities, and (iv) the PNA does not constitute an agreement on the lender's part to forbear from exercising its rights and remedies under the loan documents during the course of the negotiations. While an agreement to forbear is sometimes entered into in connection with workout discussions, that is usually documented under a separate forbearance agreement that is negotiated and entered into subsequent to the PNA. A forbearance is often more complicated than a PNA and involves more negotiation. Entering into a PNA prior to the negotiation of a forbearance agreement gives those negotiations the protection of the PNA and permits concurrent discussion of both forbearance and ultimate settlement terms. To reiterate, a PNA simply preserves the status quo as to discussions between the borrower and lender and provides that the discussions themselves are not binding. A PNA is NOT a forbearance, and the lender retains the right to commence, continue, discontinue, pursue or otherwise exercise its remedies notwithstanding the existence of the PNA. Typically, however, a lender would not be aggressively pursuing its remedies when a PNA has been entered into.

In a syndicated loan, the PNA is entered into by the administrative agent and covers any discussions between the borrower and the administrative agent, as well as any discussions between the borrower and other lenders in the syndicate. While the co-lenders are named and all provisions are also for their benefit and protection, the co-lenders, however, will usually not be signatories to a PNA and will rely on the ability of the administrative agent to protect their interests. In addition, to preserve the unity of the lending group, a PNA covering a syndicated loan will typically provide that the borrower may discuss the loan only with the administrative agent. Where a property is financed by both mortgage and mezzanine loans, the mortgage lender and the mezzanine lender should each enter into a separate PNA with its respective borrower. The holder of any preferred equity should also consider entering into a PNA in order to protect its interests over the course of workout discussions.

The lender will typically want the PNA to cover past as well as future discussions. While technically this goes beyond preserving the status quo as of the date that the PNA is entered into, a lender might find it unacceptable for a borrower to preserve its right to make claims on the basis of an

initial conversation that it had with the borrower before the PNA was prepared and entered into. It is advisable for lenders to make every effort to defer these conversations until the PNA is entered into. Beyond the sanitizing of such past discussions, PNA's will sometimes include some or all of the following, which are advantageous to the lender: (i) a ratification of the existing loan documents, (ii) a statement of the outstanding amount of the debt, (iii) an acknowledgement that the lender has performed all of its obligations under the loan documents, (iv) where the loan is in default, an acknowledgement of the default and a waiver of defenses, (v) a release of claims against the lender, and (vi) an agreement that authorizes the lender to discuss the loan and the property with other parties providing debt and equity financing to the property and other creditors. Inclusion of the above can be helpful to the lender both in pursuing an enforcement proceeding and in protecting itself from lender liability claims. Whether and the extent to which the above are included are typically determined by negotiations between the lender and borrower, and their inclusion or exclusion ultimately depends upon the particular circumstances and the relationship and relative bargaining power.

Pre-Negotiation Agreements are widely required by real estate lenders as a matter of policy and borrowers have come to understand and accept that they are necessary for lenders to obtain in order to discuss loan modifications and waivers, and that there is no stigma attached to them. While the circumstances brought about by the pandemic are extremely unfortunate, and while neither borrowers nor lenders are responsible for the economic hardships that it is inflicting, PNA's are both appropriate and necessary to facilitate the discussions that will be required to mitigate the pandemic's consequences.

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# Clients & Friends Memo

## COVID-19 Update: Anticipating Securities Litigation in Response to the Pandemic

April 16, 2020

As COVID-19 has continued to spread globally, U.S. and foreign markets have been dramatically impacted, leading to the largest declines in stock prices since the 2008 credit crisis.<sup>1</sup> Given the extreme market volatility associated with the ongoing COVID-19 pandemic, a significant rise in stock-drop securities litigation seems likely. This is particularly so given the pre-existing trend of increased securities class action filings, even before the onset of COVID-19.<sup>2</sup> Indeed, investors already have filed at least two civil suits alleging that a public company violated the federal securities laws by making misleading public statements concerning COVID-19.<sup>3</sup> Others almost surely will follow.

This memorandum provides an overview of event-driven securities litigation, including the tools employed by the plaintiffs' bar in response to previous crises, and offers guidance for mitigating the risk of COVID-19-based securities litigation, including key defensive strategies for dismissing event-driven securities litigation at the pleading stage.

### Background: Event-Driven Securities Litigation Based on Allegations of Material Misrepresentations or Omissions

While the circumstances presented by COVID-19 are unprecedented, the plaintiffs' bar is likely to draw on the same tools employed in prior crises. Under Section 10(b) of the Securities Exchange

<sup>1</sup> See, e.g., Gunjan Banerji, Anna Isaac & Joanne Chiu, *U.S. Stocks Drop Despite Fed's Latest Stimulus Move*, Wall St. J., <https://www.wsj.com/articles/global-stock-markets-dow-update-3-23-2020-11584925602> (Mar. 23, 2020, 4:38 PM); Gunjan Banerji, *Stocks Suffer Biggest Weekly Losses Since 2008*, Wall St. J., <https://www.wsj.com/articles/more-markets-head-toward-correction-territory-as-coronavirus-spooks-investors-11582864550> (Feb. 28, 2020, 6:36 PM).

<sup>2</sup> See Cornerstone Res., *Securities Class Action Filings: 2019 Year in Review* at 3 (2020), <https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2019-Year-in-Review.pdf> ("Unlike in earlier years with heightened levels of filings (e.g., at the time of the dot-com bust or the financial crisis), the current peaks have occurred despite a lack of financial market turbulence."). During 2019, plaintiffs filed 428 federal securities fraud class actions, surpassing 2017's record high of 413. This was nearly double the average number of filings over the past two decades. There were more than 1,200 filings from 2017 to 2019—a number that accounts for nearly 25% of all of the filings in the more than 20 years since 1997. *Id.* at 44.

<sup>3</sup> See Complaint, *Douglas v. Norwegian Cruise Lines*, No. 1:20-cv-21107-RNS (S.D. Fla. Mar. 12, 2020), ECF No. 1; Complaint, *McDermid v. Inovio Pharm., Inc.*, No. 2:20-cv-01402-GJP (E.D. Pa. Mar. 12, 2020), ECF No. 1.

Act of 1934 (the “Exchange Act”) and Rule 10b-5 promulgated thereunder, a plaintiff may seek damages from a company and its directors and officers for a material misrepresentation or omission in connection with the purchase or sale of a security.<sup>4</sup> Additionally, under Section 20(a) of the Exchange Act, a plaintiff may bring suit against an entity or individual that controls the primary securities violator.<sup>5</sup> A plaintiff may also bring suit against an issuer under Sections 11 and 12 of the Securities Act of 1933 (the “Securities Act”) for materially misleading misstatements or omissions in a registration statement or prospectus,<sup>6</sup> claims that, unlike 10b-5 claims, do not require the plaintiff to prove “scienter,” or fraudulent intent.<sup>7</sup> In support of such claims, plaintiffs may also allege noncompliance with Item 303 of Regulation S-K, which requires the disclosure of “any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations,” although the viability of a private right of action under Item 303 remains the subject of a circuit split.<sup>8</sup>

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- <sup>4</sup> See 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. To state a claim under Section 10(b) of the Exchange Act and Rule 10b-5, a plaintiff must plead “(1) a material misrepresentation or omission by the defendant[.], (2) scienter[.], (3) a connection between the misrepresentation or omission and the purchase or sale of a security[.], (4) reliance upon the misrepresentation or omission[.], (5) economic loss[.], and (6) loss causation.” *Stoneridge Inv. Partners, LLC v. Sci.-Atlanta, Inc.*, 552 U.S. 148, 157 (2008).
- <sup>5</sup> See 15 U.S.C. § 78t(a). Rule 12b-2 provides that control may be established by showing that the defendant possessed “the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.” 17 C.F.R. § 240.12b-2; see also *S.E.C. v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1472-73 (2d Cir. 1996) (affirming the district court’s conclusion that the CEO and owner of First Jersey Securities was personally liable under Section 20(a) of the Exchange Act given his hands-on management of the firm).
- <sup>6</sup> See 15 U.S.C. §§ 77k, 77l. To state a claim under Section 11(a) of the Securities Act, a plaintiff must plead that: “(1) she purchased a registered security, either directly from the issuer or in the aftermarket following the offering; (2) the defendant participated in the offering in a manner sufficient to give rise to liability under section 11; and (3) the registration statement ‘contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading.’” *In re Morgan Stanley Information Fund Secs. Litig.*, 592 F.3d 347, 358-59 (2d Cir. 2010); see also 15 U.S.C. § 77k(a). To state a claim under Section 12(a)(2) of the Securities Act, a plaintiff must plead that “(1) the defendant is a ‘statutory seller’; (2) the sale was effectuated ‘by means of a prospectus or oral communication’; and (3) the prospectus or oral communication ‘include[d] an untrue statement of a material fact or omit[ted] to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading.’” *In re Morgan Stanley*, 592 F.3d at 359 (quoting 15 U.S.C. § 77l(a)(2)).
- <sup>7</sup> See *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983) (under Section 11, “[l]iability against the issuer of a security is virtually absolute, even for innocent misstatements”); *Fed. Housing Fin. Agency v. Nomura Holding Am., Inc.*, 104 F. Supp. 3d 441, 568 (S.D.N.Y. 2015) (“Section 12(a)(2) imposes strict liability for statements that are materially false.”). However, Section 12(a)(2) provides for a “defense of reasonable care,” which is “less demanding than the duty of due diligence” under Section 11, and which may be asserted by all “sellers” under Section (a)(2), including the issuer of a security. *In re WorldCom, Inc. Sec. Litig.*, 346 F. Supp. 2d 628, 663 (S.D.N.Y. 2004).
- <sup>8</sup> 17 C.F.R. § 229.303(a)(3)(ii); see *Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 107-08 (2d Cir. 2015) (recognizing private cause of action); *Oran v. Stafford*, 226 F.3d 275, 287-88 (3d Cir. 2000) (no private cause of action); *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d 1046, 1054-56 (9th Cir. 2014) (no private cause of action). In June 2018, the U.S. Supreme Court dismissed a petition to resolve the issue, leaving the circuit split intact. See *Ind. Pub. Ret. Sys. v. SAIC, Inc.*, 818 F.3d 85 (2d Cir. 2017), *cert. dismissed*, 138 S. Ct. 2670 (2018).

These provisions have all been utilized in the past by plaintiffs in event-driven stock-drop litigation concerning events such as the 2008 financial crisis,<sup>9</sup> the 2014 Ebola outbreak,<sup>10</sup> the BP oil spill,<sup>11</sup> the early 2000s internet bubble,<sup>12</sup> the California energy crisis,<sup>13</sup> the #MeToo movement,<sup>14</sup> and data breaches resulting in theft of confidential or sensitive information.<sup>15</sup> Presumably, event-driven stock-drop suits will factor prominently in the COVID-19 litigation landscape as well. As summarized below, securities litigation premised on similar theories has already begun to materialize in response to COVID-19.

### Recently Filed COVID-19 Securities Litigation

At least two cases have been filed alleging violations of Sections 10(b) and 20(a) of the Exchange Act with regard to COVID-19: *Douglas v. Norwegian Cruise Lines* in the U.S. District Court for the Southern District of Florida, and *McDermid v. Inovio Pharmaceuticals, Inc.* in the U.S. District Court for the Eastern District of Pennsylvania.<sup>16</sup>

In *Norwegian Cruise Lines*, a putative class of shareholders asserted claims under Sections 10(b) and 20(a) against the cruise line and several of its officers, alleging that the defendants deceived investors through public statements in Forms 8-K and 10-K filed with the SEC touting the company's positive outlook for the coming year and its preventative measures in response to COVID-19.<sup>17</sup> In public statements included in its Form 8-K filing in February 2020, for instance,

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- <sup>9</sup> See, e.g., *Police Ret. Sys. of St. Louis v. Intuitive Surgical, Inc.*, No. 10-CV-03451-LHK, 2012 WL 1868874, at \*9 (N.D. Cal. May 22, 2012) (securities litigation triggered by statements regarding the company's ability to sustain growth in light of the 2008 financial crisis), *aff'd*, 759 F.3d 1051 (9th Cir. 2014).
- <sup>10</sup> See, e.g., *Jackson v. Halyard Health, Inc.*, No. 16-CV-05093-LTS, 2018 WL 1621539, at \*4-5 (S.D.N.Y. Mar. 30, 2018) (securities litigation triggered by statements made in relation to the Ebola outbreak), *appeal docketed*, No. 19-1300 (2d Cir. May 1, 2019).
- <sup>11</sup> See, e.g., *In re BP p.l.c. Sec. Litig.*, 922 F. Supp. 2d 600, 624-25 (S.D. Tex. 2013) (securities litigation triggered by an oil company's statements concerning its risk management system's ability to address the BP oil spill).
- <sup>12</sup> See, e.g., *In re Merrill Lynch & Co. Res. Reps. Sec. Litig.*, 568 F. Supp. 2d 349, 351-52 (S.D.N.Y. 2008) (securities litigation triggered by positive research reports on an internet holding company despite the company's severe liquidity problems following the burst of the internet bubble).
- <sup>13</sup> See, e.g., *In re Calpine Corp. Sec. Litig.*, 288 F. Supp. 2d 1054, 1085-86 (N.D. Cal. 2003) (securities litigation triggered by power company's public statements concerning the cause of the California energy crisis).
- <sup>14</sup> See, e.g., *Constr. Laborers Pension Tr. for S. Cal. v. CBS Corp.*, No. 18-CV-7796 (VEC), 2020 WL 248729, at \*13 (S.D.N.Y. Jan. 15, 2020) (securities litigation triggered by statements made at industry event regarding the #MeToo movement and company's knowledge of problems of workplace sexual harassment).
- <sup>15</sup> See, e.g., *In re Equifax Inc. Sec. Litig.*, 357 F. Supp. 3d 1189, 1216 (N.D. Ga. 2019) (securities litigation triggered by statements made regarding company's cybersecurity and efforts to protect consumer data).
- <sup>16</sup> See Complaint, *Douglas v. Norwegian Cruise Lines*, No. 1:20-cv-21107-RNS (S.D. Fla. Mar. 12, 2020), ECF No. 1; Complaint, *McDermid v. Inovio Pharm., Inc.*, No. 2:20-cv-01402-GJP (E.D. Pa. Mar. 12, 2020), ECF No. 1.
- <sup>17</sup> See Complaint ¶¶ 18-21, *Douglas v. Norwegian Cruise Lines*, No. 1:20-cv-21107-RNS (S.D. Fla. Mar. 12, 2020), ECF No. 1.

Norwegian Cruise Lines stated that “[d]espite the current known impact from COVID-19 coronavirus outbreak, as of the week of February 14, 2020, the Company’s booked position remained ahead of prior year and at higher prices on a comparable basis.”<sup>18</sup> In making such statements, the plaintiffs allege that: (1) Norwegian Cruise Lines failed to disclose the potential impact of COVID-19 on its business, operations, and prospects; and (2) the Company failed to disclose questionable sales tactics, motivated by the desire to hit sales quotas and designed to conceal the risks of COVID-19 to customers.<sup>19</sup> Such sales tactics allegedly included managers “ask[ing] sales staff to lie to customers about COVID-19 to protect the company’s bookings” and instructing sales staff to inform potential customers that COVID-19 “has caused a huge surge in demand” for all of the other non-Asia cruises.<sup>20</sup> Following the disclosure of the alleged sales tactics and declining cruise reservations, the company’s stock price initially fell 26.7% on March 11, 2020, and then fell another 35.8% on March 12, 2020.<sup>21</sup>

In *Inovio Pharmaceuticals, Inc.*, a putative class of shareholders asserted claims under Sections 10(b) and 20(a) against Inovio Pharmaceuticals, Inc. and its CEO, J. Joseph Kim, alleging that management made misleading public statements indicating that the company had created a vaccine for the COVID-19 virus, leading to a jump in the company’s stock price.<sup>22</sup> Among other things, Plaintiffs base their claims on a statement made by Inovio’s CEO, J. Joseph Kim, after a meeting with President Trump, that Inovio was “able to fully construct [its] vaccine within three hours” and that Inovio planned to start trials for the vaccine in April 2020.<sup>23</sup> Following reports from a third party indicating that Inovio had not, in fact, developed a COVID-19 vaccine, the company’s stock price plummeted on March 9, 2020, from \$18.72 to \$9.83, and fell again on March 10, 2020 to \$5.70.<sup>24</sup>

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<sup>18</sup> *Id.* ¶ 18.

<sup>19</sup> *Id.* ¶ 21. A sample sales script instructed employees to address customer concerns with allegedly false statements, such as “the Coronavirus can only survive in cold temperatures, so the Caribbean is a fantastic choice for your next cruise[.]” *Id.* ¶ 22.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.* ¶¶ 24, 27. Notably, March 12, 2020, was a particularly volatile day for the markets in general—the S&P fell 9% and the Dow plunged 10%, its largest decline since “Black Monday” on October 19, 1987. See Pippa Stevens, Maggie Fitzgerald & Fred Imbert, *Stock Market Live Thursday: Dow Tanks 2,300 in Worst Day Since Black Monday, S&P 500 Bear Market*, CNBC, <https://www.cnbc.com/2020/03/12/stock-market-today-live.html> (Mar. 12, 2020, 5:12 PM). Given these historic declines, plaintiffs will likely face an uphill battle in proving that the declines suffered by Norwegian Cruise Lines were in fact caused by Norwegian’s public statements.

<sup>22</sup> See Complaint ¶¶ 3-6, *McDermid v. Inovio Pharm., Inc.*, No. 2:20-cv-01402-GJP (E.D. Pa. Mar. 12, 2020), ECF No. 1.

<sup>23</sup> *Id.* ¶¶ 5, 18.

<sup>24</sup> *Id.* ¶¶ 6, 26.

With courts across the country freezing or reducing dockets due to COVID-19, there may be a short—but temporary—reprieve in such litigation. In the meantime, as outlined below, there are number of steps companies can take to help mitigate the risk of litigation.

### **Mitigating the Risk of COVID-19-Based Securities Litigation**

Recognizing the significance of COVID-19 to the securities markets, the U.S. Securities and Exchange Commission (“SEC”) issued an unusual [Press Release](#) on March 4, 2020, reminding “all companies to provide investors with insight regarding their assessment of, and plans for addressing, material risks to their business and operations resulting from the coronavirus to the fullest extent practicable to keep investors and markets informed of material developments.”<sup>25</sup> Notably, the SEC’s Press Release underscored that “[h]ow companies plan and respond to the events as they unfold can be material to an investment decision[.]”<sup>26</sup>

In addition, on March 25, 2020, the SEC’s Division of Corporate Finance issued additional [Disclosure Guidance](#), including a non-exhaustive list of questions that should be considered in making COVID-19 disclosures.<sup>27</sup> Further, on April 8, 2020, SEC Chairman Jay Clayton and the SEC Director of the Division of Corporation Finance, William Hinman, released an unprecedented joint [Public Statement](#) urging public companies to provide forward-looking guidance in their quarterly earnings statements and calls.<sup>28</sup> The SEC’s statements on COVID-19 offer several practical takeaways.

*First*, according to the SEC’s March 4 press release, as a first line of defense, companies should carefully “consider their activities in light of their disclosure obligations” and, if a company has become aware of a material risk related to COVID-19, it should “refrain from securities related transactions with the public” until that risk is fully disclosed.<sup>29</sup> Such activities include stock issuances and buybacks, mergers, acquisitions, tender offers, and joint ventures.

*Second*, in disclosing a risk related to COVID-19, the SEC advises companies, consistent with Regulation FD, to take “necessary steps to avoid selective disclosures and to disseminate”

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<sup>25</sup> See Press Release, U.S. Sec. & Exch. Comm’n, *SEC Provides Conditional Regulatory Relief and Assistance for Companies Affected by the Coronavirus Disease 2019 (COVID-19)* at 1 (Mar. 4, 2020), <https://www.sec.gov/news/press-release/2020-53>.

<sup>26</sup> *Id.*

<sup>27</sup> See Guidance, U.S. Sec. & Exch. Comm’n Div. of Corp. Fin., *CF Disclosure Guidance: Topic No. 9 – Coronavirus (COVID-19)* at 1-2 (Mar. 25, 2020), <https://www.sec.gov/corpfin/coronavirus-covid-19>.

<sup>28</sup> See Public Statement, U.S. Sec. & Exch. Comm’n, *The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19* at 1-2 (Apr. 8, 2020), <https://www.sec.gov/news/public-statement/statement-clayton-hinman>.

<sup>29</sup> See Press Release, U.S. Sec. & Exch. Comm’n, *SEC Provides Conditional Regulatory Relief and Assistance for Companies Affected by the Coronavirus Disease 2019 (COVID-19)* at 2 (Mar. 4, 2020), <https://www.sec.gov/news/press-release/2020-53>.

information concerning COVID-19-related risks broadly. However, according to Chairman Clayton and Director Hinman's joint statement,<sup>30</sup> companies should avoid placing sole reliance on "generic, or boilerplate, disclosures" concerning the general risks of COVID-19.<sup>31</sup> For example, non-specific statements that COVID-19 has generally harmed the economy and securities markets are unlikely to satisfy an issuer's disclosure obligations with respect to its business in particular or to insulate an issuer from securities law lawsuits under the bespeaks caution or similar doctrines.<sup>32</sup>

*Third*, companies should also be careful not to overstate their preparedness to handle the crisis or downplay the material impact of the pandemic on their business. In particular, companies should keep a close watch over public statements by their directors and officers, as the SEC's Press Release cautions public companies to "take steps to prevent directors and officers"<sup>33</sup> from exaggerating the company's preparedness to handle COVID-19. Indeed, the SEC has reportedly suspended trading in three stocks as a result of potentially inaccurate claims regarding the companies' responses to COVID-19.<sup>34</sup>

*Fourth*, in light of Chairman Clayton and Director Hinman's statement urging public companies to make forward-looking disclosures concerning "how [the company's] operations and financial condition may change as all our efforts to fight COVID-19 progress,"<sup>35</sup> companies should carefully craft their forward-looking statements to minimize their risk of liability. In particular, the SEC's March 25, 2020 Disclosure Guidance "remind[s] companies that providing forward-looking information in an effort to keep investors informed about material developments, including known trends or uncertainties regarding COVID-19, can be undertaken in a way to avail the companies of the safe harbors in Section 27A of the Securities Act and Section 21E of the Exchange Act for this

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<sup>30</sup> The joint public statement represents Chairman Clayton and Director Hinman's views, not the official position of the SEC. See Public Statement, U.S. Sec. & Exch. Comm'n, *The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19* at 1 n.i (Apr. 8, 2020), <https://www.sec.gov/news/public-statement/statement-clayton-hinman>.

<sup>31</sup> See *id.* at 4.

<sup>32</sup> See *In re Veeco Instruments, Inc., Sec. Litig.*, 235 F.R.D. 220, 235 (S.D.N.Y. 2006) (generic, boilerplate statements are insufficient); *Schottenfeld Qualified Assocs. v. Workstream, Inc.*, No. 05 Civ. 7092 (CLB), 2006 WL 4472318, at \*3 (S.D.N.Y. May 4, 2006) (finding insufficient cautionary language that "refers to the most general of economic risks"); *In re Prudential Sec. Inc. Ltd. P'ships Litig.*, 930 F. Supp. 68, 72 (S.D.N.Y. 1996) (cautionary language must "precisely address the substance of the specific statement" that is at issue).

<sup>33</sup> Press Release, U.S. Sec. & Exch. Comm'n, *SEC Provides Conditional Regulatory Relief and Assistance for Companies Affected by the Coronavirus Disease 2019 (COVID-19)* at 2 (Mar. 4, 2020), <https://www.sec.gov/news/press-release/2020-53>.

<sup>34</sup> See Al Barbino, *SEC Enforcement Expected To Surge On COVID Volatility*, Law360 (Apr. 9, 2020), <https://www.law360.com/articles/1262118/sec-enforcement-expected-to-surge-on-covid-volatility>.

<sup>35</sup> Public Statement, U.S. Sec. & Exch. Comm'n, *The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19* at 1 (Apr. 8, 2020), <https://www.sec.gov/news/public-statement/statement-clayton-hinman>.

information.”<sup>36</sup> As discussed in greater detail below, these provisions provide safe harbors for forward-looking statements accompanied by meaningful cautionary language.

*Finally*, the SEC’s Division of Corporation Finance has identified several key questions to consider with respect to a company’s present and future operations in the context of COVID-19 disclosures, including:

- “How has COVID-19 impacted your financial condition and results of operations?”
- “In light of changing trends and the overall economic outlook, how do you expect COVID-19 to impact your future operating results and near-and-long-term financial condition?”
- “Do you expect that COVID-19 will impact future operations differently than how it affected the current period?”
- “Have you experienced challenges in implementing your business continuity plans or do you foresee requiring material expenditures to do so? Do you face any material resource constraints in implementing these plans?”
- “Do you expect COVID-19 to materially affect the demand for your products or services?”
- “Do you anticipate a material adverse impact of COVID-19 on your supply chain or the methods used to distribute your products or services?”
- “Do you expect the anticipated impact of COVID-19 to materially change the relationship between costs and revenues?”
- “Will your operations be materially impacted by any constraints or other impacts on your human capital resources and productivity?”
- “Are travel restrictions and border closures expected to have a material impact on your ability to operate and achieve your business goals?”<sup>37</sup>

#### **Strategies to Dismiss COVID-19-Related Securities Litigation at the Pleading Stage**

If a company finds itself faced with a COVID-19-based securities claim, there are several tools available to defeat such a claim at the pleadings stage.

- **A defendant may defeat a claim by showing that the alleged misstatements are forward-looking statements protected by the PSLRA’s Safe Harbor.** – The Private Securities Litigation Reform Act of 1995 (“PSLRA”) provides an important safe harbor that protects forward-looking statements “accompanied by meaningful cautionary statements

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<sup>36</sup> Guidance, U.S. Sec. & Exch. Comm’n Div. of Corp. Fin., *CF Disclosure Guidance: Topic No. 9 – Coronavirus (COVID-19)* at 2 (Mar. 25, 2020), <https://www.sec.gov/corpfin/coronavirus-covid-19>.

<sup>37</sup> *Id.*

identifying important factors that could cause actual results to differ materially from those in the forward-looking statement[.]”<sup>38</sup> In *Police Retirement System of St. Louis v. Intuitive Surgical, Inc.*,<sup>39</sup> for instance, the Northern District of California held that statements concerning a company’s ability to sustain growth in light of the 2008 financial crisis were non-actionable forward-looking statements under the PSLRA’s safe harbor. Because the alleged misrepresentations concerned the rate at which the company “expected to grow” and stated that the financial crisis had “not yet looked like a real issue,” the court found that they were forward-looking.<sup>40</sup> Further, the court held that the challenged statements were accompanied by “meaningful cautionary language,” including disclosures that the statements concerned “future financial performance” and that the financial crisis may “cause variance” in the company’s performance.<sup>41</sup> Companies may similarly avail themselves of the safe harbor by cabining forward-statements about COVID-19 with meaningful warnings about the uncertainties posed by the virus. However, companies should remain wary that statements about the company’s present ability to handle the COVID-19 outbreak may not be protected. In *In re BP p.l.c. Securities Litigation*,<sup>42</sup> the Southern District of Texas held that BP’s statements concerning its new management system in response to the oil spill constituted a “mixed statement of present fact and future events,” and any misstatements concerning the *then-present* effectiveness of the operating system were not protected by the safe harbor.

- **A defendant may defeat a claim by showing that the alleged misstatements are mere expressions of corporate optimism.** – Mere opinions or expressions of corporate optimism concerning COVID-19 also cannot support a securities fraud claim. A misrepresentation is actionable only if it is “material”—that is, there is a “substantial likelihood” that it “would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”<sup>43</sup> If an alleged misrepresentation is deemed to be mere “puffery,” or a generic expression of corporate optimism, it is considered immaterial and, thus, non-actionable.<sup>44</sup> For example, in *Intuitive Surgical*, discussed above, the Northern District of California held that even if alleged misrepresentations concerning the company’s projections following the 2008 financial crisis were not shielded by the PSLRA’s safe harbor, statements such as “we don’t think we have hit a penetration ceiling,” “we will come out stronger,” and “we

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<sup>38</sup> See 15 U.S.C. § 77z-2(c)(1)(A)(i).

<sup>39</sup> No. 10-CV-03451-LHK, 2012 WL 1868874, at \*9 (N.D. Cal. May 22, 2012), *aff’d*, 759 F.3d 1051 (9th Cir. 2014).

<sup>40</sup> *Id.* at \*11.

<sup>41</sup> *Id.* at \*12.

<sup>42</sup> 922 F. Supp. 2d 600, 624-25 (S.D. Tex. 2013).

<sup>43</sup> *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (citation omitted).

<sup>44</sup> See *Singh v. Cigna Corp.*, 918 F.3d 57, 63 (2d Cir. 2019).

sit in a pretty good position” were too “vague and amorphous” to be material.<sup>45</sup> Thus, although companies making COVID-related disclosures have an obligation to report information accurately, they should not face liability merely for expressing general optimism that they will overcome difficulties caused by the pandemic.

- **A defendant may move to dismiss a claim for failure to plead that the alleged misstatement caused the plaintiff's losses.** – In order to establish securities fraud liability, a plaintiff must plead and prove a “causal link between the alleged misconduct and the economic harm ultimately suffered by the plaintiff.”<sup>46</sup> To do so, the complaint must allege “that the misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security.”<sup>47</sup> The Supreme Court has held, moreover, that allegations that investors paid an “artificially inflated purchase price” for the stock are insufficient, standing alone, to plead loss causation—investors also must plead that the revelation or materialization of the fraud caused the stock price to drop.<sup>48</sup> In *In re Merrill Lynch & Co. Research Reports Securities Litigation*,<sup>49</sup> for example, investors in an internet holding company brought securities fraud claims against certain broker-dealers alleging that, despite the company’s liquidity problems, the defendants issued positive research reports on which the investors relied to their detriment. The Southern District of New York dismissed the claims for failure to plead that the decline in stock price was caused by the revelation of the fraud, rather than the coinciding “burst[] of the Internet bubble.”<sup>50</sup> Because the complaint “fail[ed] to account . . . for the ‘cratering’ of the Internet market that occurred during the ten-month period” from December 1999 to October 2000 when the reports were issued, it failed to plead a connection between the fraud and the investors’ harm.<sup>51</sup> Given recent market volatility, companies experiencing a stock decline concurrent with COVID-19’s negative impact on markets may be able to avail themselves of a similar line of argument to dismiss securities claims at the pleading stage.
- **A defendant may move to dismiss a claim for failure to plead that the defendant made the misstatement with fraudulent intent.** – Finally, under the PSLRA, the complaint must allege “with particularity facts giving rise to a strong inference that the defendant acted

<sup>45</sup> *Police Ret. Sys. of St. Louis v. Intuitive Surgical, Inc.*, No. 10-CV-03451-LHK, 2012 WL 1868874, at \*13-14 (N.D. Cal. May 22, 2012), *aff’d*, 759 F.3d 1051 (9th Cir. 2014).

<sup>46</sup> *See Emergent Cap. Inv. Mgmt., LLC v. Stonepath Grp., Inc.*, 343 F.3d 189, 197 (2d Cir. 2003); 15 U.S.C. § 78u-4(b)(4).

<sup>47</sup> *DoubleLine Cap. LP v. Odebrecht Fin., Ltd.*, 323 F. Supp. 3d 393, 456 (S.D.N.Y. 2018) (quoting *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 173 (2d Cir. 2005)).

<sup>48</sup> *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 347 (2005).

<sup>49</sup> 568 F. Supp. 2d 349, 351 (S.D.N.Y. 2008).

<sup>50</sup> *Id.* at 363.

<sup>51</sup> *Id.* at 364.

with" fraudulent intent.<sup>52</sup> In *Jackson v. Halyard Health, Inc.*,<sup>53</sup> for example, the Southern District of New York dismissed securities fraud claims based on allegedly false statements concerning the effectiveness of a company's surgical gowns at preventing the spread of Ebola, concluding that the complaint failed to plead the requisite strong inference of scienter. According to the court, plaintiffs did not sufficiently allege that the defendants actually received or were aware of reports detailing the deficiencies in the surgical gowns, nor did it plead facts showing that they were reckless in failing to learn these facts, and thus the complaint failed to state a claim for securities fraud against them.<sup>54</sup> Likewise, the Southern District of New York, in *Sinay v. CNOOC Ltd.*,<sup>55</sup> dismissed 10b-5 claims alleging that an oil-drilling company misrepresented its preparedness to prevent and contain an oil spill for lack of scienter, concluding that "hindsight-based" allegations that the safety measures ultimately proved inadequate were "insufficient to support a strong inference of scienter," absent any factual allegations "undermining the accuracy of" the company's disclosures when made. Because the complaint was devoid of any allegations that the company's "inspections and plans" of its safety measures were ineffective or that its "estimates of the spills' magnitude was incorrect" the court dismissed the claims for lack of scienter.<sup>56</sup> Thus, as courts recognize, mere hindsight concerning the impact of a significant event like COVID-19 is insufficient to plead fraudulent intent.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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<sup>52</sup> 15 U.S.C. § 78u-4(b)(2)(A).

<sup>53</sup> No. 16-CV-05093-LTS, 2018 WL 1621539, at \*4-5 (S.D.N.Y. Mar. 30, 2018), *appeal docketed*, No. 19-1300 (2d Cir. May 1, 2019).

<sup>54</sup> *Id.* at \*5-8.

<sup>55</sup> No. 12 CIV. 1513 (KBF, 2013 WL 1890291, at \*8 (S.D.N.Y. May 6, 2013), *aff'd*, 554 F. App'x 40 (2d Cir. 2014) (Summary Order).

<sup>56</sup> *Id.* It is well-settled that allegations of "fraud by hindsight," *i.e.*, misrepresentations that the speaker believed were true at the time they were made, but later proved to be false, are not actionable. See *Waterford Twp. Police & Fire Ret. Sys. v. Reg'l Mgmt. Corp.*, 723 F. App'x 20, 22 (2d Cir. 2018) (Summary Order).

# Clients & Friends Memo

## COVID-19 Update: Federal Reserve Announces Main Street Lending Program

April 16, 2020

On April 9, 2020, the Federal Reserve established a \$600 billion lending program to aid small and medium-sized businesses affected by the COVID-19 pandemic. The new initiative—the Main Street Lending Program—will purchase qualifying loans from lenders that lend to U.S. businesses with up to 10,000 employees or up to \$2.5 billion in 2019 annual revenues.<sup>1</sup> Firms that have taken advantage of the Small Business Administration's previously announced Paycheck Protection Program are eligible to participate in the Main Street program.<sup>2</sup>

The program is not yet operational or accepting applications. For now, the Federal Reserve and the Department of the Treasury are seeking input from lenders, borrowers and other stakeholders, with comments on the program being accepted through April 16.

The program will operate through two facilities: the Main Street New Loan Facility (“**MSNLF**”), which will purchase participations in eligible loans originated by lenders *on or after* April 8, 2020, and the Main Street Expanded Loan Facility (“**MSELF**”), which will purchase upsized tranches of loans originated by lenders *before* April 8, 2020, that meet specified eligibility criteria.<sup>3</sup> In both cases, purchases will be on a risk-shared basis, with the lender retaining a 5% loan participation and the applicable facility purchasing a 95% participation. The Main Street Lending Program is the

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<sup>1</sup> Federal Reserve Takes Additional Actions to Provide Up to \$2.3 Trillion in Loans to Support the Economy, *available [here](#)*.

<sup>2</sup> The Paycheck Protection Program (“**PPP**”) provides financial assistance to small businesses to keep employees on the payroll by extending unsecured loans guaranteed by the Small Business Administration. Compared with the Main Street Lending Program, lending under the PPP is limited to smaller businesses (borrowers must meet the SBA's small business size standards), loan sizes are lower (the lesser of \$10 million and 2.5x of the borrower's average monthly payroll cost in 2019), and the use of proceeds are more restricted (75% of the PPP loan proceeds must be used for payroll purposes). For more on the PPP, *see* Cadwalader's COVID-19 Update: The SBA's Paycheck Protection Program Explained, *available [here](#)*.

<sup>3</sup> Main Street New Loan Facility Term Sheet, *available [here](#)*; Main Street Expanded Loan Facility Term Sheet, *available [here](#)*.

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first of the Federal Reserve's pandemic response facilities to use SOFR-based interest as a requirement for collateral eligibility.

Borrower and lender eligibility requirements are the same across the two facilities, but, in addition to the origination date, there are a few notable differences in terms. The MSNLF will purchase unsecured term loans and charge a 100-basis-point facility fee. The MSELF, which facilitates increases to loans that predate the program, will purchase secured loans, will not charge a facility fee and allows for potentially larger loan sizes. We review terms of the program in more detail below.

### **Main Street New Loan Facility**

**Who can participate?** Loans will be extended through regulated banking organizations. More specifically, only U.S. insured depository institutions, U.S. bank holding companies and U.S. savings and loan holding companies are eligible to extend loans under the program.

**What assets are eligible?** Eligibility criteria address both the borrower and the underlying loan terms. To qualify for participation, a borrower must be a business with up to 10,000 employees or up to \$2.5 billion in 2019 revenue. Further, a borrower must be a U.S. business, which is defined as a business created or organized in the United States or under the laws of the United States with significant operations in and a majority of its employees based in the United States.

Another Federal Reserve program, the Primary Market Corporate Credit Facility, can also originate loans to U.S. businesses, and to address the potential overlap, the Main Street Lending Program requires participating borrowers not to use the Primary Market Corporate Credit Facility.

To be eligible for purchase by the MSNLF, loans must be originated on or after April 8, 2020, and must meet the following criteria:

- a four-year maturity;
- deferral of interest and principal during the first year of the loan term;
- an interest rate of 250-400 basis points over SOFR;
- a minimum loan size of \$1 million; and
- prepayment without penalty.

Maximum loan size for the MSNLF is capped at the lesser of (i) \$25 million and (ii) the loan amount that results in a four times debt-to-EBITDA ratio based on the borrower's existing outstanding and committed but undrawn debt and its 2019 EBITDA.

**What are the other key terms?** Both the borrower and lender are required to make specific attestations.

The borrower is required to certify the following:

- it will refrain from using loan proceeds to repay other debt of equal or lower priority other than mandatory principal until the loan is repaid in full;
- it will not seek to cancel or reduce its outstanding lines of credit with any lender;
- the loan is necessitated by the COVID-19 pandemic and the borrower will make reasonable efforts to maintain its payroll and retain its employees during the term of the loan;
- it complies with the debt-to-EBITDA loan size limit;
- it will comply with the compensation, stock repurchase, dividend and capital distribution restrictions under the CARES Act; and
- it is eligible to participate in the facility, including under the conflicts of interest prohibition in the CARES Act.<sup>4</sup>

These attestations serve as a compliance mechanism for enforcing, among other terms, the stock repurchase, dividend and capital distribution restrictions under the CARES Act.<sup>5</sup> More specifically, borrowers are prohibited from buying back listed equities (except under a pre-existing contract), paying dividends, or making other capital distributions with respect to common stock until 12 months after the loan is no longer outstanding. Participating businesses are also required, to the extent practicable, to maintain employment at the March 24, 2020 level until September 30, 2020 and, in any case, not to reduce employment by more than 10% from the initial level.

The certifications also address compensation, and apply the CARES Act provisions that (i) prohibit pay increases to employees and officers who received more than \$425,000 in total compensation in 2019 (excluding employees paid under a collective bargaining agreement), (ii) cap severance payments at two times 2019 earnings for employees who earned more than \$425,000 in total compensation in 2019 (excluding employees paid under a collective bargaining agreement), and (iii) limit total compensation to officers and employees who received more than \$3,000,000 in total compensation in 2019 to no more than \$3,000,000 plus 50% of the excess over \$3,000,000 of

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<sup>4</sup> Section 4019(b) of the CARES Act bars the President, Vice President, heads of Executive departments, Members of Congress and their specified relatives from participating in the emergency relief funding under the CARES Act.

<sup>5</sup> Section 4003(c)(3)(A)(ii) of the CARES Act.

the total compensation received in 2019.<sup>6</sup> The compensation limits remain in effect through the one-year period after the loan is no longer outstanding.

A lender is required to certify that:

- loan proceeds will not be used to repay or refinance pre-existing loans or lines of credit that the lender has in place with the borrower;
- it will not cancel or reduce existing lines of credit outstanding to the borrower; and
- it is eligible to participate in the facility, including under the conflicts of interest prohibition in the CARES Act.

Risk sharing between the facility and the lender is on a *pari passu* basis. The MSNLF will purchase a 95% participation of an eligible loan at par value, and the lender will retain 5%.

Borrowers under the MSNLF are charged a 100-basis-point origination fee. The lender is required to pay to the MSNLF a facility fee of 100 basis points of the principal amount of the loan participation purchased by the facility. This facility fee may be paid by the borrower. In turn, the MSNLF will pay the lender a yearly servicing fee of 25 basis points, also calculated based on the principal amount of the facility's loan participation.

**How long will the program continue?** Unless extended by the Federal Reserve and the Treasury Department, the MSNLF will cease purchasing loan participations on September 30, 2020. The facility will remain funded until its underlying assets mature or are sold.

### **Main Street Expanded Loan Facility**

**Who can participate?** Lender eligibility criteria are the same as those for the MSNLF.

**What assets are eligible?** Borrower eligibility criteria are the same as those for the MSNLF. Qualifying upsized tranches of existing loans are eligible for purchase, and required terms relating to tenure, first-year deferral of interest and principal, interest rate, loan size, and prepayment terms track the MSNLF. The maximum size for an upsized tranche is capped at the lesser of (i) \$150 million, (ii) 30% of the borrower's outstanding and committed but undrawn bank debt, and (iii) the loan amount that results in a six times debt-to-EBITDA ratio based on the borrower's existing outstanding and committed but undrawn debt and its 2019 EBITDA.

**What are the other key terms?** The required borrower and lender attestations track those of the MSNLF, as does the risk sharing arrangement. The MSELF will purchase secured loans. Collateral

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<sup>6</sup> Section 4004 of the CARES Act.

that secures the loan, including collateral pledged under the original loan or at the time of upsizing, will secure the loan participation on a *pro rata* basis.

Borrowers under the MSELF are charged a 100-basis-point upsize fee assessed on the principal amount of the upsized tranche. The MSELF does not charge a facility fee. The facility will pay a 25-basis-point annual servicing fee to lender based on the facility participation amount in the upsized tranche.

**How long will the program continue?** Unless extended by the Federal Reserve and the Treasury Department, the MSELF will cease purchasing loan participations on September 30, 2020. The facility will remain funded until its underlying assets mature or are sold.

\* \* \*

The CARES Act made available \$454 billion for loans and loan guarantees under programs of the Federal Reserve. With \$75 billion committed to the program by the Treasury, the Main Street Lending Program accounts for one of the largest equity commitments to date to such a lending program.<sup>7</sup> Even so, total equity commitments across all the lending programs announced to date account for less than half of the earmarked allocation under the CARES Act. This leaves significant room for increased commitments to existing programs or additional future market support initiatives from the Federal Reserve and Treasury.

If you have any questions concerning this memorandum, please reach out to your regular Cadwalader contact.

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<sup>7</sup> The combined equity commitment to the Primary Market Corporate Credit Facility and the Secondary Market Corporate Credit Facility also totals \$75 billion after the Federal Reserve and Treasury announced an upsized commitment to both programs on April 9, 2020.

# Clients & Friends Memo

## COVID-19 Update: Federal Reserve Announces Municipal Liquidity Facility

April 15, 2020

The Federal Reserve has announced the Municipal Liquidity Facility (the “MLF”) to provide liquidity to state and local governmental authorities affected by the COVID-19 pandemic.<sup>1</sup> The MLF, which is established pursuant to the Federal Reserve’s emergency lending authority under Section 13(3) of the Federal Reserve Act,<sup>2</sup> will lend up to \$500 billion to “Eligible Issuers” through September 30, 2020, subject to extension.

Under the MLF, a Federal Reserve Bank will commit to lend funds to a special purpose vehicle (the “SPV”), on a full-recourse basis and secured by all assets of the SPV. The SPV will also be funded by the Treasury Department, which will make an initial equity investment of \$35 billion.<sup>3</sup> The SPV is permitted to purchase up to \$500 billion of short-term notes directly from states, cities and municipalities upon their issuance.<sup>4</sup>

This memorandum outlines the key terms of the MLF.

### Eligible Issuers:

- U.S. states and the District of Columbia (“States”); U.S. cities with populations of at least one million residents (“Cities”), U.S. counties with populations of at least two million residents

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<sup>1</sup> See Federal Reserve Takes Additional Actions to Provide Up to \$2.3 Trillion in Loans to Support the Economy (Apr. 9, 2020), available [here](#); see also [Municipal Liquidity Facility Term Sheet](#) (Apr. 9, 2020), available [here](#).

<sup>2</sup> Section 13(3) allows the Federal Reserve to take certain emergency actions in “unusual and exigent circumstances,” including by authorizing any Federal Reserve Bank to discount notes in any program or facility with “broad-based eligibility.”

<sup>3</sup> The Treasury Department will use funds appropriated pursuant to Section 4027 of the CARES Act to make the equity investment.

<sup>4</sup> It is not clear whether the MLF contemplates the use of an agent dealer or other institution to assist in purchases.

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("Counties"); or an instrumentality thereof that issues notes on behalf of such State, City or County for the purpose of managing cash flows.<sup>5</sup>

- Only one issuer per State, City or County is eligible to participate in the MLF.

Eligible Notes:

- Tax anticipation notes, tax and revenue anticipation notes, bond anticipation notes and other similar short-term notes issued by Eligible Issuers.
- Notes must have maturities of 24 months or less from the date of issuance.

Limitations:

- The SPV may purchase Eligible Notes in one or more issuances up to an aggregate amount of 20% of the sum of (1) the general revenue from own sources for fiscal year 2017 and (2) utility revenue of the relevant State, City or County government for fiscal year 2017.
- A State may request the SPV to purchase Eligible Notes in excess of the above limitation in order to provide financial support to political subdivisions and instrumentalities that are not Eligible Issuers.

Use of Proceeds:

- Eligible Issuers may use the proceeds of Eligible Notes to manage (1) reductions in cash flow caused by an extension of an income tax filing deadline, (2) potential reductions of tax and other revenues or increases in expenses related to or resulting from the COVID-19 pandemic, and (3) required payments of principal and interest on obligations of the relevant State, City or County.
- An Eligible Issuer may also use the proceeds of Eligible Notes to purchase similar notes issued by, or otherwise to assist, political subdivisions and instrumentalities of the relevant State, City or County for the purposes enumerated above.

Pricing, Fees and Other Terms:

- Pricing will be based on an Eligible Issuer's rating at the time the SPV purchases the Eligible Notes. The Federal Reserve indicated that further details on the rating point will be provided.
- To participate in the MLF, an Eligible Issuer will pay an origination fee equal to 10 basis points of the aggregate principal amount of the Eligible Notes purchased by the SPV with respect to that Eligible Issuer. The origination fee can be paid from the proceeds of the Eligible Notes.
- Eligible Notes purchased by the SPV are callable by the Eligible Issuer, at par, at any time.

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<sup>5</sup> Eligible Issuers will be determined using U.S. Census Bureau data.

Termination:

- The SPV will not purchase Eligible Notes after September 30, 2020, unless the MLF is extended by both the Federal Reserve and the Treasury Department.
- The Federal Reserve Bank will continue funding the SPV until its underlying assets either mature or are sold.

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# Clients & Friends Memo

## COVID-19 Update: COVID-19 and the Courts: Part II

### How Appellate Court Procedures Are Changing and What May Be Here to Stay

April 15, 2020

#### Overview

In the second of our series of articles examining emergency procedures in the wake of the COVID-19 pandemic ("pandemic"), we examine the emergency procedures put into place in Federal Appellate Courts and explore which changes may disappear as the pandemic wanes and which are likely to stick around. Most commonly, appellate courts have changed proceedings for oral arguments, either postponing them or allowing them to continue by telephone or video or allowing some cases to be decided on the briefs alone, without oral argument. One court is even canceling oral arguments for *en banc* matters during May, and requesting, instead, attorneys submit written answers to written questions. Many courts have also temporarily suspended the requirement that paper copies be submitted with filings. A full overview is provided below:

#### Federal Circuit

In its response to the pandemic, the Federal Circuit first acted to restrict public access to the National Courts Building Complex. Pursuant to a March 16, 2020 advisory issued by the court, no members of the public are permitted to attend oral arguments. On scheduled argument and hearing days, only (a) arguing counsel and parties with a scheduled in-person hearing and (b) credentialed members of the press are permitted in the National Courts Building.

In an updated public advisory issued March 18, 2020, the Federal Circuit ordered that all cases scheduled for argument during April 2020 would be conducted via telephonic conference, with no in-person hearings to be held. Prior to the crisis, the Federal Circuit had an established practice of releasing same-day audio of its oral arguments, and continues to release them on its website.

In an order dated March 20, 2020, the Federal Circuit suspended all requirements to provide paper copies of documents submitted electronically filed on or after March 20, 2020. Of note, the order applies only to documents electronically filed on or after the date of the order; paper copies are still

required for documents electronically filed before that date. The order also specified that all existing case deadlines remain in effect.<sup>1</sup>

### **DC Circuit**

On March 17, 2020, the DC Circuit suspended all in-person onsite oral arguments pending further order of the court. In addition, each panel will decide whether scheduled arguments would proceed by teleconference, be postponed until a later date, or be decided without oral argument on the briefs.

Though arguments are proceeding with this “new” technology approach, attorneys have reported some hiccups in arguing telephonically; Judge Thomas Griffith reported being dropped from the conference call and locked out of an oral argument for five to six minutes in the DC Circuit.<sup>2</sup>

The DC Circuit Court of Appeals also offers live audio streaming of oral arguments.<sup>3</sup>

### **First Circuit**

In response to the COVID-19 pandemic, on March 26, 2020, the First Circuit ordered automatic extensions for all non-emergency filing deadlines due between March 26, 2020 and April 24, 2020 for all cases not presently calendared for oral argument, not having been argued before a panel and not otherwise expedited.

The sitting of the United States Court of Appeals for the First Circuit scheduled for April 6 through April 9, 2020 was cancelled. Further information regarding the cases previously scheduled for argument in that period will be provided by further court order in those cases.

### **Second Circuit**

The Second Circuit ordered, effective March 23, 2020, that oral arguments would be heard by way of teleconference and, further, provided for public access by way of livestreaming the oral arguments. In addition, the Second Circuit, like many of its sister circuits, suspended the paper copy requirement for non-*pro se* litigants.

The New York Law Journal reported that the maiden voyage of this technology was not without its hitches. Attorneys and judges sometimes spoke over each other without meaning to without visual

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<sup>1</sup> <http://www.ca9.uscourts.gov/sites/default/files/rules-of-practice/Administrative-Orders/AdministrativeOrder-ModifiedOperations-03202020.pdf>.

<sup>2</sup> Jacqueline Thomsen, “‘It’s Kind of a Mess’: Phone Arguments Get Rocky Debut at DC Circuit During COVID-19 Pandemic,” THE NATIONAL LAW JOURNAL (March 20, 2020), <https://www.law.com/nationallawjournal/2020/03/20/its-kind-of-a-mess-phone-arguments-get-rocky-debut-at-dc-circuit-during-covid-19-pandemic/>.

<sup>3</sup> [https://www.cadc.uscourts.gov/intranet/home.nsf/Content/Announcement+-+Standing+Order+In+Re+Oral+Arguments+COVID-19/\\$FILE/COVIDStandingOrder.pdf](https://www.cadc.uscourts.gov/intranet/home.nsf/Content/Announcement+-+Standing+Order+In+Re+Oral+Arguments+COVID-19/$FILE/COVIDStandingOrder.pdf).

cues. Otherwise, Chief Judge Robert A. Katzmann had positive things to say about the new use of technology, stating in an interview, "It isn't perfect, but I think it works pretty well under the circumstances."<sup>4</sup> (Interestingly, the California Supreme Court may have anticipated such a potential talk-over problem by allocating up to 5 minutes for each side to make uninterrupted opening statements.<sup>5</sup>)

### Third Circuit

In the Third Circuit, oral arguments are set to go forward as scheduled, though parties may request to appear by audioconference by filing a motion. Recordings of oral arguments will be made available on the court's website within 24 hours after the argument concludes.

Electronically filed documents received within 3 days of the current deadlines are deemed to be timely without parties having filed a motion unless the parties are specifically advised otherwise.

The court also stated that during this time, the requirement to file hard copies of filings is deferred until further notice.<sup>6</sup>

### Fourth Circuit

In a standing order issued March 23, 2020, the Fourth Circuit temporarily suspended the requirement that an oral argument take place before the publication of an opinion. Cases calendared for oral argument in March or April 2020 but not presented at oral argument may be decided by published opinion by unanimous consent of the panel.<sup>7</sup>

Cases previously scheduled for argument during the March 17-20, 2020 and April 7, 2020 argument sessions will be heard at a later session, heard by teleconference or videoconference, or submitted on the briefs at the discretion of assigned panels.

The Fourth Circuit, as of March 17, 2020, suspended the requirement of paper copies of formal briefs and appendices pending further notice.<sup>8</sup>

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<sup>4</sup> Tom McParland, "'Maiden Voyage' on a Stormy Sea: 2<sup>nd</sup> Circuit Holds 1<sup>st</sup> Set of Oral Argument Teleconferences in Face of Coronavirus", NEW YORK LAW JOURNAL (March 19, 2020), <https://www.law.com/newyorklawjournal/2020/03/19/maiden-voyage-on-a-stormy-sea-2nd-circuit-holds-1st-set-of-oral-argument-teleconferences-in-face-of-coronavirus/>.

<sup>5</sup> Second Standing Order Concerning Oral Argument, Admin. 2020-03-27 (Cal. 2020).

<sup>6</sup> <https://www.ca3.uscourts.gov/sites/ca3/files/COVID%20Notice.pdf>.

<sup>7</sup> <http://www.ca4.uscourts.gov/docs/pdfs/noticestandingorder20-01.pdf?sfvrsn=8>.

<sup>8</sup> <http://www.ca4.uscourts.gov/docs/pdfs/publicadvisorycovidoperatingprocedures.pdf?sfvrsn=4>.

**Fifth Circuit**

In an order dated March 25, 2020, the Fifth Circuit canceled oral arguments scheduled for April 27-30, 2020.<sup>9</sup> The court initially cancelled oral arguments scheduled to take place between March 30, 2020 and April 2, 2020 and rescheduled them to take place April 27-30, 2020. The court is working with counsel in those cases for the submission of those cases to three-judge panels.<sup>10</sup>

The Fifth Circuit also suspended all requirements to file paper copies until further notice of the court. The Clerk of the Court may direct the parties or counsel to provide paper copies on a case-by-case basis, and at a future date, parties or counsel may be directed to provide paper copies of filings previously submitted electronically. Otherwise, all current deadlines remain in effect.

Although we haven't yet located a general (or case-specific) order from the Fifth Circuit, in an interview with LAW360, Judge Jennifer Elrod provided another unique — at least as best as we can tell — procedural change whereby the Court decided to forgo oral arguments for *en banc* matters during May and, instead, will ask the lawyers to submit answers to written questions.

**Sixth Circuit**

On March 16, 2020, the Sixth Circuit announced that oral arguments scheduled to take place during March 17-20, 2020 would be postponed. On April 7, 2020, the Sixth Circuit announced that in-person oral arguments have been cancelled for the weeks of April 27 and May 4, 2020. The court will reschedule some arguments to be heard remotely. All remote arguments will be recorded and posted to the court's website on the same day that arguments are held.<sup>11</sup>

The requirement that non-prisoner *pro se* litigants file exclusive in-paper format was temporarily suspended, and the suspension is effective until May 30, 2020. Litigants in this category can submit their documents to a dedicated e-mail address.

**Seventh Circuit**

In a notice dated March 18, 2020, the Seventh Circuit announced that all cases scheduled for oral argument from March 30, 2020 through the end of April 2020 will be argued telephonically by counsel. The courtroom will be closed to the public, but arguments will be recorded and posted on the court's website. The court did not give a timeline for posting arguments. If all parties agree

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<sup>9</sup> [http://www.ca5.uscourts.gov/docs/default-source/default-document-library/general-order-2-covid-19.pdf?sfvrsn=17ffcb2d\\_0](http://www.ca5.uscourts.gov/docs/default-source/default-document-library/general-order-2-covid-19.pdf?sfvrsn=17ffcb2d_0).

<sup>10</sup> [http://www.ca5.uscourts.gov/docs/default-source/default-document-library/order-1-clerks-office-covid-19.pdf?sfvrsn=def8cb2d\\_2](http://www.ca5.uscourts.gov/docs/default-source/default-document-library/order-1-clerks-office-covid-19.pdf?sfvrsn=def8cb2d_2).

<sup>11</sup> <https://www.ca6.uscourts.gov/sites/ca6/files/2nd%20Web%20Notice-April%207%202020.pdf>.

among themselves to waive oral argument, they may jointly file a motion with the court seeking permission to do so.

In an order dated March 31, 2020, the Seventh Circuit suspended the paper copy requirement for all electronically filed briefs, appendices and petitions for rehearing required by F.R.A.P. 30(a)(3), C.R. 31(b) and C.R. 40(b). The order specified that the court may direct the counsel of parties to provide paper copies of filings on a case-by-case basis. The suspension does not apply to any cases currently scheduled for oral argument. Paper copies must still be served on *pro se* litigants.

### **Eighth Circuit**

The Eighth Circuit has restricted access to its courthouse but otherwise remains open for business.<sup>12</sup>

### **Ninth Circuit**

As of March 26, 2020, oral arguments currently scheduled in March, April and May of 2020 are being evaluated one at a time, and individual orders will issue in those cases giving direction to the parties. Panels may exercise their discretion under the rules to submit cases without argument, to postpone argument to a later date, or to hold argument via telephone or video. When argument is held, it will be livestreamed to facilitate public access.

The court will extend filing deadlines as needed. For any case not yet calendared, the Court asked that paper copies of electronically filed briefs or excerpts not be submitted until further order of the court. This suspension does not apply to cases that are already calendared.<sup>13</sup>

### **Tenth Circuit**

In a general order filed March 16, 2020, the Tenth Circuit closed its courthouse to the public, effective March 17, 2020. Filings are to be made electronically or via mail.

In addition, the order stated that the requirement for parties to submit paper copies of briefs, appendices, and petitions for rehearing *en banc* is temporarily suspended until further notice. However, the paper-copy requirement will be reinstituted at a later date. At that time, parties may be required to submit paper copies of briefs, appendices and petitions for rehearing *en banc* filed during the period of suspension.<sup>14</sup>

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<sup>12</sup> <https://ecf.ca8.uscourts.gov/files/coronavirusweb.pdf>.

<sup>13</sup> <http://cdn.ca9.uscourts.gov/datastore/general/2020/03/16/COVID-19%20Notice.pdf>.

<sup>14</sup> [https://www.ca10.uscourts.gov/sites/default/files/clerk/RestrictionsOnPublicAccess\\_March162020%20%28002%29.pdf](https://www.ca10.uscourts.gov/sites/default/files/clerk/RestrictionsOnPublicAccess_March162020%20%28002%29.pdf).

Cases scheduled for argument in April or May of 2020 will be argued telephonically, submitted on the briefs, or be reset for in-person argument at a later date. The court has not made a statement about whether recordings of arguments that take place will be made available online.

### **Eleventh Circuit**

In a general order submitted March 15, 2020, the Eleventh Circuit announced that access to the courthouse would be restricted to judges, court staff, members of the media, and visitors with official business with the court.<sup>15</sup>

Parties who have filed their briefs through CM/ECF will temporarily not be required to file paper copies of briefs and appendices should that party file a notice stating that they are unable to comply with the requirement but will do so at a future date to be established by the court.<sup>16</sup>

In an order dated March 20, 2020, the Eleventh Circuit authorized panels to hear any and all oral arguments by audio or teleconferencing instead of in person. Where feasible, oral arguments not conducted in the open courtroom but instead are done by audio or teleconferencing will be livestreamed to the public at no cost to anyone who wishes to listen. In any event, recordings of oral arguments will be made available to the public without cost on the court's website after the argument.<sup>17</sup>

### **What's Ahead**

Some appellate courts have been offering live or same-day access to oral arguments since before the crisis hit, and more are signing on to offer increased public access. Access to live or same-day audio is likely to persist, in the name of offering increased public access to court proceedings, even after the pandemic. In contrast, the relaxed requirements for paper filings are likely to be temporary; many appellate courts have explicitly stated that the suspension is temporary, and parties and counsel may be asked to provide paper copies at a later date. Some courts, such as the Federal Circuit, are still actively collecting paper copies of submissions. It remains to be seen whether the option to proceed with oral arguments remotely will last beyond the current crisis. Some courts, such as the Tenth Circuit, have already offered the option of presenting oral arguments by interactive videoconference to reduce the cost of litigation for attorneys and their clients, and this option may continue to be provided by appellate courts in the future.

The Fifth Circuit's use of written questions/answers in lieu of oral argument for *en banc* hearings presents an interesting consideration — not so much whether it will persist as a substitute for hearings once the pandemic subsides, but also whether it might find utilization in conjunction with

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<sup>15</sup> <http://www.ca11.uscourts.gov/sites/default/files/courtdocs/clk/GeneralOrder44.pdf>.

<sup>16</sup> <http://www.ca11.uscourts.gov/sites/default/files/courtdocs/clk/GeneralOrder44.pdf>.

<sup>17</sup> <http://www.ca11.uscourts.gov/sites/default/files/courtdocs/clk/GeneralOrder45.pdf>.

hearings. Perhaps, then, depending on the Fifth Circuit experience, we may see follow-up interviews with judges and/or attorneys praising the written questions/answers procedure as being efficient, allowing deeper elucidation of issues, etc. or criticizing it as being too rigid or confining, etc. We will monitor and follow up as this practice unfolds.

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# Clients & Friends Memo

## COVID-19 Update: FCA Publishes Final Guidance on Temporary Financial Relief for Consumer Credit Customers Affected by COVID-19

April 15, 2020

### Background

As discussed in a previous clients and friends [memorandum](#), on 2 April 2020, the UK Financial Conduct Authority (“**FCA**”) proposed a number of temporary measures designed to support users of certain consumer credit products during the adverse economic conditions in the UK generated by the COVID-19 pandemic. Following a very short consultation period, the FCA published its final guidance<sup>1</sup> for firms on 9 April 2020.

The FCA’s guidance only applies where consumers are already experiencing, or reasonably expected to experience, temporary payment difficulties as a result of the COVID-19 pandemic. Where a customer was in pre-existing financial difficulty, the FCA’s existing forbearance rules and guidance in the Consumer Credit section of the FCA’s Handbook (“**CONC**”) will continue to apply. These would include, for example, the firm considering suspending, reducing, waiving or cancelling any further interest or charges, deferring payment of arrears or accepting token payments for a reasonable period of time.

The guidance explains and gives context to Principle 6 of the FCA’s Principles for Business (“*A firm must pay due regard to the interests of its customers and treat them fairly*”). The FCA states that the guidance is potentially relevant to enforcement cases and will likely take it into account when considering whether it could reasonably have been understood or predicted at the time that the conduct in question fell below the standards required by Principle 6.

The key aspect of the final guidance, in respect of personal loans and credit cards, is that firms should provide a three-month payment deferral in most cases where requested by a borrower. The FCA has, however, made a number of significant changes and clarifications to the guidance consulted on last week. Alongside the guidance, the FCA also published a feedback statement,

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<sup>1</sup> The FCA temporary guidance for credit cards is available [here](#), guidance for personal loans [here](#) and guidance for overdrafts [here](#).

available [here](#), explaining its views on the responses to the consultation. This memorandum highlights the key differences between the proposals of 2 April 2020 and the final guidance.

### **Scope of Application of Personal Loan Guidance**

In relation to “personal loans”, the FCA have clarified that a “personal loan” refers to a regulated credit agreement, secured (other than on land) or unsecured; including a guarantor loan, a logbook loan (secured by Bill of Sale), home collected credit or a loan issued by a Community Development Finance Institution. The personal loans guidance does not apply to business loans, high-cost short-term credit agreement, buy now pay later agreements, hire purchase agreements (including motor finance), peer to peer agreements, pawnbroking agreements, premium finance, credit card and other retail revolving credit agreement or overdraft. That said, the regulator has made clear it will act in relation to high cost credit and motor finance in the coming days, while credit card and overdrafts are covered by other revised FCA temporary guidance.

### **Timing**

The measures in the guidance should be brought into effect no later than 14 April 2020, to give firms an opportunity to amend their systems and documentation. Firms are free, however, to implement these measures sooner, at any time from 9 April, if they wish, and the FCA would welcome firms doing so. To facilitate this, the changes to CONC rules come into effect on 9 April 2020.

### **Ability to Refuse Requests for a Deferral**

The guidance for both personal loans and credit cards states that “*A firm should grant the customer a payment deferral for three months unless the firm determines (acting reasonably) that it is obviously not in the customer’s interests to do so*”. There is further detail on how firms might be able to reach the conclusion that deferral would be “obviously not in a customer’s best interests”, referring to an assessment of the customer’s need for temporary support and the longer term effects of the payment deferral on a customer’s financial situation. The FCA gives an example of a situation where a deferral would be obviously not in a customer’s best interest: where granting a payment deferral would give the firms’ customers a greater overall debt burden compared to other solutions available (that might involve reduced or waived interest for example) that could equally meet customers’ needs and that burden would be clearly unsustainable.

### **Alternative Measures**

Where the firm has determined that a 3 month payment deferral is not considered appropriate, firms should offer other ways to provide temporary relief to the customer, “*without unreasonable delay*”. The guidance does not prevent firms from providing more favourable forms of assistance (e.g. a longer payment deferral) if deemed appropriate.

**Additional CONC Rule Changes and the Need to Investigate a Customer's Circumstances**

In relation to both personal loans and credit cards, the FCA have clarified that there is no expectation under the guidance that the firm makes enquiries with each customer to determine the circumstances surrounding a request for a payment deferral, or whether this is not in the customer's interests. This is a change from the original guidance which referred to firms being able to make enquiries to determine whether a deferral serves a customer's best interests. This seems to leave as the position that a firm can only make the determination as to whether a deferral would be "obviously not in a customer's best interest" (referred to above) based on existing information it holds in relation to a customer and should not ask for financial information or evidence of COVID-19 related financial hardship. To ensure customers are offered quick support, the FCA has confirmed in its feedback statement that firms can consider whether the offering of a payment deferral period is in customers' best interests at a book/cohort level, rather than having individual conversations with customers about their circumstances. The FCA will also disapply CONC 6.7.18R and CONC 6.7.19R (consumer credit rules relating to refinancing of customer's debt) to allow for the scheme.

**Timing for Applications for Deferral**

The FCA have clarified that customers do not have to apply immediately for a payment deferral – the FCA said they should be able to request a payment deferral at any point in the three months from the date of application of the guidance. This means that payment deferrals could run beyond 14 July 2020.

**Impact on Credit Status and Firms' Operational Difficulties**

Where customers have been unable to reach timely agreement with firms for a payment deferral, because of firms' operational difficulties, and subsequently miss a payment which is reported to their credit file, or where they have entered into a similar temporary payment deferral arrangement with their lender as a result of the coronavirus situation which has resulted in a worsening arrears status being reported, the FCA expects firms to work with customers and Credit Reference Agencies to ensure that any necessary rectifications are made to credit files to ensure no worsening arrears status is recorded during the payment deferral period. Firms will also have to ensure no default or arrears charges are levied in relation to payments missed in these circumstances.

**Indulgences and Waivers**

For credit card lenders using indulgences or waivers to give customers a payment deferral under this guidance, the FCA expects such firms to also give these customers indulgences or waivers to relieve the customers from any potentially adverse consequences arising under the contract from non-payment during the payment deferral (for example in relation to fees and charges and 0% interest deals).

**No Card Suspensions**

Credit card customers whose payments have been deferred under this guidance should not have the use of their cards or credit facility suspended except where the firm acts in accordance with its obligations under section 98A of the Consumer Credit Act 1974, for example in the event of fraud.

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# Clients & Friends Memo

## COVID-19 Update: IRS Issues Securitization Guidance on Coronavirus-Related Forbearances

April 13, 2020

On April 13, 2020, the Internal Revenue Service issued a helpful [revenue procedure](#) that permits loans that are subject to certain forbearances and related modifications as a result of the COVID-19 pandemic to be contributed to, and held in, real estate mortgage investment conduits (**REMICs**) and grantor trusts without jeopardizing these vehicles' U.S. tax status.

More specifically, under the revenue procedure:

- *LTV test.* A mortgage loan's LTV does not have to be retested as a result of a qualified forbearance to determine whether the loan is REMIC-eligible;
- *Deemed reissuance.* A qualified forbearance of a loan that is held by a REMIC or grantor trust does not jeopardize the tax status of the REMIC or grantor trust;
- *Foreclosure-restriction.* A qualified forbearance before a loan is contributed to a REMIC does not restrict the REMIC from later foreclosing on the loan; and
- *Unconditional entitlement to payments.* Interest shortfalls and special servicing fees incurred as a result of a qualified forbearance do not cause a REMIC's regular interests to fail to qualify as such.

For these purposes, qualified forbearances are:

- Forbearances under certain federally backed residential and multifamily mortgage loans that are granted under the Coronavirus Aid, Relief, and Economic Security Act (the **CARES Act**);<sup>1</sup> and
- Similar forbearances of up to six months that are provided to borrowers experiencing a financial hardship due, directly or indirectly, to the COVID-19 emergency and are requested or agreed to between March 27, 2020, and December 31, 2020,

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<sup>1</sup> For a discussion of the CARES Act, see our recent [Clients & Friends Memo](#).

in each case together with any related modifications. The revenue procedure does not define related modifications, but gives as examples (1) the capitalization of deferred interest and (2) the re-amortization of a loan to preserve its original maturity date.

The remainder of this memo describes the relief provided by the revenue procedure in greater detail.

### **Qualified Mortgages**

An entity qualifies as a REMIC only if, in general, substantially all of its assets consist of qualified mortgages, foreclosure property, and specified short-term investments and reserves.

A mortgage loan is a qualified mortgage only if it is principally secured by an interest in real property and is contributed to the REMIC on its startup day. Tax regulations provide that a mortgage loan is principally secured by real property if the value of the underlying real property is at least 80% of the mortgage loan's adjusted issue price (that is, the mortgage loan's loan-to-value (**LTV**) ratio is less than 125%).

Tax regulations permit the LTV test to be satisfied on either the date that the loan was contributed to the REMIC or the date that the loan was originated. In the current economic environment, there is a risk that a loan will not satisfy the LTV test on the date that it is contributed to a REMIC. Accordingly, REMICs may have to rely on the loan's origination-date LTV to establish that it is a qualified mortgage.

The revenue procedure provides that a loan's LTV will not have to be retested after its origination as a result of a qualified forbearance.

### **Modifications**

A "significant modification" of a mortgage loan is treated as a taxable exchange of the loan for a new loan. If a REMIC holds the loan, then, unless an exception applies, this deemed exchange would be an impermissible acquisition of a newly issued non-qualified mortgage. If a grantor trust holds the loan, then the deemed exchange could be an impermissible exercise of a "power to vary." In either case, the deemed exchange could jeopardize the entity's U.S. tax status.

The revenue procedure provides that a qualified forbearance does not jeopardize a REMIC's or grantor trust's U.S. tax status.

### **Foreclosure-Restricted Loans**

Real property acquired in foreclosure does not constitute a good REMIC asset if, when the REMIC acquired the related loan, the REMIC knew or had reason to know that the loan would default (that is, the REMIC had **improper knowledge**). A REMIC can lose its REMIC status if at any time

beginning three months after the REMIC's start-up day, more than a *de minimis* amount of its assets are bad REMIC assets. Accordingly, if a REMIC has improper knowledge with respect to a loan, then it must sell the loan before foreclosure.

The revenue procedure provides that a qualified forbearance does not cause a REMIC to have improper knowledge.

#### **Unconditional Entitlement to Payment**

The "regular interests" that a REMIC issues to investors must unconditionally entitle the investors to receive a specified principal amount (or a similar amount). Some market participants have expressed concern that if a REMIC acquires a pool of mortgage loans on which it does not expect principal to be fully repaid (because some of the loans are distressed), the REMIC cannot issue regular interests that "unconditionally entitle" the holders to a face amount equal to the principal amount on the mortgage loans.

Similarly, a servicer may be unable to advance interest on loans or a special servicer might charge additional fees to the REMIC in connection with workout and foreclosure activities; the servicer's inability to advance or the imposition of these fees also would delay and/or reduce amounts that otherwise would be payable on the REMIC's regular interests. Finally, payments under a forbearance may not accrue compound interest, resulting in shortfalls on the REMIC's regular interests.

The revenue procedure provides that these potential shortfalls do not cause an interest to fail to qualify as a REMIC regular interest.

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# Clients & Friends Memo

## COVID-19 Update: The Paycheck Protection Program and the Secondary Market

April 13, 2020

Last week, the Board of Governors of the Federal Reserve System (the “Federal Reserve”), the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively, the “Banking Agencies”) adopted two measures to facilitate aid to small business employees under the CARES Act. First, the Federal Reserve announced the formation of the Paycheck Protection Program Loan Facility (the “PPPLF”), a program established under Section 13(3) of the Federal Reserve Act which enables insured depository institution to obtain financing from the Federal Reserve Banks collateralized by Paycheck Protection Program (“PPP”) loans. The Federal Reserve’s announcement stated that the PPPLF would later be expanded to include PPP financing for loans held by nonbank lenders.<sup>1</sup> Second, the Banking Agencies announced that PPP loans held by banking organizations are assigned a zero-percent risk-weight for purposes of U.S. risk-based capital requirements, essentially making PPP loans exempt from risk-based (but not leverage) capital requirements when held by a banking organization subject to U.S. capital requirements.<sup>2</sup> The imposition of a zero-percent risk-weight requirement was mandated by Section 1102(O) of the CARES Act.

Considerable confusion remains, however, regarding how PPP loans may be transferred in the secondary market. Until this confusion is resolved, banking entities and other entities with regulatory or internal funding constraints may be unwilling to originate PPP loans without a clear path for obtaining financing or otherwise transferring such loans into the secondary market. This confusion must be addressed promptly to promote the smooth working of the PPP and the delivery of economic aid to small businesses.

This confusion exists due to the nature of the PPP loans and how they are regulated. Section 1102(N) of the CARES Act provides that PPP loans “shall be eligible to be sold in the secondary market consistent with this subsection.” This statement regarding sales in the secondary market

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<sup>1</sup> <https://www.federalreserve.gov/newsevents/pressreleases/monetary20200409a.htm>

<sup>2</sup> <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200409a1.pdf>

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was echoed in Treasury Department releases describing the PPP. “This subsection” refers to Section 7(a) of the Small Business Act.<sup>3</sup> As explained in our prior Clients & Friends memo, [“COVID-19 Update: The SBA’s Paycheck Protection Program Explained”](#), PPP loans are a form of SBA Section 7(a) loans, a traditional form of SBA guaranteed loan. Although not addressed in the CARES Act, the SBA’s existing regulations implementing the CARES Act restrict the ability of Section 7(a) loan to be transferred in the secondary market. In particular, whole loan sales, participations, securitization (referred to as pooled certificates arrangements), and pledges require the consent of the SBA and the involvement of the SBA’s designated fiscal and transfer agent (Colson Services Corp.), and generally require the transferee to be SBA licensed. Given that such loans are guaranteed, these requirements are designed in part to ensure that the SBA is aware of the identity of the holder to whom the SBA owes an obligation under the guarantee.

PPP loans are not only 100% guaranteed but are subject to forgiveness provided that certain conditions were satisfied by the borrower, and thus it is not unreasonable for the SBA to ensure that the entity claiming a right to payment from the SBA holds valid title to the SBA loan and that proper procedures were followed to determine whether the PPP’s forgiveness requirements were fulfilled by the borrower. Unrestricted transfer of PPPs in the secondary market could result in chaos when the PPP loans are later presented to the SBA by the holder for reimbursement for forgiveness or guarantee. In addition, unrestricted transfer could mean that natural persons become direct owners of small business loans, which would be a highly unusual outcome for any credit market. On the other hand, prior approval requirements for loan transfers inhibit the ability to transfer newly originated PPP loans into the secondary market. Given that the PPP entails a massive amount of loans – \$349 billion – to be originated in a very short period – less than three months,<sup>4</sup> transfer restrictions could have a material impact on the ability to get much needed funding to small business quickly. Some compromise is required. It would not be unreasonable to permit PPP loans to be transferred once without prior SBA approval, if transferred to a federal regulated entity (such as an insured depository institution) that provides after the fact notice to the SBA (or Colson). The originating SBA lender could be required to retain responsibility for servicing the loan and for performing the very important role of determining whether the forgiveness conditions have been met (and both the SBA and the transferee bank should be entitled to rely on such originating lender’s determinations).

As for the PPPLF and the capital relief measures, questions remain regarding exactly what type of loan interests are eligible. For example, neither the terms sheet nor the capital relief regulation addresses whether participation interests or pooled certificates are encompassed, or whether these measures instead apply only to whole loans. Likewise, some confusion exists as to whether these measures apply solely to PPP loans originated by the banking organization or whether the measures

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<sup>3</sup> 15 U.S.C. 636.

<sup>4</sup> Note that \$349 billion is more than the prior decade’s worth of SBA 7(a) loan origination.

also include loans acquired by the banking organization. With respect to this last point, the capital relief regulation contains statements that are somewhat inconsistent with each other. To enhance support for the PPP, the Federal Reserve should consider including participation and securitization interests, as well as acquired whole loans, into the PPPLF.

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# Clients & Friends Memo

## COVID-19 Update: ISS Provides Policy Guidance on Limited Duration Poison Pills to Address the Impact of COVID-19

April 10, 2020

On April 8, 2020, Institutional Shareholder Services (“ISS”) published guidance on its voting policies in light of the market-wide effects of the COVID-19 pandemic. While ISS maintains that its existing policies are sufficiently flexible to take into account the impact of COVID-19 on a case-by-case basis, ISS provided more specific guidance on certain issues, including shareholder rights plans, stating that plans with a duration of less than one year will likely be justified in most cases given the impact of the pandemic on stock prices.

The general policy of ISS encourages boards to put rights plans to a shareholder vote, but provides companies with latitude in adopting plans without a shareholder vote if the plan’s duration is less than one year. ISS will evaluate such plans on a case-by-case basis considering the rationale for the plan, its duration and other relevant factors.

Without affirmatively changing its policy on poison pills, the new guidance provides that a “severe stock price decline as a result of the COVID-19 pandemic is likely to be considered valid justification in most cases for adopting a pill of less than one year in duration; however, boards should provide detailed disclosure regarding their choice of duration, or on any decisions to delay or avoid putting plans to a shareholder vote beyond that period.” ISS indicated that the triggers for such plans will continue to be closely evaluated in light of the rationale provided for the plan and its duration. ISS will continue to take a case-by-case approach to evaluating rights plans with a term of less than one year, which will include an examination of the terms and duration of such plans, the board’s justification for adopting the plan, the potential to protect shareholders from abusive bidders without inappropriately entrenching the existing directors and management and any commitments by adopting companies to seek shareholder approval for any plan renewals.

ISS issued the guidance partially in response to a recent increase in the number of companies that have adopted poison pills and the advice of several law firms and financial advisors that boards consider implementing plans. Since March 15, 2020, 20 companies have announced the adoption of a shareholder rights plan, and the overwhelming majority have cited COVID-19 or the desire to

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protect against opportunistic bidders in light of recent downward trends in stock prices.<sup>1</sup> These recently adopted plans all have a duration of less than one year and contain beneficial ownership triggers ranging from 5% to 20% (12 plans have a 10% trigger, 6 have a 15% trigger, 1 has a 20% trigger and 1 has a 5% trigger<sup>2</sup>).

ISS will continue to evaluate on a case-by-case basis whether to recommend a vote against or a withhold vote for directors who approve a rights plan with less than one year in duration without a shareholder vote. Companies seeking to implement rights plans and receive a favorable recommendation from ISS will need to structure their plans appropriately and effectively communicate through detailed disclosure the specific rationale for adopting the plan.

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<sup>1</sup> This total excludes rights plans adopted to protect net operating loss carryforwards which serve a different purpose and typically contain different terms.

<sup>2</sup> ISS recently recommended shareholders of a company that adopted a rights plan with a 5% trigger vote against election of the company's Chairman because the recently adopted plan was not put up for a shareholder vote. In making its recommendation, ISS noted that excluding NOL pills, 5% triggers were "extremely rare" and "highly restrictive."

# Clients & Friends Memo

## COVID-19 Update: NYSE Temporarily Waives Certain Shareholder Approval Requirements

April 9, 2020

In order to provide temporary relief to listed companies that may have urgent liquidity needs as a result of the market disruption caused by COVID-19, the New York Stock Exchange has (i) partially waived its shareholder approval requirement for issuances of stock to a “related party” when the number of new shares to be issued is more than 1% of total share volume or voting power and (ii) expanded the existing exception to its shareholder approval requirement for transactions involving the issuance of 20% or more of the company’s outstanding common stock or 20% of the voting power outstanding before such issuance, other than a public offering for cash.<sup>1</sup> The waivers are effective immediately and will remain in effect through June 30, 2020.

### Related Party Transactions

NYSE Listed Company Manual Section 312.03(b) requires, among other things, shareholder approval of any issuance to “related parties,” including directors, officers or substantial security holders or to an affiliate of a related party, if the number of shares of common stock to be issued (or into which the securities may be convertible or exercisable), exceeds either 1% of the number of shares of common stock or 1% of the voting power outstanding before the issuance (the “Related Party Rule”). There is a limited exception to the Related Party Rule for issuances to parties that are related parties only because they are substantial shareholders. Under this exception, shareholder approval is not required for cash sales of up to 5% of the company’s outstanding stock if such sales meet the “minimum price” test: “a price that is the lower of (i) the Official Closing Price<sup>2</sup> immediately preceding the signing of the binding agreement or (ii) the average Official Closing

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<sup>1</sup> NYSE noted that the proposed waivers will temporarily conform the treatment of transactions benefitting from the waivers to their treatment under the comparable Nasdaq Stock Market rules.

<sup>2</sup> NYSE Listed Company Manual Section 312.04(j) defines “Official Closing Price” of an issuer’s common stock as the official closing price on the Exchange as reported to the Consolidated Tape immediately preceding the signing of a binding agreement to issue the securities.

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Price for the five trading days immediately preceding the signing of the binding agreement”<sup>3</sup> (the “Minimum Price”).

NYSE will waive through June 30, 2020, the 1% and 5% limits on share issuances to related parties for transactions that (i) involve the sale of the company’s securities for cash at a price that meets the Minimum Price and (ii) have been reviewed and approved by the company’s audit committee or a comparable committee comprised solely of independent directors.<sup>4</sup> In its proposal, NYSE explained the effect of this waiver will be “to allow companies to sell their securities to Related Parties and other persons subject to Section 312.03(b) without complying with the numerical limitations of that rule,”<sup>5</sup> as long as the transaction meets the requirements noted above.

This waiver, however, will not apply to any sale to a related party where the proceeds will be used to fund an acquisition of another company in which the related party has an interest. Specifically, the waiver will not apply to any transaction where a related party has a 5% or greater interest (or related parties collectively have a 10% or greater interest), directly or indirectly, in the company or assets to be acquired *and* the issuance of stock (including securities convertible into or exercisable for common stock) could result in an increase of 5% or more in outstanding stock or voting power.

#### **Transactions of 20% or More of Outstanding Common Stock**

NYSE Listed Company Manual Section 312.03(c) requires shareholder approval for transactions involving the issuance of 20% or more of the company’s outstanding common stock or 20% of the voting power outstanding before such issuance, other than a public offering for cash (the “20% Rule”). Section 312.03(c) provides an exception to the 20% Rule for transactions involving a cash sale of the company’s securities that comply with the Minimum Price requirement and also meet the definition of a “bona fide private financing,” as set forth in Section 312.04(g): A “bona fide private financing” refers to a sale in which either (i) a registered broker-dealer purchases the securities from the issuer with a view to the private sale of such securities to one or more purchasers or (ii) the issuer sells the securities to multiple purchasers, and no one such purchaser, or group of related purchasers, acquires, or has the right to acquire upon exercise or conversion of the securities, more than 5% of the shares of the issuer’s common stock or more than 5% of the issuer’s voting power before the sale.

NYSE will waive through June 30, 2020, for purposes of the “bona fide private financing” exception to the 20% Rule, the 5% limitation for any sale to an individual investor in a bona fide private financing and permit companies to undertake a bona fide private financing during that period in

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<sup>3</sup> NYSE Listed Company Manual Section 312.04(j).

<sup>4</sup> This NYSE waiver is consistent with the application of Nasdaq Marketplace Rule 5635(a).

<sup>5</sup> Securities Exchange Act Release No. 34-88572 (April 6, 2020).

which there is only a single purchaser.<sup>6</sup> Any transaction benefiting from this waiver must be a sale of the company's securities for cash at a price that meets the Minimum Price requirement. NYSE explained that the effect of this waiver will be that "a listed company [will] be exempt from the shareholder approval requirement of Section 312.03(c) in relation to a private placement transaction regardless of its size or the number of participating investors or the amount of securities purchased by any single investor, provided that the transaction is a sale of the company's securities for cash at a price that meets the Minimum Price requirement."<sup>7</sup>

### **Additional Considerations**

It is important to note that, as provided by NYSE Listed Company Manual Section 312.03, any transaction benefiting from either of these two waivers is still subject to shareholder approval if required under any other applicable rule, including the equity compensation requirements of Section 303A.08 and the change of control requirements of Section 312.03(d).

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<sup>6</sup> This NYSE waiver is consistent with the application of Nasdaq Marketplace Rule 5635(c).

<sup>7</sup> See *supra* note 5.

# Clients & Friends Memo

## COVID-19 Update: Federal Reserve Broadens Range of Eligible Collateral for Term Asset-Backed Securities Loan Facility (TALF)

April 9, 2020

### TALF Extended to Legacy CMBS and CLOs

On April 9, 2020, the Federal Reserve unveiled an array of additional programs to bolster the U.S. economy in response to the COVID-19 pandemic. One of those programs is aimed at expanding the coverage of the Federal Reserve's previously announced Term Asset-Backed Securities Loan Facility (TALF). TALF is a facility intended to help lenders meet the credit needs of households and U.S. businesses by supporting the issuance of asset-backed securities. A summary of the facility is available [here](#).

Today's announcement includes the following updates to the TALF program:

- Eligible Collateral to include Certain CMBS and CLOs. Both commercial mortgage-backed securities (CMBS) and collateralized loan obligations (CLOs) other than commercial real estate CLOs (CRE CLOs) will be included in the assets that are eligible to be pledged to the Federal Reserve under the TALF.
  - CMBS must have been issued *prior* to March 23, 2020 and the underlying credit exposures must be to real property located in the United States or one of its territories.
  - Only static CLOs will be eligible collateral. The eligible issuer must be a U.S. company and all or substantially all of the underlying loans must be "newly issued." Whether the standard CLO Cayman/Delaware co-issuer structure will be an eligible issuer and the meaning of "newly issued" are open questions.
- Eligible Borrower. The definition of Eligible Borrower was updated to "a business that is created or organized in the United States or under U.S. laws and that has significant operations in and a majority of its employees based in the United States."
- Exclusions from Eligible Collateral. Single-asset, single-borrower (SASB) CMBS and CRE CLOs will not be eligible collateral. In addition, servicing advance receivables are no longer eligible collateral.

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- Other Additional Eligible Collateral. Equipment leases and leveraged loans were also added as eligible collateral.

These updates are reflected in a new term sheet released by the Federal Reserve that is available [here](#). The term sheet includes the “haircut” schedule that will be imposed on the different asset-classes that are permitted to be purchased under the TALF, which is consistent with the schedule used for the TALF program established in 2008. A comparison of the term sheet released on April 9, 2020 against the original term sheet released on March 23, 2020 is annexed to this memorandum.

### Feedback

As the Federal Reserve and the Treasury Department finalize the programs, they continue to seek input from lenders, borrowers and other stakeholders. Comments may be sent until April 16, 2020 on the feedback form provided [here](#).

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**Term Asset-Backed Securities Loan Facility**

[Effective April 9, 2020<sup>1</sup>](#)

**Facility:** The TALF is a credit facility authorized under section 13(3) of the Federal Reserve Act intended to help meet the credit needs of consumers and ~~small~~ businesses by facilitating the issuance of asset-backed securities ("ABS") and improving the market conditions for ABS more generally. The TALF will serve as a funding backstop to facilitate the issuance of eligible ABS on or after March 23, 2020.

Under the TALF, the Federal Reserve Bank of New York ("Reserve Bank") will commit to lend to a special purpose vehicle ("SPV") on a recourse basis. The Department of the Treasury will make an equity investment of \$10 billion in the SPV ~~in connection with the Facility~~, as described below.

The TALF SPV initially will make up to \$100 billion of loans available. The loans will have a term of three years; will be nonrecourse to the borrower; and will be fully secured by eligible ABS.

**Eligible Borrowers:** All U.S. companies that own eligible collateral and maintain an account relationship with a primary dealer are eligible to borrow under the TALF. ~~For the purpose of this document, a U.S. company would be~~ [defined as a U.S. business entity that is created or organized in the United States or under the laws of the United States or a political subdivision or territory thereof \(including such an entity that has a non-U.S. parent company\), or a U.S. branch or agency of a foreign bank and that has significant operations in and a majority of its employees based in the United States.](#)

**Eligible Collateral:** Eligible collateral includes U.S. dollar denominated cash (that is, not synthetic) ABS that have a credit rating in the highest long-term or [in the case of non-mortgage backed ABS](#), the highest short-term investment-grade rating category from at least two eligible nationally recognized statistical rating organizations ("NRSROs") and do not have a credit rating below the highest investment-grade rating category from an eligible NRSRO. All or substantially all of the credit exposures underlying eligible ABS must have been originated by a U.S. company: ~~Eligible, and the issuer of eligible collateral must be a U.S. company. With the exception of commercial mortgage-backed securities ("CMBS"), eligible~~ [ABS must be issued on or after March 23, 2020. CMBS issued on or after March 23, 2020, will not be eligible. For CMBS, the underlying credit exposures must be to real property located in the United States or one of its territories.](#)

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<sup>1</sup> [The Board of Governors of the Federal Reserve System \("Board"\) and Secretary of the Treasury may make adjustments to the terms and conditions described in this term sheet. Any changes will be announced on the Board's website.](#)

Eligible collateral must be ABS where the underlying credit exposures are one of the following:

- 1) Auto loans and leases;
- 2) Student loans;
- 3) Credit card receivables (both consumer and corporate);
- 4) Equipment loans and leases;
- 5) Floorplan loans;
- 6) Insurance premium finance loans;
- 7) Certain small business loans that are guaranteed by the Small Business Administration;
- 8) Leveraged loans; or
- 9) ~~8) Eligible servicing advance receivables.~~<sup>†</sup> Commercial mortgages.<sup>2</sup>

Eligible collateral will not include ABS that bear interest payments that step up or step down to predetermined levels on specific dates. In addition, the underlying credit exposures of eligible collateral must not include exposures that are themselves cash ABS or synthetic ABS.

To be eligible collateral, all or substantially all of the underlying credit exposures must be newly issued, except for legacy CMBS.

The feasibility of adding other asset classes to the facility or expanding the scope of existing asset classes will be considered in the future.

**Conflicts of interest:** Eligible borrowers and issuers of eligible collateral will be subject to the conflicts of interest requirements of section 4019 of the CARES Act.

**Restriction on single-asset single-borrower (“SASB”) CMBS and commercial real estate collateralized loan obligations (“CRE CLOs”):** SASB CMBS and CRE CLOs will not be eligible collateral.

**Restrictions on CLO loan substitution:** Only static CLOs will be eligible collateral.

**Collateral Valuation:** Haircut schedule is below. The ~~pledged eligible collateral will be valued and assigned a haircut according to a schedule based on its sector, the weighted average life, and historical volatility of the ABS. This haircut schedule will be published in the detailed terms and conditions and will be roughly in line with the haircut schedule used for the TALF Facility~~ haircut schedule is consistent with the haircut scheduled used for the TALF established in 2008.

**Pricing:** For CLOs, the interest rate will be 150 basis points over the 30-day average secured overnight financing rate (“SOFR”). For SBA Pool Certificates (7(a) loans), the interest rate will be the top of the federal funds target range plus 75 basis points. For SBA Development Company

<sup>†2</sup> The detailed terms and conditions will further define the eligible underlying credit exposures for purposes of the TALF. The definitions are expected to be broadly consistent with the defined terms used for purposes of the TALF established in 2008.

Participation Certificates (504 loans), the interest rate will be 75 basis points over the 3-year fed funds overnight index swap ("OIS") rate.

For all other eligible ABS with underlying credit exposures that do not have a government guarantee, the interest rate will be ~~100~~125 basis points over the 2-year ~~LIBOR swap~~OIS rate for securities with a weighted average life less than two years, or ~~100~~125 basis points over the 3-year ~~LIBOR swap~~OIS rate for securities with a weighted average life of two years or greater.<sup>2</sup> The pricing for other eligible ABS will be set forth in the detailed terms and conditions.

**Fees:** The SPV will assess an administrative fee equal to 10 basis points of the loan amount on the settlement date for collateral.

**Maturity:** Each loan provided under this facility will have a maturity of three years.

**Investment by the Department of the Treasury:** The Department of the Treasury, using the Exchange Stabilization Fund, will make an ~~initial~~ equity investment of \$10 billion in the SPV.

**Non-Recourse:** Loans made under the TALF are made without recourse to the borrower, provided the requirements of the TALF are met.

**Prepayment:** Loans made under the TALF will be pre-payable in whole or in part at the option of the borrower, but substitution of collateral during the term of the loan generally will not be allowed.

**Program Termination:** No new credit extensions will be made after September 30, 2020, unless the TALF is extended by the Board of Governors of the Federal Reserve System and the Department of the Treasury.

**Other Terms and Conditions:** More detailed terms and conditions will be provided at a later date, primarily based off of the terms and conditions used for the 2008 TALF. In addition, the Federal Reserve reserves the right to review and make adjustments to these terms and conditions ~~=~~ = including size of program, pricing, loan maturity, collateral haircuts, and asset and borrower eligibility requirements ~~=~~ = consistent with the policy objectives of the TALF.

#### Haircut Schedule:

Sector	Subsector	ABS Average Life (years)*						
		0-<1	1-<2	2-<3	3-<4	4-<5	5-<6	6-<7

<sup>2</sup> if necessary, the pricing structure would be updated to account for the expected industry transition away from LIBOR.

<u>Auto</u>	<u>Prime retail lease</u>	<u>10%</u>	<u>11%</u>	<u>12%</u>	<u>13%</u>	<u>14%</u>		
<u>Auto</u>	<u>Prime retail loan</u>	<u>6%</u>	<u>7%</u>	<u>8%</u>	<u>9%</u>	<u>10%</u>		
<u>Auto</u>	<u>Subprime retail loan</u>	<u>9%</u>	<u>10%</u>	<u>11%</u>	<u>12%</u>	<u>13%</u>		
<u>Auto</u>	<u>Motorcycle/ other recreational vehicles</u>	<u>7%</u>	<u>8%</u>	<u>9%</u>	<u>10%</u>	<u>11%</u>		
<u>Auto</u>	<u>Commercial and government fleets</u>	<u>9%</u>	<u>10%</u>	<u>11%</u>	<u>12%</u>	<u>13%</u>		
<u>Auto</u>	<u>Rental fleets</u>	<u>12%</u>	<u>13%</u>	<u>14%</u>	<u>15%</u>	<u>16%</u>		
<u>Credit Card</u>	<u>Prime</u>	<u>5%</u>	<u>5%</u>	<u>6%</u>	<u>7%</u>	<u>8%</u>		
<u>Credit Card</u>	<u>Subprime</u>	<u>6%</u>	<u>7%</u>	<u>8%</u>	<u>9%</u>	<u>10%</u>		
<u>Equipment</u>	<u>Loans and Leases</u>	<u>5%</u>	<u>6%</u>	<u>7%</u>	<u>8%</u>	<u>9%</u>		
<u>Floorplan</u>	<u>Auto</u>	<u>12%</u>	<u>13%</u>	<u>14%</u>	<u>15%</u>	<u>16%</u>		
<u>Floorplan</u>	<u>Non-Auto</u>	<u>11%</u>	<u>12%</u>	<u>13%</u>	<u>14%</u>	<u>15%</u>		
<u>Premium Finance</u>	<u>Property and casualty</u>	<u>5%</u>	<u>6%</u>	<u>7%</u>	<u>8%</u>	<u>9%</u>		
<u>Small Business</u>	<u>SBA Loans</u>	<u>5%</u>	<u>5%</u>	<u>5%</u>	<u>5%</u>	<u>5%</u>	<u>6%</u>	<u>6%</u>
<u>Student Loan</u>	<u>Private</u>	<u>8%</u>	<u>9%</u>	<u>10%</u>	<u>11%</u>	<u>12%</u>	<u>13%</u>	<u>14%</u>
<u>Leveraged Loans</u>	<u>Static</u>	<u>20%</u>	<u>20%</u>	<u>20%</u>	<u>20%</u>	<u>20%</u>	<u>21%</u>	<u>22%</u>
<u>Commercial Mortgages</u>	<u>Legacy, Conduit</u>	<u>15%</u>	<u>15%</u>	<u>15%</u>	<u>15%</u>	<u>15%</u>	<u>16%</u>	<u>17%</u>

\* For auto, credit card, equipment, floorplan, and premium finance ABS, the weighted average life must be five years or less. For other new-issue eligible collateral, haircuts will increase by one percentage point for each additional year (or portion thereof) of average life beyond five years. For legacy CMBS with average lives beyond five years, base dollar haircuts will increase by one percentage point of par for each additional year (or portion thereof) of average life beyond five years. No securitization may have an average life beyond ten years.

# Clients & Friends Memo

## COVID-19 Update: COVID-19 and the Courts

### How Court Procedures Across the Country Are Changing and What May Be Here To Stay

April 7, 2020

#### Overview

Americans are no stranger to calamitous events—whether human-induced (*e.g.*, the 2008 financial crisis) or nature-induced (*e.g.*, Superstorm Sandy)—and the immediate, and often long-term, changes which result. Currently, we face a disastrous pandemic not experienced by generations of Americans and it is causing profound changes in virtually every facet of life—health, personal mobility, business disruption, financial hardship, etc. The aim of this series of articles is to explore the numerous and varied procedural changes occurring in the legal system and to attempt to project those that may persist, even if in modified form, once the emergency is declared over.

#### Emergency Procedures in New York District Courts

In this article, we examine selected procedural changes implemented by the Federal Courts of New York. Specifically, all four District Courts have issued orders suspending commencement of all civil and criminal jury trials for a limited period of time. Personal service of process requirements for the U.S. Marshals Service under Federal Rule of Procedure 4(c)(3) or 28 U.S.C. § 1915(d) are currently suspended in the Southern, Eastern, and Western Districts of New York; and, most of the District Judges and Magistrate Judges for these courts issued individual orders granting filing extensions and hearing adjournments for specific cases on their dockets, as well as “Emergency Individual Rules and Practices” which specify preferred procedures for communicating with chambers and conducting conferences and hearings remotely.

While suspensions, adjournments, and extensions are likely to be limited to the duration of the COVID-19 emergency, other procedures—such as the use of remote-access technology—may persist. For example, new procedures being implemented for teleconferences and remote-participant hearings may become the new norm (or at least more widely offered as options), although they may largely depend on the nature of the hearing and the experiences of the Judiciary (and the Bar) utilizing them. Consider the modified court operations set forth in the notice issued by

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the Southern District of New York, effective March 30, 2020, which indicates that court reporting and interpreting services are to be provided remotely.<sup>1</sup> As participants work through, and solve (in short order), any technological issues and related disruptions that might occur, and, perhaps, realize the judicial and party efficiencies which may result without loss of substantive impact, these mechanisms may become a “new normal.”

### Emergency Procedures in the Second Circuit

The Second Circuit has also adopted the use of technology to ensure the furtherance of justice amidst the limitations on social interactions. On March 23, 2020, the Second Circuit ordered that oral arguments would be heard by way of teleconference and, further, provided for public access by way of livestreaming the oral arguments. Depending on experience over the duration of the emergency, livestreaming public access could very well remain in place because it would allow, indeed encourage, more real-time public participation/observation of court proceedings in the future. In fact, an April 3, 2020 Law360.com article reported that the Clerk of the Court Catherine O'Hagan Wolfe said, “[t]he livestream has been working well.”<sup>2</sup> However, the proverbial jury remains out on whether the Second Circuit will conduct its oral arguments by means of teleconference beyond the current emergency. While perhaps it may remain available under special circumstances where, *e.g.*, arguing counsel cannot appear in-person, the art of oral arguments before the U.S. Courts of Appeals is practiced in a way that renders it far more effective in person—and possibly even via videoconference<sup>3</sup>—than teleconference.

### What's Ahead

As time goes on, we will attempt to follow and examine on-going experiences of the judiciary and the Bar with emergency procedures of the type outlined above and let you know if our predictions may still have viability. To the same end, we will continue to monitor the various courts for new or different emergency procedures and offer similar thoughts on their potential for persisting beyond the COVID-19 emergency.

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<sup>1</sup> Similarly, Local Rules requiring personal appearances for attorney admissions may be waived or performed remotely via teleconference or videoconference at the discretion of the presiding judge in the Eastern and Western Districts of New York. It is very possible that the courts make a decision, in a post COVID-19 world, to permit admissions remotely and only offer in-person swearing in ceremonies on a limited basis.

<sup>2</sup> Brush, Pete; *Virtual 2nd Cir. Off To Smooth Start But No End In Sight*, LAW360.com; <https://www.law360.com/articles/1260407/virtual-2nd-circ-off-to-smooth-start-but-no-end-in-sight>, last visited April 6, 2020.

<sup>3</sup> The U.S. Court of Appeals for the Tenth Circuit, while designating a number of criminal and prison appeals on an oral argument calendar for videoconferencing, also allows counsel in any civil or criminal appeal to request leave to present oral argument by videoconference. <https://www.ca10.uscourts.gov/clerk/videoconferenced-arguments-guide>, last visited April 6, 2020.

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# Clients & Friends Memo

## COVID-19 Update: FCA Proposals on Temporary Financial Relief for Consumer Credit Customers Affected by COVID-19

6 April 2020

### Background

On 2 April 2020, the UK Financial Conduct Authority (“**FCA**”) [proposed](#) a number of temporary measures designed to support users of certain consumer credit products during the adverse economic conditions in the UK generated by the COVID-19 pandemic. These proposals provide guidance to FCA regulated providers of credit cards, retail revolving credit facilities, arranged overdrafts and personal loans. The FCA decided to consult for an unusually short period on these proposals, with the consultation closing at 9:00 a.m. on 6 April 2020. The FCA intends for these measures to come into effect on 9 April 2020.

This memorandum focuses on the FCA’s proposals for firms providing personal loans and credit cards under the UK’s regulated consumer credit regime.

### The FCA’s General Approach to COVID-19 and Consumer Credit

The FCA’s proposed guidance only applies where consumers are already experiencing, or reasonably expected to experience, temporary payment difficulties as a result of the COVID-19 pandemic. Where a customer was in pre-existing financial difficulty, the FCA’s existing forbearance rules and guidance in the Consumer Credit section of the FCA’s Handbook (“**CONC**”) will continue to apply. These would include, for example, the firm considering suspending, reducing, waiving or cancelling any further interest or charges, deferring payment of arrears or accepting token payments for a reasonable period of time.

The proposed guidance is designed to explain and give context to Principle 6 of the FCA’s Principles for Business (“*A firm must pay due regard to the interests of its customers and treat them fairly*”). The FCA states that the guidance is potentially relevant to enforcement cases and will likely take it into account when considering whether it could reasonably have been understood or predicted at the time that the conduct in question fell below the standards required by Principle 6.

**New Guidance Proposed for Personal Loans, Credit Cards and Revolving Credit Facilities**

The proposed guidance suggests the key action firms should take during the crisis is to allow for payment deferrals by a consumer.

In the context of personal loans, a 'payment deferral' is defined as an arrangement under which a consumer credit firm permits the borrower to make no payments under their regulated credit agreement for a specified period without being considered to be in arrears.

In the context of credit cards and revolving credit agreements, a 'payment deferral' means an arrangement under which a firm permits the customer to make no payments (or a token payment not exceeding a £1 where firms' system will not allow a zero payment) under their credit card or revolving credit agreement for a specified period without being considered to be in arrears.

Two separate but similar sets of guidance provide the regulator's expectations in respect of payment deferrals for both types of consumer credit, including the following key aspects:

- Where a customer is experiencing, or reasonably expects to experience, temporary payment difficulties as a result of circumstances relating to COVID-19 (*e.g.*, a reduction in household income), and wishes to receive a payment deferral, a firm should grant the customer a payment deferral for a recommended period of **3 months** (although a firm may grant a payment deferral of fewer than 3 months in certain circumstances – see below).
- The FCA does not expect that firm to investigate the circumstances surrounding a request for deferral (although firms can choose to make enquiries necessary to determine whether a payment deferral serves a customer's best interests). This is an area of the proposed guidance which may need to be refined – it is not clear whether a firm will be entitled to ask for proof of the COVID-19 related circumstances *e.g.*, a wage slip evidencing reduced hours or reduced pay after a customer requests a payment deferral.
- Firms will need to make clear on their websites and in other communications to customers that payment deferrals are available. Even where a customer has not requested a deferral, if a firm receives from the customer information that he or she is experiencing or could reasonably expect to experience, temporary payment difficulties as a result of circumstances relating to COVID-19, the firm should ask whether the customer wishes it to consider granting a payment deferral.
- Firms will need to give customers adequate information about the implications of a payment deferral, including the consequences of interest that is accrued during this period and its effect on the balance due under the agreement and on future payments.
- Firms may continue to charge interest during the 3-month deferral period. If the consumer is unable to resume payments at the end of this period because of payment difficulties at that time,

they should contact the firm. The firm should work with the customer to resolve these difficulties in advance of payments being missed.

- A firm may decide to put in place an option other than a 3-month payment deferral, providing it is appropriate to do so in the individual circumstances of the case and the firm reasonably considers it needs to do this to treat the customer fairly. This could include a payment deferral of fewer than 3 months if, for example, the expected loss of income is for a shorter period, or accepting a sum below the normal payment due if, for example, the loss of income is partial.
- Firms should ensure that there is no negative impact on the customer's credit file because of the payment deferral. In particular, the account of the customer should not be recorded as having any form of detrimental arrears.
- Firms are not permitted to charge any fee or charge to the customer in connection with the granting of a payment deferral.

#### **Specific Provisions Relating to Credit Cards and Revolving Credit Facilities**

- To allow for payment deferrals, the FCA rules in CONC 6.7.5R (which require a firm to set a minimum repayment amount equal to at least the interest, fees and charges that have been applied to the account, plus one percentage of the amount outstanding) will not apply if the firm decides to vary its contracts in order to follow this guidance. The FCA proposing to amend CONC 6.7.5R through secondary legislation<sup>1</sup> to address this.
- The FCA also proposes to suspend the 'persistent debt' remedies provisions in CONC 6.7.27R to 6.7.40G for certain customers. These provisions relate to a situation where a customer is over time paying more in interest, fees and charges than they are paying off their balance and requires firms to engage with the customer at specified intervals. The suspension will apply in respect of a customer, who the firm has allowed to defer repayments for the duration set out in this guidance, for the period of the deferment. The provisions will again start to apply in respect of these customers after the deferment period ends.
- In the light of Principle 6 of the FCA's Principle for Businesses, the proposed guidance suggests firms should review their pricing and interest strategies to consider whether they are consistent with the obligation to treat customers fairly in the light of the exceptional circumstances arising out of COVID-19. According to the FCA, interest rates for these types of products should not pose unjustifiable burdens on these consumers who may be experiencing payment difficulties. Note that the proposed guidance stops short of requiring card lenders to reduce interest rates during the pandemic and recognises that firms will sometimes charge much higher rates for cards which are usually marketed or offered to low income customers or those with poor credit ratings. That said, the clear regulatory expectation is that firms should

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<sup>1</sup> Consumer Credit (Temporary COVID-19 Support Measures) Order 2020.

consider whether it is in line with Principle 6 to maintain such higher rates during the COVID-19 pandemic.

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# Clients & Friends Memo

## COVID-19 Update: Extraordinary Measures in Extraordinary Times: The Federal Reserve Responds to the Coronavirus Pandemic

April 3, 2020

The Federal Reserve has established a number of programs to provide targeted support to the corporate credit, asset-backed securities, money market and commercial paper markets in light of the evolving coronavirus disease 2019 (COVID-19) pandemic. In broad strokes, these temporary programs backstop markets through the purchase or financing of highly rated securities. In this memorandum, we review the mandate and key terms of each program.

The programs fit within a broader context of an extraordinary monetary response to the pandemic. Specifically, to date, the Federal Reserve has addressed the market impact of the coronavirus pandemic by:

- Reducing the federal funds rate to a target range of 0% to 0.25%;<sup>1</sup>
- Expanding the outright purchases of Treasury and agency mortgage-backed securities to open-ended amounts and including the purchase of agency CMBS;<sup>2</sup>
- Reducing the primary credit rate at the Discount Window by 150 bps to 0.25% and permitting depository institution to borrow from the Discount Window for periods of up to 90 days, prepayable and renewable on a daily basis;<sup>3</sup>
- Reducing the rate on standing swap lines, increasing the frequency of operations and adding temporary swap arrangements with nine central banks;<sup>4</sup>

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<sup>1</sup> FOMC Statement, *available* [here](#).

<sup>2</sup> Federal Reserve Announces New Measures to Support the Economy, *available* [here](#); Statement Regarding Agency Commercial Mortgage-Backed Securities Operations, *available* [here](#).

<sup>3</sup> Federal Reserve Actions to Support the Flow of Credit to Households and Businesses, *available* [here](#).

<sup>4</sup> Coordinated Central Bank Action to Enhance the Provision of U.S. Dollar Liquidity, *available* [here](#); Establishment of Temporary U.S. Dollar Liquidity Arrangements with Other Central Banks, *available* [here](#); Coordinated Central Bank Action to Further Enhance the Provision of U.S. Dollar Liquidity, *available* [here](#).

- Restarting the Primary Dealer Credit Facility, allowing primary dealers to finance a wide range of assets for terms of up to 90 days at the same rate as is in effect for depository institutions through the Discount Window;<sup>5</sup> and
- Establishing a temporary repurchase facility to allow central banks and other international monetary authorities to obtain dollar financing against their Treasury securities.<sup>6</sup>

These actions have been complemented by an array of other efforts by the Federal Reserve and other banking agencies to reduce regulatory burdens on lending institutions and remove disincentives to lend.<sup>7</sup> Examples of recent regulatory include the following: (i) an interim final rule to mitigate the regulatory capital effects of the current expected credit loss (“CECL”) methodology for loan loss provisioning on financial on banking organizations;<sup>8</sup> (ii) temporarily excluding Treasury security holdings and reserves on deposit at Federal Reserve Banks from the calculation of the supplementary leverage ratio, which is aimed at relieving balance sheet constraints on large banks;<sup>9</sup> (iii) granting financial institutions additional time to remediate non-critical existing supervisory findings;<sup>10</sup> (iv) allowing the early adoption of the “standardized approach for measuring counterparty credit risk” rule (SA-CCR), which addresses how banking organizations are required to measure counterparty credit risk in derivative contracts;<sup>11</sup> and (v) encouraging depository institutions to use intraday credit extended by the Federal Reserve Banks.<sup>12</sup>

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<sup>5</sup> Federal Reserve Board Announces Establishment of a Primary Dealer Credit Facility (PDCF) to Support the Credit Needs of Households and Businesses, *available [here](#)*.

<sup>6</sup> Federal Reserve Announces Establishment of a Temporary FIMA Repo Facility to Help Support the Smooth Functioning of Financial Markets, *available [here](#)*.

<sup>7</sup> The Federal Reserve maintains a list of supervisory and regulatory actions taken to date in response to the COVID-19 pandemic, *available [here](#)*.

<sup>8</sup> The federal banking agencies issued an interim final rule addressing the regulatory capital impact of CECL, *available [here](#)*. The rulemaking is in addition to the relief from the accounting standard contained in the CARES Act, which provides that insured depository institutions, bank holding companies and their affiliates are not required to comply with the accounting standard until the termination of the COVID-19 outbreak or December 31, 2020, whichever is sooner. Cadwalader published a Clients & Friends Memo on the inter-agency regulatory capital rule, *available [here](#)*.

<sup>9</sup> Federal Reserve Board Announces Temporary Change to Its Supplementary Leverage Ratio Rule to Ease Strains in the Treasury Market Resulting from the Coronavirus and Increase Banking Organizations’ Ability To Provide Credit to Households and Businesses, *available [here](#)*.

<sup>10</sup> Federal Reserve Statement on Supervisory Activities, *available [here](#)*.

<sup>11</sup> Agencies Announce Two Actions to Support Lending to Households and Businesses, *available [here](#)*.

<sup>12</sup> Federal Reserve Actions to Support the Flow of Credit to Households and Businesses, *available [here](#)*.

**PRIMARY MARKET CORPORATE CREDIT FACILITY**

**What is it?** The Primary Market Corporate Credit Facility (“PMCCF”) is the first of the Federal Reserve’s two-part support for corporate debt markets. The PMCCF supports corporate issuers by purchasing newly issued corporate bonds or extending loans based on specified eligibility criteria.

**Who can participate?** The PMCCF may purchase the new issue bonds of or make loans to U.S. companies headquartered in the United States and with material operations in the United States. Eligible issuers do not include companies that are expected to receive direct financial assistance under federal legislation that was pending at the time the program was announced.

**What assets are eligible?** To be eligible, the obligor must be an eligible issuer and rated at least BBB-/Baa3 by a major nationally recognized statistical rating organization (“NRSRO”) and rated at least BBB-/Baa3 by two or more NRSROs if rated by multiple major NRSROs. Eligible assets are required to have a remaining maturity of four years or less.

**What are the other key terms?** The maximum availability to an issuer under the PMCCF is the product of a multiplier based on the issuer rating and the issuer’s maximum outstanding bonds and loans on any day between March 22, 2019 and March 22, 2020. The facility will charge a 100 basis points commitment fee. The borrower may elect to defer the first six months of interest provided that a borrower that makes this election does not pay dividends or make stock buybacks during the period of the interest deferral. Bonds purchased and loans originated under the facility may be callable at par at any time. The PMCCF is administered by the Federal Reserve Bank of New York (“New York Fed”), and the New York Fed has retained BlackRock Financial Markets Advisory as a third-party vendor to serve as the investment manager for the facility.<sup>13</sup>

**How long will the program continue?** Unless extended by the Federal Reserve, the PMCCF will cease purchasing eligible corporate bonds or extending loans on September 30, 2020. The facility will remain funded until its underlying assets mature.

**Where can I find out more?** The term sheet published by the Federal Reserve summarizing the program can be found [here](#). The New York Fed has also provided contact information for inquiries related to the program [here](#).

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<sup>13</sup> Federal Reserve Bank of New York Primary Market Corporate Credit Facility, *available* [here](#).

**SECONDARY MARKET CORPORATE CREDIT FACILITY**

**What is it?** The Secondary Market Corporate Credit Facility (“SMCCF”) is the second part of the Federal Reserve’s support for corporate debt markets. The SMCCF specifically addresses the functioning of the secondary market by purchasing outstanding corporate bonds issued by investment grade U.S. companies. The facility mandate further recognizes the significance of exchange traded funds (“ETFs”) and the SMCCF may purchase broad market U.S. investment grade corporate bonds ETFs.

**Who can participate?** The SMCCF may purchase bonds of U.S. companies headquartered in the United States and with material operations in the United States. Eligible issuers do not include companies that are expected to receive direct financial assistance under federal legislation that was pending at the time the program was announced.

**What assets are eligible?** To be eligible for purchase by the SMCCF, bonds must be issued by an eligible issuer rated at least BBB-/Baa3 by a major NRSRO and rated at least BBB-/Baa3 by two or more NRSROs if rated by multiple major NRSROs. Eligible assets are required to have a remaining maturity of five years or less. The SMCCF may also purchase interests in U.S.-listed ETFs that have the objective of providing broad exposure to the market for U.S. investment grade corporate bonds.

**What are the other key terms?** The maximum amount of bonds that the Facility will purchase from any eligible issuer will be capped at 10 percent of the issuer’s maximum bonds outstanding on any day between March 22, 2019 and March 22, 2020. Specific to ETFs, the facility will not purchase more than 20 percent of the assets of any particular ETF measured as of March 22, 2020. The SMCCF is administered by the New York Fed, and BlackRock Financial Markets Advisory has been selected as a third-party vendor to serve as the investment manager for the facility.<sup>14</sup>

**How long will the program continue?** Unless extended by the Federal Reserve, the SMCCF will cease purchasing eligible corporate bonds on September 30, 2020. The facility will remain funded until its underlying assets mature.

**Where can I find out more?** The term sheet published by the Federal Reserve summarizing the program can be found [here](#). The New York Fed has also provided contact information for inquiries related to the program [here](#).

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<sup>14</sup> Federal Reserve Bank of New York Secondary Market Corporate Credit Facility, *available* [here](#).

**MONEY MARKET MUTUAL FUND LIQUIDITY FACILITY**

**What is it?** The Money Market Mutual Fund Liquidity Facility (“MMLF”) makes funding available to bank entities to purchase high quality assets from money market funds as these funds meet demands for redemptions. The program was initially announced on March 18, 2020 and subsequently expanded on March 23, 2020 to include a wider range of securities.

**Who can participate?** Funding through the MMLF is available to all U.S. depository institutions, U.S. bank holding companies (parent companies incorporated in the United States or their U.S. broker-dealer subsidiaries), or U.S. branches and agencies of foreign banks. Assets must be purchased from a fund that identifies itself as a Prime, Single State, or Other Tax Exempt money market fund under item A.10 of Securities and Exchange Commission Form N-MFP.

**What assets are eligible?** The MMLF permits five categories of eligible assets: (1) U.S. Treasuries and fully guaranteed agency securities; (2) securities issued by U.S. Government Sponsored Entities; (3) Asset-backed commercial paper, unsecured commercial paper, or a negotiable certificate of deposit that is issued by a U.S. issuer (4) U.S. municipal short-term debt; and (5) Variable rate demand note that has a demand feature that allows holders to tender the note at their option within 12 months. Additional ratings and maturity eligibility criteria apply depending on the asset class.

**What are the other key terms?** Advances made under the Facility that are secured by U.S. Treasuries and Fully Guaranteed Agencies or Securities issued by U.S. Government Sponsored Entities will set at the primary credit (Discount Window) rate in effect at the time the advance is made. Advances secured by U.S. municipal short-term debt, including variable rate demand notes, will be made at a rate equal to the primary credit rate in effect at the time the advance is made plus 25 bps. Receivables from certain repurchase agreements and other asset classes may be considered for inclusion in the future. In terms of bank regulatory capital, assets purchased under the MMLF may be excluded from assets for purposes of calculating risk-based capital or leverage.<sup>15</sup>

**How long will the program continue?** Unless extended by the Federal Reserve, the MMLF will stop making new credit extensions on September 30, 2020. The facility will remain funded until its underlying assets mature.

**Where can I find out more?** The term sheet published by the Federal Reserve summarizing the program can be found [here](#). Documentation, terms and program contact information may be found [here](#).

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<sup>15</sup> Regulatory Capital Rule: Money Market Mutual Fund Liquidity Facility, *available* [here](#).

**COMMERCIAL PAPER FUNDING FACILITY**

**What is it?** The Commercial Paper Funding Facility (“CPFF”) supports the issuance of term commercial paper by eligible issuers by purchasing eligible commercial paper through primary dealers.

**Who can participate?** Eligible issuers are U.S. issuers of commercial paper, including U.S. issuers with a foreign parent company.

**What assets are eligible?** U.S. dollar-denominated commercial paper (including asset-backed commercial paper) that is rated at least A1/P1/F1 by a major NRSRO or, if rated by multiple major NRSROs, is rated at least A1/P1/F1 by two or more major NRSROs. (The CPFF also permitted one-time purchases of commercial paper from issuers that met the eligibility criteria as of March 17 and were rated at least A-2/P-2/F-2 as of the purchase date.)

**What are the other key terms?** The maximum amount of a single issuer's commercial paper the facility may own at any time will be the greatest amount of U.S. dollar-denominated commercial paper the issuer had outstanding on any day between March 16, 2019 and March 16, 2020. In addition, the CPFF will not purchase additional commercial paper from an issuer whose total commercial paper outstanding to all investors (including the CPFF) equals or exceeds the issuer's limit.

Together, the above two limits make the facility inaccessible to any commercial paper issuer that has outstandings in excess of the maximum under the 12-month lookback to March 16, 2020. The limits are in play, for example for issuers that have grown outstandings since March 16, 2020, and may additionally limit the ability of issuers to access the facility as existing customers draw on unutilized commitments that predate the current market crisis.<sup>16</sup>

Pricing will be based on the then-current three-month overnight index swap rate plus 200 basis points. At the time of its registration to use the CPFF, each issuer must pay a facility fee equal to 10 basis points of the maximum amount of its commercial paper the CPFF may own.

**How long will the program continue?** Unless extended by the Federal Reserve, the CPFF will stop purchasing commercial paper on March 17, 2021. The facility will remain funded until its underlying assets mature.

**Where can I find out more?** The term sheet published by the Federal Reserve summarizing the program can be found [here](#). Additional information and program contracts may be found [here](#).

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<sup>16</sup> The SFA has submitted comments on the challenges associated with the size limits to the New York Fed.

**PRIMARY DEALER CREDIT FACILITY**

**What is it?** Rather than targeting a particular market, the Primary Dealer Credit Facility (“PDCF”) supports the overall functioning of primary dealers by making repurchase financing available on a broad range of investment grade debt securities, including commercial paper and municipal bonds, and a broad range of equity securities.

**Who can participate?** The PDCF is available only to primary dealers of the New York Fed.

**What assets are eligible?** The collateral eligible for pledge under the PDCF includes all collateral that is eligible to be pledged in open market operations (Treasury securities, agency mortgage backed securities and agency CMBS), investment grade corporate debt securities, AAA-rated CMBS and CLOs, international agency securities, commercial paper, municipal securities, mortgage-backed securities, and asset-backed securities and certain equity securities. Foreign currency-denominated securities and collateral that is not priced by the clearing bank are not be eligible for pledge under the PDCF.

**What are the other key terms?** The PDCF provides same-day-settlement funding for terms of up to 90 days. Loans are priced at the primary credit rate available from the Discount Window regardless of term. Pledged collateral is valued by the Bank of New York Mellon in line with the margin schedule for lending by the Discount Window.

**How long will the program continue?** While no definite date has been set for duration of the program, PDCF will remain available to primary dealers for at least six months.

**Where can I find out more?** The term sheet published by the Federal Reserve summarizing the program can be found [here](#). Additional information and program contracts may be found [here](#) and answers to frequently asked questions [here](#).

**TERM ASSET-BACKED SECURITIES LOAN FACILITY**

**What is it?** The Term Asset-Backed Securities Loan Fund (“TALF”) provides non-recourse term funding to holders of certain AAA-rated newly and recently originated asset backed securities (“ABS”) backed by specified categories of consumer and small business loan collateral.

**Who can participate?** Three criteria apply: To participate, an entity must (1) be a U.S. company (2) own eligible collateral and (3) maintain an account relationship with a primary dealer. A U.S. company is defined as a U.S. business entity organized under the laws of the United States or a political subdivision or territory thereof (including such an entity that has a non-U.S. parent company), or a U.S. branch or agency of a foreign bank.

**What assets are eligible?** Eligibility criteria address the issuer, the collateral and the securities. To be eligible, the ABS must be issued on or after March 23, 2020. All or substantially all of the credit exposures underlying eligible ABS must have been originated by a U.S. company. Underlying credit exposure must be auto loans and leases, student loans, credit cards receivables, equipment loans, floorplan loans, insurance premium finance loans, small business loans guaranteed by the SBA or eligible servicing advance receivables. The securities must be denominated in dollars and carry credit rating in the highest long-term or the highest short-term investment-grade rating category from at least two eligible NRSROs and not have a credit rating below the highest investment-grade rating category from an eligible NRSRO. ABS that includes cash or synthetic ABS in the underlying collateral are ineligible as are ABS that bear interest payments that step up or step down to predetermined levels on specific dates.

**What are the other key terms?** Advance rates will be determined based on the sector, weighted average life and historical volatility of the ABS. While the haircut schedule and other terms are expected to be broadly consistent with the terms of the TALF program from 2008,<sup>17</sup> finalized terms have not been published as of this writing. For eligible ABS with underlying credit exposures that do not have a government guarantee, the interest rate will be 100 basis points over the two-year swap rate for securities with a weighted average life less than two years, or 100 basis points over the three-year swap rate for securities with a weighted average life of two years or greater. The pricing for other eligible ABS may be further detailed in the future. Among the asset classes not included in the program are CMBS, agency CMBS, CLOs, and personal loan securitizations, although the Federal Reserve has left open the possibility of considering additional asset classes for future inclusion.

**How long will the program continue?** The TALF will make up to \$100 billion of loans available. Unless the TALF is extended by the Federal Reserve, no new credit extensions will be made after September 30, 2020. The facility will remain funded until its underlying assets mature.

**Where can I find out more?** The term sheet published by the Federal Reserve summarizing the program can be found [here](#).

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The Federal Reserve's response to the coronavirus marks a new chapter in the central bank's approach to market intervention. Application has so far targeted specific capital markets but illustrate how the Federal Reserve can act to further expand its support if called upon. Market

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<sup>17</sup> The Structured Finance Association has published a helpful comparison of the TALF 2008 and TALF 2020 programs: available [here](#).

participants have a defined window within which to evaluate and participate in these programs. Please feel free to contact the following Cadwalader contacts with questions.

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# Clients & Friends Memo

## COVID-19 Update: The SBA's Paycheck Protection Program Explained

April 3, 2020

On March 27, 2020, the President signed the Coronavirus Aid, Relief, and Economic Security (CARES) Act (the "**Act**") into law following the Act's approval by both chambers of Congress. The Act amends Section 7(a) of the Small Business Act to include a new guaranteed, unsecured loan program (the "**Paycheck Protection Program**"). The Paycheck Protection Program is an expansion of the Small Business Administration (the "**SBA**") Economic Injury Disaster Loan program. The program provides for \$349 billion to support loans to a broader segment of small businesses than those that would otherwise be eligible to receive SBA 7(a) loans. The key terms of the existing program and the related modifications are as follows:

### **Traditional SBA 7(a) Program**

The Small Business Administration's 7(a) Loan Program is designed to provide financial assistance to small businesses. The SBA does not offer these loans itself but instead uses a network of SBA-approved lenders nationwide.

*Loan Terms.* For traditional SBA 7(a) loans, the borrowing maximum is \$5 million. For loans up to \$150,000, the SBA guarantees 85%. For loans greater than \$150,000, the SBA guarantees 75%. The repayment terms are between 5-7 years for working capital, up to 10 years for business acquisition and equipment, and up to 25 years for real estate purchase or construction. The interest rate is usually negotiated between the borrower and the lender, but cannot exceed the SBA maximum interest rate. Prepayment penalties may apply. Processing fees, origination fees, application fees, points, brokerage fees, bonus points and other fees are prohibited. A personal guarantee is required from any 20% owner of the small business. There are no collateral requirements for loans of up to \$25,000. For loans in excess of \$25,000, the lender must collateralize the loan to the maximum extent possible up to the loan amount.

*Permissible Purposes.* SBA loan proceeds generally may be used only for a "sound business purpose." Certain uses are prohibited, including: payments, distributions or loans to associates of the applicant (except for ordinary compensation for services rendered); investments in real or personal property acquired and held primarily for sale, lease, or investment (subject to certain exceptions); or the payment of federal or state taxes. The proceeds of Section 7(a) loans may not

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be used to pay any creditor in a position to sustain a loss causing a shift to SBA of all or part of a potential loss from an existing debt, or to purchase a portion of a business or a portion of another owner's interest.

*SBA Borrower Eligibility Requirements.* A borrower must meet the SBA's small business "size" standards, which vary by the NAICS code of the particular borrower. These size standards take into consideration the borrower's annual receipts (*i.e.*, revenues) and/or number of employees. Depending on the applicable NAICS code, the maximum receipts can be as low as \$1MM and the maximum number of employees can be as few as 100.

In addition, the small business must:

- Operate on a for-profit basis;
- Currently do business in the U.S. or its territories, or plan to do so;
- Be able to invest reasonable owner equity (new businesses should have \$1 of cash or business assets for each \$3 of the loan, while established businesses should have at least \$1 for every \$4 of the loan); and
- Use personal assets and other financial resources before applying for assistance.

Certain businesses are ineligible for SBA Section 7(a) loans, including but not limited to:

- Non-profit businesses (for-profit subsidiaries are eligible);
- Financial businesses primarily engaged in the business of lending, such as banks, finance companies, and factors (pawn shops, although engaged in lending, may qualify in some circumstances);
- Passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds (except Eligible Passive Companies under §120.111);
- Life insurance companies;
- Businesses located in a foreign country (businesses in the U.S. owned by aliens may qualify);
- Loan packagers earning more than one third of their gross annual revenue from packaging SBA loans;
- Businesses primarily engaged in political or lobbying activities; and
- Speculative businesses (such as oil wildcatting).

SBA provides business loan assistance only to applicants for whom the desired credit is not otherwise available on reasonable terms from non-Federal sources. The lender must certify or otherwise show that the desired credit is unavailable to the applicant on reasonable terms and conditions from non-Federal sources without SBA assistance, taking into consideration the

prevailing rates and terms in the community in or near where the applicant conducts business, for similar purposes and periods of time.

*SBA Affiliation Standards.* For purposes of determining borrower eligibility under the size standards, the SBA has adopted affiliation standards. Entities deemed affiliated with the borrower are aggregated with the borrower for purposes of applying the SBA's receipts and employee tests. Affiliation is determined based on the existence of "control," although the SBA's concept of "control" differs from concepts used by other government agencies, such as the banking regulators. Generally speaking, for SBA purposes, affiliation is deemed to exist at the 50% ownership or common ownership level and affiliation may arise where one or more officers, directors, managing members, or partners who control the board of directors and/or management of one concern also control the board of directors or management of one or more other concerns, but the SBA's affiliation standards take into account a variety of other factors and each situation should be reviewed individually.

*SBA Approved Lender Criteria.* To be an eligible lender, a lender must apply to the SBA through one of the SBA local offices and be approved.

- Have a continuing ability to evaluate, process, close, disburse, service, and liquidate small business loans;
- Satisfy SBA capital requirements (for bank lenders, compliance with bank regulatory capital suffices);
- Be open to the public to issue loans (and not be a financing subsidiary, engaged primarily in financing the operations of an affiliate);
- Have continuing good character and reputation, and otherwise meet and maintain the ethical requirements as identified in SBA regulations (13 CFR § 120.140); and
- Be supervised and examined by a state or federal banking agency (in the case of a bank), or by the SBA itself.

SBA lenders are required to maintain a satisfactory level of SBA operating performance (*e.g.*, default rates, loan volumes, etc.) based on standards adopted by the SBA.

*SBA Secondary Market Transactions.* SBA regulations limit the transferability of SBA 7(a) loans. With the prior approval of the SBA, the guaranteed portion of the loans may be transferred, sold, or assigned to another SBA participating lender (along with a "Guaranteed Interest Certificate" indicating the SBA's guarantee of principal and interest on the loan). Settlement is effected via a Bank of New York subsidiary, Colson. Transfer is accomplished by filling out an SBA Form 1086 (signed by all parties) and submitting that via Colson, as the Fiscal and Transfer Agent (FTA), along with a certified copy of the borrower's note.

The guaranteed portion of SBA loans (in this case, 100%) can also be sold in the secondary market as loan pools with a "Guaranteed Loan Pool Certificate." Under the terms of the Guaranteed Interest Certificate, the SBA guarantees the payment of principal and interest on the loan underlying the Certificate. The SBA will pay principal and interest on the loan up through the date of payment by the SBA. In this form, payment of principal and interest up to the time of payment is guaranteed by the SBA which is backed by the full faith and credit of the United States, but such payment is not guaranteed as to timeliness.

In addition, the guaranteed portion of SBA can also be assembled by so-called SBA 7(a) approved "Loan Pool Assemblers." The SBA and Colson both maintain a list of such assemblers on their websites. These pools are retained by the Loan Pool Assemblers with the original lender acting as servicer and Colson (the FTA) acting as collateral bank and paying agent. The SBA will issue to each investor in the pool a fractional Guaranteed Loan Pool Certificate, which represents the SBA's guarantee of the timely payment of principal and interest on the loans underlying the Pool Certificate. The SBA will pay principal and interest on the loans underlying the Pool Certificate through the date of payment by the SBA, with such payments guaranteed as to timeliness. These Certificates are liquid and may be held by a wide range of investors, not just SBA licensed 7(a) lenders.

SBA Section 7(a) loans may be pledged with the prior consent of the SBA, but no prior consent is required to pledge the loan to a Federal Reserve Bank in connection with a Federal Reserve financing program (such as TALF). SBA Section 7(a) loans can be securitized by an SBA lender subject to certain restrictions.

#### ***The SBA Section 7(a) Paycheck Protection Program***

The CARES Act's Paycheck Protection Program (PPP) will be offered under the auspices of the Section 7(a) program authority, with some differences from the traditional SBA 7(a) program. In this regard, a PPP loan is intended to enable eligible small business borrowers to keep their workers on the payroll.

Key differences between the PPP and the standard 7(a) SBA loan program are as follows:

- The PPP maximum loan amount is increased from \$5 million to \$10 million during the "covered period," which is from February 15, 2020 through June 30, 2020. The maximum value of a company's loan will be an amount equal to the lesser of (i) \$10 million and (ii) 2.5x of the average monthly payroll cost in 2019. This includes employee wages and benefits.
- Under the PPP, the SBA temporarily guarantees 100% of the loans, regardless of size. As set forth above, loans up to \$150,000 were 85% guaranteed by the SBA, while loans greater than \$150,000 were 75% guaranteed by the SBA.

- Under the PPP, loans are available to any small business with less than 500 employees (including sole proprietorships, independent contractors and self-employed persons), private non-profit organizations or 501(c)(19) veterans organizations. In addition, employers with more than 500 employees are eligible for PPP loans if the employer otherwise satisfies the SBA's small business size standards. The SBA website also states that food and hospitality employers with multiple locations may be eligible if the locations employ less than 500 employees, although this clarification does not appear in the regulations or the application forms.
- Under the PPP, loan terms will be two years, with an interest rate of 1%. Interest will be deferred for the first six months.
- For PPP loans, the requirement that businesses show they cannot obtain credit elsewhere is waived.
- The annual or guarantee fees for the loan and all prepayment penalties is not applicable. As set forth above, prepayment penalties applies in certain circumstances for PPP loans.
- For PPP loans, the SBA has indicated that it plans to have a process in place by which loans can be made and disbursed in the same day. SBA guidelines state that it usually takes five to 10 business days.
- With respect to PPP loans, businesses will not need to provide a personal guarantee or collateral. As set forth above, lenders will not require collateral for loans up to \$25,000. For loans in excess of \$350,000, the SBA traditionally requires that the lender collateralize the loan to the maximum extent possible up to the loan amount--and that may include requiring a person to secure his or her loan with personal assets.
- For PPP loans, the SBA is expanding the permitted use of funds to explicitly include payroll support, paid sick leave, mortgage payments, rent payments, and servicing existing debt. However, 75% of the PPP loan proceeds must be used for payroll purposes.
- For PPP loans, it does not appear that the SBA is incorporating certain of the 7(a) borrower eligibility restrictions, such as restrictions on loans made to passive companies, financial companies, or life insurance companies. In particular, there is no reference to these eligibility restrictions in the PPP regulations, the PPP loan forms (SBA Forms 2483 & 2484), or the SBA published guidance.

The SBA will forgive PPP loans if all employees are kept on the payroll for eight weeks and the money is used for payroll, rent, mortgage interest, or utilities. The loan will be fully forgiven if the funds are used for payroll costs (and at least 75% of the forgiven amount must have been used for payroll), interest on mortgages, rent, and utilities. PPP loan payments of principal, interest, and fees will also be deferred for six months (but not more than one year). Forgiveness is based on the employer maintaining or quickly rehiring employees and maintaining salary levels. Forgiveness will be reduced if full-time headcount declines, or if salaries and wages decrease.

FDIC-insured depository institutions are automatically eligible to participate in the PPP upon filing a notice with the SBA.

The implementing regulations provide that the SBA will “promptly” provide further guidance regarding the application of the SBA’s existing “affiliation” concepts to PPP loans. It is not clear what changes to those concepts, if any, are under consideration. The implementing regulations also state that PPP loans may be freely sold in the secondary market. Thus, it appears that, with respect to the PPP program, the SBA is lifting some if not all of the transfer restrictions applicable to 7(a) loans, although no details were provided.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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# Clients & Friends Memo

## COVID-19 Update: What Are the Effects on the SEC's Enforcement Program?

April 3, 2020

In response to the COVID-19 crisis, the SEC has sought to reassure investors and the financial industry that it is maintaining its investor protection and enforcement efforts. In a [statement](#) setting out the Commission's initial response to the crisis, issued on March 20, the SEC pledged that its enforcement and examination programs will continue to execute their missions and are fully operational.

The Enforcement Division is focused on monitoring the markets for misconduct related to the COVID-19 crisis. In a [statement](#) issued on March 23, 2020, the Co-Directors of the Division of Enforcement "emphasize[d] the importance of maintaining market integrity and following corporate controls and procedures." In particular, they noted that material nonpublic information available to corporate insiders may be even more valuable during the COVID-19 crisis and cautioned people with access to material non-public information—including "directors, officers, employees, consultants and other outside professions"—to be "mindful of their obligations to keep this information confidential and comply with the prohibitions on illegal securities trading." The Co-Directors urged public companies to be aware of their disclosure obligations, including "established disclosure controls and procedures, insider trading prohibitions, codes of ethics, and Regulation FD and selective disclosure prohibitions[.]" They also reminded investment professionals that they must comply with policies and procedures designed to prevent misuse of material nonpublic information.

For now, it looks like the SEC is making good on its word, having announced a flurry of new enforcement actions in the past week as if trying to prove its commitment to zealous enforcement during the crisis. It recently suspended trading in the securities of two companies for COVID-19 related conduct. Trading in the first company's shares was [suspended](#) due to concerns about, among other things, information in the marketplace disseminated by third parties concerning the viability of the company's product to treat COVID-19. Trading in the second company's shares was [suspended](#) due to concerns about, among other things, information in the marketplace about the company's marketing rights to a COVID-19 treatment. Moreover, anecdotal evidence suggests

that the staff is pushing investigations forward by issuing subpoenas, chasing parties for document productions, making Wells calls, etc.

### **Practical Effects on SEC Enforcement**

Of course, the SEC's enforcement efforts are not unaffected by COVID-19. The SEC's cases in active litigation are being impacted by the various court closures and related delays throughout the country. In addition, like many of us, SEC enforcement staff is working from home and facing significant travel restrictions. The Co-Directors recently held a virtual town meeting for Division of Enforcement staff where they stressed that work must go on but acknowledged inevitable challenges and delays. They encouraged the staff to do their best under the circumstances and be accommodating within reason.

Where the COVID-19 crisis will likely have the biggest impact is situations that would normally call for face-to-face interaction. This includes investigative testimony as well as meetings with the staff such as Wells meetings, pre-Wells meetings, evidence reviews and attorney proffers. Initially, the staff delayed or rescheduled testimony and in-person meetings to later this spring. In many instances, they are now requesting that testimony and other in person meetings go forward telephonically, by video conference, or via web-based programs. In some instances, the staff has agreed to accept informal phone interviews or attorney proffers in lieu of official sworn testimony. Companies and individuals who are involved in ongoing investigations should expect requests of this nature going forward.

### **Considerations for Remote Interactions with Staff**

Companies and individuals should be thoughtful about how they approach remote testimony and other remote meetings that would normally be held in person, including thinking carefully about whether they agree to such a request. While the ability to work remotely has allowed many of us to continue working effectively during social distancing, there can be significant disadvantages in the context of a SEC investigation.

These disadvantages are most apparent with investigative testimony. For example, take the situation where a witness and his or her counsel do not live in the same city and neither is allowed to travel due to COVID-19 concerns. Under these circumstances, it will be difficult for the witness to adequately prepare for testimony if he/she cannot meet with counsel in person before testifying, and difficult for counsel to effectively represent the witness during testimony if they are not in the same room. The same concerns are present for informal witness interviews. It remains to be seen how hard the SEC pushes for remote investigative testimony given the unique situation and complications COVID-19 has caused.

There are also disadvantages to remote meetings solely between defense counsel and staff. Simply put, there is no substitute for face-to-face meetings in terms of being able to “read the room” and effectively advocate a position. Therefore, as a practical matter, it is far less likely that a witness or counsel will be able to change the staff’s minds over the phone or via videoconference. It can be more difficult to be an effective advocate, read and respond to your audience and deliver your message with conviction via a phone call or video conference. While the SEC staff will likely seek these kinds of meetings moving forward, parties should think carefully about pushing back and delaying the meeting until after the crisis—especially if it is critical, like a Wells meeting or sensitive attorney proffer.

Given how rapidly the COVID-19 crisis is changing, the SEC’s response and path forward is evolving in real time. We will continue to monitor these events and apprise you as future developments warrant.

\* \* \*

If you have any questions, please feel free to contact either of the following Cadwalader attorneys.

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# Clients & Friends Memo

## COVID-19 Update: Litigation, Incarceration, and Investigation in the Time of COVID-19

April 3, 2020

### I. Introduction

In ways unimagined less than three weeks ago, the face of in-court litigation in civil and criminal matters transformed seemingly overnight and continue at near breakneck speed. The following article describes the key changes trial lawyers and their clients are likely to experience as the impact of COVID-19 continues to increase unabated.

### II. Civil Litigation

As stay-at-home orders are going into effect around the country, the legal community is grappling with how to attend to client needs and litigation schedules when getting in a room together is no longer an option. With guidance from courts changing daily, if not hourly, the ultimate effects of the COVID-19 pandemic on the administration of justice remains to be seen.

Courts across the US and UK are making alterations to the way that business is conducted in light of COVID-19. Generally, courts are either moving hearings to virtual formats or severely limiting who may be admitted into the courthouse for in person arguments. Additionally, jury trials across the country are being continued as courts are unable to fill petit juries because of infection concerns. The National Center for State Courts has compiled a comprehensive website with links to each state court relative to COVID orders.<sup>1</sup> Additionally, the US Judicial Conference has temporarily approved the use of video and teleconferencing of certain criminal proceedings and teleconferencing for civil proceedings.<sup>2</sup> Some examples:

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<sup>1</sup> *Coronavirus: News updates, court administrative orders, and more resources*, National Center for State Courts, <https://www.ncsc.org/> (last accessed April 1, 2020).

<sup>2</sup> *Judiciary Authorizes Video/Audio Access During COVID-19 Pandemic*, United States Courts (March 31, 2020), <https://www.uscourts.gov/news/2020/03/31/judiciary-authorizes-videoaudio-access-during-covid-19-pandemic>.

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- US Supreme Court

For the first time since 1918, the Supreme Court delayed oral arguments scheduled between March 23 and April 1. And for the first time since 2000, the Justices did not take the bench to read their decisions aloud. Rather, in several cases argued in the Fall term, the Court published decisions online every five minutes. The Court has issued a standing order<sup>3</sup> generally extending filing deadlines, and the building remains closed to the public indefinitely.

- New York

New York State courts have ceased hearing all non-essential matters, and have prevented all non-essential ECF. All state courthouses in New York City have moved to virtual hearings for essential matters, with the rest of the state implementing virtual hearings as soon as is practicable.<sup>4</sup> Essential matters in civil courts are extremely limited and do not explicitly include commercial cases at this time.<sup>5</sup> Essential matters in criminal proceedings include: arraignments, bail applications, reviews and writs, temporary orders of protection, resentencing of retained and incarcerated defendants, and essential sex offender registration act (SORA) matters.<sup>6</sup> Governor Cuomo has issued an order tolling any affected statutes of limitations until April 19, 2020.<sup>7</sup>

The federal courts in New York continue to conduct business, but have implemented certain distancing measures. These measures include the ability for counsel to teleconference into hearings, body temperature screenings for people on probation or supervised release, and limiting physical access to the courthouse.<sup>8</sup> The Southern District of New York (SDNY) has also ordered continuances on all jury trials scheduled to begin before April 27, 2020.<sup>9</sup> Criminal defendants, particularly those detained pending trial, may make a motion seeking an exemption from this order to the District Judge assigned to the matter in the first instance.<sup>10</sup> The Eastern District of New York

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<sup>3</sup> Miscellaneous Order, 589 U.S. – (March 19, 2020), [https://www.supremecourt.gov/orders/courtorders/031920zr\\_d1o3.pdf](https://www.supremecourt.gov/orders/courtorders/031920zr_d1o3.pdf)

<sup>4</sup> *March 30th: New Message from Chief Judge DiFiore*, NYCourts.Gov (March 30, 2020), <http://www.nycourts.gov/index.shtml> (last visited April 1, 2020).

<sup>5</sup> Administrative Order of the Chief Administrative Judge of the Courts, March 22, 2020 at Exhibit A.

<sup>6</sup> *Id.*

<sup>7</sup> Executive Order 202.8.

<sup>8</sup> COVID-19 Protocols Memorandum dated March 20, 2020; *In re Coronavirus/COVID-19 Pandemic*, 20 Misc. 161 (S.D.N.Y. March 17, 2020); *In re Coronavirus/COVID-19 Pandemic*, 20 Misc. 155 (S.D.N.Y. March 16, 2020); *In re Coronavirus/COVID-19 Pandemic*, 20 Misc. 138 (S.D.N.Y. March 13, 2020).

<sup>9</sup> *In re: Coronavirus/COVID-19 Pandemic*, 20 Misc. 154 (S.D.N.Y. March 13, 2020).

<sup>10</sup> *Id.*

has also restricted access to the physical courthouse, extended the time for preliminary hearings in criminal matters for sixty days after the initial appearance and continued all jury trials.<sup>11</sup>

- District of Columbia

The D.C. District Court (DDC) and Bankruptcy Courts remain open with limited operations.<sup>12</sup> Access to the E. Barrett Prettyman Courthouse and the William B. Bryant Annex is restricted to judges, court staff, members of the media, and visitors with official business with the courts.<sup>13</sup> All civil and criminal petit jury selections and trials scheduled to commence between March 17, 2020 and May 11, 2020 have been continued pending further notice of the Court.<sup>14</sup> DDC has also postponed all other court appearances and hearings in civil, criminal, and bankruptcy proceedings set to occur between March 17, 2020 and April 17, 2020 unless the presiding judge issues an order in an individual case to the contrary.<sup>15</sup>

- North Carolina

The North Carolina Judicial Branch has ordered an extension of all court system deadlines, ordering that all documents due to be filed between March 16, 2020 and April 17, 2020 will be deemed timely filed if received before the close of business on April 17, 2020.<sup>16</sup> The order does not apply to deadlines in the appellate courts.<sup>17</sup> Chief Justice Cheri Beasley has directed that superior court and district court proceedings will be rescheduled for at least 30 days as of March 16, 2020 unless the proceeding can be conducted remotely, the proceeding is necessary to preserve the right to due process of law, or the proceeding is for the purpose of obtaining emergency relief.<sup>18</sup>

The United States District Court for the Eastern District of North Carolina (EDNC) has issued an order continuing all civil and criminal jury trials, but leaving all other hearings and proceedings subject to the discretion of individual judges.<sup>19</sup> Grand jury matters will proceed pending further

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<sup>11</sup> *In re Coronavirus/COVID-19 Pandemic*, Administrative Order No. 2020-11 (E.D.N.Y. March 18, 2020); *In re Coronavirus/COVID-19 Pandemic*, Administrative Order No. 2020-06 (E.D.N.Y. March 16, 2020); *In re Coronavirus/COVID-19 Pandemic*, Administrative Order No. 2020-08 (E.D.N.Y. March 17, 2020).

<sup>12</sup> *In re: Court Operations in Exigent Circumstances Created by the COVID-19 Pandemic*, Standing Orders No. 20-9 (BAH) (D.D.C. March 16, 2020).

<sup>13</sup> Notice – Restricted Access to Courthouse (D.D.C. March 12, 2020).

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> Order of the Chief Justice of the Supreme Court of North Carolina (March 19, 2020).

<sup>17</sup> *Id.*

<sup>18</sup> Order of the Chief Justice of the Supreme Court of North Carolina (March 13, 2020).

<sup>19</sup> *In re: Court Operations Under the Exigent Circumstances Created by the COVID-19 Pandemic*, Standing Order No. 20-SO-5 (E.D.N.C. March 18, 2020).

order of the Court, and Magistrate judges will continue to preside over criminal matters such as arraignments, initial appearances, detention hearings, and issuance of warrants.<sup>20</sup> The use of video conferencing is encouraged whenever appropriate.<sup>21</sup> EDNC has also issued an order limiting access to courthouses.

The United States District Court for the Western District of North Carolina continues to have physical hearings with limitations. Any detainees who are ill are to be immediately removed from the courthouse, judges are to stagger court hearings to the extent possible, and Magistrate Judge hearings have been moved into larger courtrooms and may utilize the “After Hours Warrants” procedures previously in place to use Skype for initial appearances and arraignments.<sup>22</sup> Criminal case proceedings continue to take place. However, due to the difficulty of obtaining an adequate venire of jurors, any continuances will be excluded under the Speedy Trial Act.<sup>23</sup>

The United States District Court for the Middle District of North Carolina has issued an order continuing all civil and criminal jury trials scheduled to begin before April 16, 2020.<sup>24</sup> Grand Jury proceedings scheduled for the month of March are cancelled.<sup>25</sup>

#### A. How Litigants are Coping

With most courts closing or severely limiting physical interactions, litigants are being faced with the question of how best to proceed. For many cases, the answer may well be to sit back and wait for the dust to settle. However for those cases that cannot wait, creative solutions will be the name of the game.

On March 18, 2020, the Second Circuit held oral arguments over the telephone for the first time in its history.<sup>26</sup> Though there were speedbumps along the way, including sounds of sirens in the background and one lawyer inadvertently interrupting Judge Wesley, participants seemed optimistic that the situation was the best possible outcome given the circumstances.<sup>27</sup> Conversely, the D.C.

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<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *In re: Coronavirus COVID-19* (W.D.N.C. March 13, 2020).

<sup>23</sup> *Id.*

<sup>24</sup> *In re: Court Operations Under the Exigent Circumstances Created by COVID-19*, Standing Order 13 (M.D.N.C. March 16, 2020).

<sup>25</sup> *Id.*

<sup>26</sup> Tom McParland, ‘Maiden Voyage’ on a Stormy Sea: 2nd Circuit Holds 1st Set of Oral Argument Teleconferences in Face of Coronavirus, New York Law Journal (March 19, 2020, 5:25 PM), <https://www.law.com/newyorklawjournal/2020/03/19/maiden-voyage-on-a-stormy-sea-2nd-circuit-holds-1st-set-of-oral-argument-teleconferences-in-face-of-coronavirus/>.

<sup>27</sup> *Id.*

Circuit held remote arguments on March 20, 2020 with less success.<sup>28</sup> During arguments, a call dropped and an arguing attorney was unable to get back into the proceeding for several minutes.<sup>29</sup> A US magistrate judge in a civil case in the Southern District of Florida severely admonished litigants who could not resolve a fairly basic discovery dispute, leading to one party filing an emergency motion for a protective order seeking the delay of a deposition for a corporate representative. The judge reminded the parties, “we are living in an unprecedented situation. Nevertheless, the lawyers in this case have been exchanging snippy emails over the past two weeks over the scheduling of a corporate representative deposition. Moreover, defense counsel certified that this routine discovery dust-up is so important that it merits ‘emergency’ status. No, it doesn’t.” The attorneys will be required to appear at some point in the future to “explain their behavior in the context of the far-more-important issues this Court (and the entire world) is facing.”

It remains to be seen whether remote proceedings will remain in use after the COVID-19 crisis has passed, but in the meantime litigants should be prepared to proceed remotely. That includes contingency plans for technology failures and patience and understanding in dealing with the opposing side. Truly urgent matters will require flexibility in the weeks to come.

### III. Criminal Cases

Both the Department of Justice and the Division of Enforcement of the Securities and Exchange Commission have gone to great lengths to assure the public that investigations and prosecutions would continue, even while many law enforcement personnel work remotely. Depending on location, proffer sessions and government interviews have continued, albeit virtually. What were once commonplace internal investigations or proactive reviews are being conducted via video or telephone. Subpoenas continue to flow, though response times have in many cases been extended. Both the SEC<sup>30</sup> and DOJ have announced that fraudulent activities relating to COVID-19, including false claims to consumers, price fixing, and dishonest stock claims will be prioritized

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<sup>28</sup> Josh Gerstein, *‘Kind of a mess’: D.C. Circuit arguments enter the coronavirus era*, Politico (March 20, 2020, 5:45 PM), <https://www.politico.com/news/2020/03/20/dc-circuit-court-cases-coronavirus-139628>.

<sup>29</sup> *Id.*

<sup>30</sup> The Enforcement Division is focused on monitoring the markets for misconduct related to the COVID-19 crisis. In a statement issued on March 23, 2020, the Co-Directors of the Division of Enforcement “emphasize[d] the importance of maintaining market integrity and following corporate controls and procedures.” SEC, Statement from Stephanie Avakian and Steven Peikin, Co-Directors of the SEC’s Division of Enforcement, Regarding Market Integrity (Mar. 23, 2020), <https://www.sec.gov/news/public-statement/statement-enforcement-co-directors-market-integrity>, <https://www.cadwalader.com/resources/clients-friends-memos/covid-19-update-what-are-the-effects-on-the-secs-enforcement-program>

for enforcement activity.<sup>31</sup> The SEC suspended trading in the securities of two companies over concerns about potential misinformation about the companies' marketing rights to a COVID-19 treatment, as well as the effectiveness of one company's product to treat COVID-19.<sup>32</sup> But perhaps the greatest impact of COVID-19 on criminal cases is on about-to-be or currently incarcerated defendants.

### A. Impact on Incarceration

While staying home and social distancing are keeping many Americans healthy during the COVID-19 pandemic, those options are unavailable to many in the criminal justice system. Those individuals—whether temporarily confined in detention centers or courthouse holding facilities, or incarcerated in jails or prisons—face potentially dire circumstances as the virus spreads. Criminal defendants and their attorneys are petitioning courts for action, and many courts are following through.

Jurisdictions have already started addressing the unique risks posed by incarceration given the realities of COVID-19. Some state courts have held mass bail and plea hearings to reduce the jail populations.<sup>33</sup> Attorneys contemplating such requests should consider arguing that their client's particular "physical and mental condition" are factors to consider when setting release conditions<sup>34</sup> and that detention unnecessarily imperils their client. Also, attorneys may argue that state "stay-at-home" orders and limitations on international travel render their client unlikely "to flee or pose a danger to the safety of any other person or the community," which is a factor weighing in support of pretrial release or release pending sentencing or appeal.<sup>35</sup>

For those defendants who cannot avoid pretrial or post-conviction detention, they face the challenge of maintaining continuous contact with their legal counsel during a health pandemic. To mediate an ongoing dispute between the Federal Public Defenders and the Bureau of Prisons ("BOP") regarding attorney access to detainees, a federal judge in the Eastern District of New York appointed former US Attorney General Loretta Lynch to help the parties formulate new protocols

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<sup>31</sup> See DOJ, Press Release (20-289): Justice Department Cautions Business Community Against Violating Antitrust Laws in the Manufacturing, Distribution, and Sale of Public Health Products (Mar. 9, 2020), <https://www.justice.gov/opa/pr/justice-department-cautions-business-community-against-violating-antitrust-laws-manufacturing>.

<sup>32</sup> See SEC, Release No. 88142 (Feb. 7, 2020), <https://www.sec.gov/litigation/suspensions/2020/34-88142.pdf>; SEC, Release No. 88265 (Feb. 24, 2020), <https://www.sec.gov/litigation/suspensions/2020/34-88265.pdf>.

<sup>33</sup> See Cleveland.com, "Cuyahoga County officials will hold mass plea, bond hearings to reduce jail population over coronavirus concerns" (Mar. 12, 2020), <https://www.cleveland.com/court-justice/2020/03/cuyahoga-county-officials-will-hold-mass-plea-hearings-to-reduce-jail-population-over-coronavirus-concerns.html>.

<sup>34</sup> 18 U.S.C. § 3142(g)(3)(A) (factors to be considered for release of a defendant pending trial).

<sup>35</sup> 18 U.S.C. §§ 3142(d)(2), 3143(a)(1), (b)(1)(A).

during the pandemic.<sup>36</sup> As the Second Circuit wrote in its opinion remanding the case to the district court for further proceedings, COVID-19 poses “a different and even more dramatic challenge.”<sup>37</sup>

For its part, BOP maintains a website dedicated to its COVID-19 response.<sup>38</sup> Lawyer visitation privileges were suspended for 30 days starting March 13, 2020, though, BOP asserts that “case-by-case accommodation will be accomplished at the local level and confidential legal calls will be allowed in order to ensure inmates maintain access to counsel.”<sup>39</sup> Attorneys seeking in-person visits with their clients should be prepared to submit to the BOP’s “COVID-19 Screening Tool,” which asks visitors whether they have visited areas with high concentration of COVID-19 cases and whether they are currently experiencing COVID-19 symptoms.<sup>40</sup>

## B. Trial Deadlines

The Sixth Amendment guarantees criminal defendants a “speedy” trial.<sup>41</sup> That right is on an uncertain footing with many courts closing or limiting operations in the immediately foreseeable future.

The federal Speedy Trial Act establishes time limits for completing various stages in a federal criminal prosecution.<sup>42</sup> For instance, an information or indictment must be filed within 30 days of an arrest or service of a summons, and trial must commence within 70 days of that (or “from the date the defendant has appeared before a judicial officer of the court in which such charge is pending, whichever date last occurs”).<sup>43</sup>

Federal courts have issued administrative orders that suspend the Act in their respective courts, meaning that criminal defendants’ constitutional right to a jury trial will be put on temporary hold.

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<sup>36</sup> Law360.com, “Loretta Lynch To Referee Dispute Over Detainees’ Atty Access” (Mar. 23, 2020), [https://www.law360.com/whitecollar/articles/1256200/loretta-lynch-to-referee-dispute-over-detainees-atty-access?nl\\_pk=5da50ce1-c87e-4a40-a009-022a5094923e&utm\\_source=newsletter&utm\\_medium=email&utm\\_campaign=whitecollar](https://www.law360.com/whitecollar/articles/1256200/loretta-lynch-to-referee-dispute-over-detainees-atty-access?nl_pk=5da50ce1-c87e-4a40-a009-022a5094923e&utm_source=newsletter&utm_medium=email&utm_campaign=whitecollar).

<sup>37</sup> *Federal Defenders of New York, Inc. v. Federal Bureau of Prisons*, No. 19-1778, Slip Op. at 27 (2d Cir. Mar. 20, 2020), [http://www.ca2.uscourts.gov/decisions/isysquery/e6c13c51-4c4b-4e8b-aa8e-00221dbdbb1b/3/doc/19-1778\\_opn.pdf#xml=http://www.ca2.uscourts.gov/decisions/isysquery/e6c13c51-4c4b-4e8b-aa8e-00221dbdbb1b/3/hilite/](http://www.ca2.uscourts.gov/decisions/isysquery/e6c13c51-4c4b-4e8b-aa8e-00221dbdbb1b/3/doc/19-1778_opn.pdf#xml=http://www.ca2.uscourts.gov/decisions/isysquery/e6c13c51-4c4b-4e8b-aa8e-00221dbdbb1b/3/hilite/).

<sup>38</sup> See BOP, COVID-19 Coronavirus, <https://www.bop.gov/coronavirus/index.jsp>.

<sup>39</sup> BOP, COVID-19 Action Plan (Mar. 13, 2020), [https://www.bop.gov/resources/news/20200313\\_covid-19.jsp](https://www.bop.gov/resources/news/20200313_covid-19.jsp).

<sup>40</sup> BOP, Visitor/Volunteer/Contractor COVID-19 Screening Tool (Mar. 13, 2020), [https://www.bop.gov/coronavirus/docs/Visitor\\_Volunteer\\_Contractor\\_COVID-19%20Screening\\_v1\\_March\\_2020.pdf](https://www.bop.gov/coronavirus/docs/Visitor_Volunteer_Contractor_COVID-19%20Screening_v1_March_2020.pdf).

<sup>41</sup> U.S. Const. amend. VI.

<sup>42</sup> 18 U.S.C. §§ 3161–3174.

<sup>43</sup> 18 U.S.C. §§ 3161(b), (c)(1).

For instance, the SDNY issued an administrative order excluding the time between March 16, 2020 and April 27, 2020 from counting under the Act, as the court found “that the ends of justice served by taking such action outweigh the interests of the parties and the public in a speedy trial.”<sup>44</sup> Practitioners should check local orders to understand, and to advise their clients regarding, how much delay should be expected.

### C. Sentencing and Surrender Issues

It will likely be in clients' best interest to seek a continuance of any upcoming sentencing. Although a court must impose a sentence “without unnecessary delay,” sentencing schedules may be varied “for good cause.”<sup>45</sup> Court closures and the unavailability of administrative staff may very well make it impossible to complete the required presentence investigation, defendant interview, and presentence report in an effective manner. Moreover, health and social-distancing concerns may make it difficult for the defendant to arrange for witnesses to testify in court on his or her behalf at the sentencing hearing.

For unavoidable sentencings, a variance to a noncustodial sentence should be the immediate goal. The Sentencing Guidelines allow for variances in cases where “age” and “physical condition” are “present to an unusual degree and distinguish the case from the typical cases covered by the guidelines.”<sup>46</sup> The judiciary's increasing recognition of the severity of the COVID-19 pandemic may open the door for arguments that a client's unique risk factors warrant home detention in lieu of incarceration.

Defendants who have been sentenced should seek a continuance of their surrender dates, citing the risks posed by the growing number of COVID-19 cases in correctional facilities.<sup>47</sup> As the end of the pandemic is hardly in sight, extensions may be granted that are much further out in time than typically granted.

Defendants who are under removal orders face a particular hurdle. Those who must voluntarily leave the country by a certain date face a shrinking number of available international flights. If flights

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<sup>44</sup> *In re: Coronavirus/COVID-19 Pandemic*, Standing Order (SDNY, Mar. 13, 2020), [https://www.nysd.uscourts.gov/sites/default/files/2020-03/20%20MISC%20154a%20\(002\)%20-%20In%20Re%20Coronavirus-COVID-19%20Pandemic.pdf](https://www.nysd.uscourts.gov/sites/default/files/2020-03/20%20MISC%20154a%20(002)%20-%20In%20Re%20Coronavirus-COVID-19%20Pandemic.pdf).

<sup>45</sup> Fed. R. Crim. P. 32(b).

<sup>46</sup> United States Sentencing Commission, Guidelines Manual, § 5H1.1 (Age) (Nov. 2018); *id.*, § 5H1.4 (Physical Condition) (Nov. 2018).

<sup>47</sup> As of the date of this article, BOP reports that 57 inmates and 37 staff in its facilities have tested positive for COVID-19. See BOP, COVID-19 Tested Positive Cases, <https://www.bop.gov/coronavirus/index.jsp> (last accessed on April 1, 2020).

are unavailable by the removal date, changes to the removal order should be promptly sought lest clients face additional time in ICE detention facilities.

#### D. Compassionate Release

With over 2 million prisoners, the United States has the world's largest prison population.<sup>48</sup> The BOP alone houses some 175,000 inmates across its facilities.<sup>49</sup> The close proximity of inmates and prison staff, and unsanitary conditions at some facilities, make prisons potential hotbeds for contagion. The risk is not unique to the US—prison officials across the globe are considering inmate releases, some at mass scales, to offset the unique risks posed by the pandemic.

The need for a rapid response is acute. There are at least 94 positive COVID-19 cases among inmates and staff in the federal prison system.<sup>50</sup> The number is likely to grow exponentially. In light of this risk, on March 26, 2020, the Attorney General directed the BOP to ensure that the BOP utilized home confinement for at-risk inmates who are non-violent and pose minimal likelihood of recidivism, and laid out a series of criteria relating both to the health of inmates and public safety to assess the propriety of early release. The Federal Public Defenders has an informative website setting out forms, relevant guidance and pertinent decisions for lawyers considering any release petition, or pretrial or pre-sentence delay or avoidance of incarceration.<sup>51</sup>

In addition to the DOJ's order, compassionate release is also potentially available through the First Step Act. However, the First Step Act requires an inmate to first petition the BOP for release, and to allow the BOP up to 30 days to act on the petition. However, in light of the urgency of the health crisis, some defendants have petitioned courts directly, on an emergency basis, for compassionate release. Their arguments for bypassing the exhaustion requirement include the futility of waiting for BOP to deny their request, the urgency for an immediate decision, and that exposing inmates to the risk of COVID-19 amounts to cruel and unusual punishment prohibited by the Eighth Amendment. Despite relatively few cases of release being granted thus far,<sup>52</sup> whether these arguments will be successful largely remains to be seen.

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<sup>48</sup> See World Prison Brief, Highest to Lowest – Prison Population Total, <https://www.prisonstudies.org/highest-to-lowest/prison-population-total>.

<sup>49</sup> See BOP, Population Statistics, [https://www.bop.gov/about/statistics/population\\_statistics.jsp](https://www.bop.gov/about/statistics/population_statistics.jsp) (statistics as of March 12, 2020).

<sup>50</sup> See BOP, COVID-19 Tested Positive Cases, <https://www.bop.gov/coronavirus/index.jsp> (last accessed on April 1, 2020).

<sup>51</sup> See Federal Defender Service Office, Coronavirus Disease 2019 Resources, <https://www.fd.org/coronavirus-disease-2019-covid-19>.

<sup>52</sup> In notable examples, courts refused to grant compassionate release without exhaustion to Michael Cohen and “Real Housewife” star Brynne Baylor.

#### IV. UK Impact

The COVID-19 epidemic in the UK has accelerated the attempts to resolve the tension between established procedure and technology in criminal cases. It is an integral part of criminal procedure that the defendant and witnesses attend in person and that hearings generally take place in public. As Lord Chief Justice Hewart said in *R v Sussex Justices*, “Justice should not only be done, but should manifestly and undoubtedly be seen to be done.”<sup>53</sup> This principle of open justice is reflected in Criminal Procedure Rule 9.2—“that the court must exercise its powers in public.”

These two related but distinct issues—the attendance of parties in a case in person or remotely, and the broadcasting of hearings—have moved uneasily forward alongside technological advances. COVID-19 has accelerated the pace of change.

##### A. Remote Attendance

The Coronavirus Bill 2020 (the “Bill”) received Royal Assent and passed into law on Wednesday, March 25, 2020. Amongst a wide range of emergency measures, the Bill includes urgently-needed provisions allowing for the greater use of video and telephone communication in UK criminal court proceedings. The Bill updates several pieces of legislation including the Criminal Justice Act 2003, the Crime and Disorder Act 1998 and the Criminal Procedure Rules (“CrimPR”).

Under the Criminal Justice Act 2003 (“CJA”) and the Crime and Disorder Act 1998, the courts may allow a participant, including someone who is to give evidence, to take part by live link in a trial, a criminal appeal to the Crown Court or other hearings. The court may make such a direction which includes any or all of the participants, including the court itself.<sup>54</sup>

Proceedings are regarded as taking place at the location where the member or members of the court takes part in the proceedings and joining via video or audio live link will be considered as complying with any obligation for a person to attend court. A hearing may now be conducted entirely as a video or audio hearing (subject to certain prohibitions and limitations) and a participant may take part by live link from any place in the world.

Part 18 of the CrimPR has been amended and is now titled “*Measures to assist a Witness, Defendant or other person to give evidence and participate*.”<sup>55</sup> A key amendment, can be found at 18.1(e) where the court is now empowered to grant a direction to permit a “*defendant or other person to give evidence or to attend a hearing when not giving evidence by live link*.” Previously,

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<sup>53</sup> *R v Sussex Justices, ex parte McCarthy* ([1924] 1 KB 256, [1923] All ER Rep 233).

<sup>54</sup> Section 53(1) of Criminal Justice Act 2003 states that “The court may sit for the purposes of the whole or any part of the proceedings at any place at which such facilities are available”.

<sup>55</sup> The underlining denotes additions to the title.

this solely applied to witnesses giving evidence to the court. It is clear that the aim of these amendments is to assist parties, the public and courts themselves with continuing normal operations.

The main exception, as previously announced by the Lord Chief Justice on Monday, is that no juror may participate by live link (section 51(1B) of the CJA). Another relevant exception to note is that under section 51(10) of the CJA, a court may not refuse or revoke bail for a person if any person (other than someone giving evidence) attends proceedings via a live audio link and that person also objects to the refusal or revocation.<sup>56</sup>

It remains to be seen how jury trials can be accommodated in the present reality. The live event of a jury trial includes numerous safeguards designed to protect the rights of defendants – unscheduled private consultation between lawyers and clients, the ability to observe and react in real time to developments in court, and the ability for the jury to physically get together and debate amongst others.

## B. Broadcasting of Hearings

Photography and broadcasting of criminal cases in the UK is prohibited under section 42 of the Criminal Justice Act 1925 and reinforced under the Contempt of Court Act 1981. Taking photographs or private recording of cases is dealt with harshly by the courts.

UK Supreme Court cases have been broadcast since 2009. The public can watch the live stream of almost all hearings. Court of Appeal cases have allowed some broadcasting since 2013. In January this year, Parliament introduced the Crown Court (Recording and Broadcasting) Order 2020 which will allow cameras to broadcast the sentencing remarks of High Court and Senior Circuit judges in some of the most high-profile courts across the country, including the Old Bailey.

Filming will be restricted to sentencing remarks only and no other court user—including victims, witnesses, jurors and court staff—will be filmed.

But now that it is relatively easy for most people to video conference with off the shelf software how does the criminal justice system balance remote access with a prohibition on photography and recording? Is the prohibition actually necessary in many cases and how does it sit with the principle of open justice? It is not clear how the courts could continue to maintain current restrictions in an era of public video transmission.

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<sup>56</sup> Criminal Justice Act 2003 Section 51(11) contains an exception to this rule: "But subsection (10) does not apply if section 4 of the Bail Act 1976 does not apply to P".

In terms of immediate practical effects, there is already anecdotal evidence of the COVID-19 emergency affecting bail and sentencing decisions. It is plainly much harder for the prosecutor to assert that there is a real risk of a defendant fleeing the jurisdiction if granted bail. As is set out above, the BBC has reported that consideration is being given to releasing prisoners on temporary license to relieve pressure on prisons. In such circumstances remands into custody and custodial sentences are less likely to be ordered. Conversely, it is practically much harder for a community based punishment to be imposed and undertaken.

#### V. Looking Forward in the US and Across the Pond

If the practical challenges can be overcome, allowing remote attendance of both civil litigants and criminal defendants will continue and might be a sensible path forward in many cases. Perhaps staggered proceedings and more flexible rules for non-jury proceedings than for jury trials can be permanently implemented. Could a jury trial take place with all parties and the jury attending remotely? Could trials be staggered to reduce the disruption to individual jurors? Will trial strategists develop techniques better suited to the screen than the court room? Can a defendant be fairly sentenced if she does not appear in person in front of the sentencing court? Will this finally resolve persistent questions of over-incarceration? The answers remain to be seen, but, COVID-19 is likely to have unimagined impact on litigation and criminal justice beyond just the lawsuits that surely will emanate from this crisis.

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# Clients & Friends Memo

## COVID-19 Update: Cybersecurity and Data Privacy Best Practices Remain Critical During the Coronavirus Pandemic

April 3, 2020

With much of the nation's workforce transitioning to telework for the foreseeable future, hackers and scammers are lurking to take advantage of technical vulnerabilities and anxious targets. As companies amass—and create new repositories of—personal and health information for employees and customers as a result of the coronavirus (COVID-19) pandemic, adherence to cyber and data privacy best practices remains critically important. Companies, firms, employees, and consumers are increasingly relying on home networks, virtual workspaces, videoconferencing, and other forms of remote work practices, further opening the door to cyber concerns.

Over the past few weeks, various federal and state agencies and industry groups have issued guidance and published information on these threats and recommendations. This information is a helpful reminder of best practices that companies should follow to solidify their cyber controls.

### I. Cybersecurity Concerns Relating to Teleworking

- The Cybersecurity and Infrastructure Security Agency (CISA) published an [alert](#) to employers stating that telework options require an enterprise virtual private network (VPN) solution to connect employees to an organization's information technology network. The alert contains a number of recommendations for organizations to review when considering alternate workplace options for employees. (Mar 13, 2020)
- The Financial Industry Regulatory Authority (FINRA) published an [information notice](#) encouraging firms and their associated persons to take appropriate measures to address increased cyber vulnerabilities and protect customer and firm data on company and home networks as well as mobile devices. The notice provides measures that firms and associated persons can take to reduce cyber risks related to the COVID-19 outbreak. (Mar 26, 2020)

## II. Continuity of Operations Plans

- New York's Department of Financial Services (DFS) issued [guidance](#) to regulated institutions in the virtual currency space. DFS urges businesses to implement a preparedness plan to manage the risk of disruption to services and operations in light of the COVID-19 outbreak. At a minimum, plans should include an assessment of potential increased risk of cyber-attacks and fraud. Responses detailing such plans are required within 30 days of the notice. (Mar 10, 2020)

## III. Data Privacy Issues

- Entities that are regulated under the Health Insurance Portability and Accountability Act (HIPAA) should review two pieces of guidance from the U.S. Department of Health and Human Services: (1) a [bulletin](#) (Feb 2020) addressing application of the HIPAA Privacy Rule in the context of the COVID-19 outbreak, and (2) a [notice](#) (Mar 23, 2020) regarding enforcement of HIPAA rules against health care providers in connection with the good faith provision of telehealth during the COVID-19 nationwide public health emergency.
- California's Attorney General [rejected](#) industry requests to postpone the effective date of the state's new data privacy law, the [California Consumer Privacy Act \(CCPA\)](#), which is currently set for July 1, 2020. Unless this changes, covered businesses that collect certain health related information from California residents, employees, or customers should plan to comply with the CCPA's various requirements regarding the collection and use of personal information. Covered businesses subject to the CCPA should specifically consider the law's implications if they intend to share their employees' or consumers' personal information as it relates to the COVID-19 pandemic with health authorities.

## IV. Critical Infrastructure

- CISA [issued](#) an advisory memorandum (Mar 28, 2020) for state, local, and tribal authorities and their industry partners to assist in the identification of essential workers in seventeen critical infrastructure sectors in light of the COVID-19 pandemic.

## V. Anti-Fraud Precautions

- CISA published a [warning](#) to individuals to remain vigilant for scams related to COVID-19. These include emails with malicious attachments or links to fraudulent websites to trick victims into revealing sensitive information or donating to fraudulent charities. (Mar 6, 2020)
- The Federal Bureau of Investigation (FBI) issued a [public service announcement](#) warning that it has seen a rise in COVID-19-related fraud schemes from scammers trying to steal money or personal information. The public should remain vigilant about fake emails claiming to be from the Centers for Disease Control and Prevention (CDC), phishing emails asking the recipient to

verify their personal information to receive a federal economic stimulus check, and offers to sell counterfeit treatment or equipment to prevent, treat, diagnose, or cure COVID-19. (Mar 20, 2020)

- The Federal Trade Commission (FTC) is hosting a [page](#) dedicated to helping consumers avoid coronavirus scams, including how to handle robocalls, online offers for vaccinations and home test kits, and how to identify fraudulent emails about government stimulus checks and public health information.
- The Department of Justice (DOJ) has created a [page](#) outlining its efforts to detect, investigate, and prosecute wrongdoing related to fraud schemes and COVID-19. Individual United States Attorney's Offices have also launched efforts to protect residents, such as the [Virginia Coronavirus Fraud Task Force](#).
- The Consumer Financial Protection Bureau (CFPB) published an [informational guidance](#) for consumers regarding the rise of COVID-19 related fraud schemes. In addition to scams related to vaccines, test kits, cures and treatments, there has been an increase in the number of fake coronavirus-related charity scams, "person in need" scams from purported friends and relatives asking for money, and scams targeting Social Security benefits. Individuals who believe they are a victim of a scam or attempted fraud involving COVID-19 can report it to the [National Center for Disaster Fraud](#) Hotline at 866-720-5721 or via email to [disaster@leo.gov](mailto:disaster@leo.gov). Individuals who believe they are the victim of an internet scam or cyber-crime should report it to the FBI's Internet Crime Complaint Center at 804-261-1044 or [www.ic3.gov](http://www.ic3.gov).

## VI. Looking Ahead

As state and federal governments respond to the cybersecurity challenges posed by the COVID-19 pandemic over the coming weeks and months, businesses should stay abreast of additional guidance and information provided by government agencies and regulators. At the same time, companies must take steps to maintain a healthy (remote) security environment: placing a premium on continuing regular internal communications, keeping a close eye on potential system vulnerabilities, and practicing good digital hygiene.

*Cadwalader clients and friends are urged to stay apprised of cybersecurity, data privacy and other regulatory developments using our legal research platform, the [Cadwalader Cabinet](#), which is being provided free during this time. Cadwalader's Cybersecurity and Data Privacy Team will continue to monitor events throughout the COVID-19 pandemic and will keep you apprised of significant developments.*

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# Clients & Friends Memo

## COVID-19 Update: Protecting Trade Secrets in the Midst of the COVID-19 Pandemic

April 1, 2020

Millions of Americans and others around the globe have been told to work from home in order to blunt the spread of COVID-19. In short order, companies have been faced with unprecedented strain on internal networks and demands from employees to access confidential business information from home. While the COVID-19 Pandemic presents serious challenges to public health and the economy, the extraordinary access of confidential business information at home should present a lurking concern for companies, since employees themselves are typically the largest source of trade secret misappropriation. Moreover, cybercriminals may prey on employees inexperienced with working from home and those who fail to follow proper cyber-hygiene.

During this new era of forced remote working—at levels unthinkable mere months ago—sensitive technical information, business know-how, customer lists, and even HR records are being routed to employee's homes, where they might be copied and disseminated in an unsecured manner. Further, employees are turning to Zoom and Webex meetings at unequaled levels during the Pandemic to host meetings. The increased level of such interactive videoconferencing software represents a new risk where third parties, that are not under obligations of confidentiality, may be included and exposed to trade secrets even if inadvertently. This new age of home offices may also lead to a higher level of job mobility, which will only increase the risk that employees who had access to important trade secrets may be working for a competitor in the future.

The Defend Trade Secrets Act ("DTSA") provides a way for companies to mitigate the damage caused by the unauthorized dissemination of confidential business information. The DTSA provides a federal cause of action allowing for injunctive relief, money damages, and in extraordinary circumstances, *ex parte* seizure of property when "necessary to prevent the propagation or dissemination of the trade secret that is the subject of the action."<sup>1</sup> The DTSA broadly defines trade secrets as "all forms and types of financial, business, scientific, technical, economic, or engineering

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<sup>1</sup> 18 U.S.C § 1836.

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information[.]”<sup>2</sup> The term “misappropriation” is defined to include the acquisition, disclosure or use of a trade secret.<sup>3</sup>

The DTSA amended and supplemented sections of the previously enacted Economic Espionage Act of 1996, but left unchanged the explicit application of the statute to conduct occurring outside the United States when:

1. the offender is a natural person who is a citizen or permanent resident alien of the United States, or an organization organized under the laws of the United States or a State or political subdivision thereof; or
2. an act in furtherance of the offense was committed in the United States.<sup>4</sup>

A number of district courts have held that the private cause of action created by § 1836 is likewise extraterritorial.<sup>5</sup> In particular, two recent decisions highlight the capability to use the DTSA to protect against misappropriation of trade secrets through remote access by employees or third parties—even beyond the borders of the United States.

In *Motorola*, three engineers were hired away by another firm abroad, and those engineers stole and brought trade secrets with them to their new employer.<sup>6</sup> The Northern District of Illinois allowed for extraterritorial damages—*i.e.*, damages relating to conduct occurring outside the United States—because evidence existed that the defendant had “used” the alleged trade secret in the United States, including by marketing products in the United States embodying the alleged trade secrets.<sup>7</sup>

Similarly, in *vPersonalize*, a United Kingdom-based defendant acquired trade secrets that had been downloaded by a third party in the United States. In rejecting the defendant’s motion to dismiss, the Western District of Washington held that foreign entities were subject to the DTSA and, further, reasoned that the “in furtherance of the offense” requirement of § 1837(2) could be met vicariously

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<sup>2</sup> 18 U.S.C § 1839(3).

<sup>3</sup> 18 U.S.C § 1839 (5).

<sup>4</sup> 18 U.S.C § 1837.

<sup>5</sup> See *Motorola Solutions Inc., v. Hytera Comm. Corp.*, 1:17-cv-1973, ECF No. 834 at 1, 25 (N.D. Ill., Jan. 31, 2020); *vPersonalize Inc. v. Magnetize Consultants Ltd.*, No. 2:18-CV-01836-BJR, 2020 WL 534505, at \*12-13 (W.D. Wash., Feb. 3, 2020); see also *Motorola*, 1:17-cv-1973, ECF No. 834 at 10-11 (listing District Court decisions finding extraterritorial application and noting that it did not identify any court that has held the DTSA does not apply extraterritorially to private rights of action).

<sup>6</sup> *Motorola*, 1:17-cv-1973, ECF No. 834 at 1-2.

<sup>7</sup> *Id.* at 21.

via the domestic acts of a third party or directly via the defendant's attempts to market products and services embodying the trade secrets within the United States.<sup>8</sup>

Given the global reach of both many corporations and the COVID-19 Pandemic, such interpretations provide increased assurances to corporations that they can redress the harms caused by trade secret misappropriations—wherever they might occur.<sup>9</sup>

### **Recommendations**

It is more important than ever before that companies maintain reasonable measures to safeguard confidential business information. Companies should ensure that access to sensitive information is only given to those employees who truly require access to further company business objectives.

In addition to using industry best practices to maintain such information on company systems, companies should remind remote employees to maintain proper cyber-hygiene, and to avoid any unnecessary dissemination of company information.

U.S.-based legal departments should also consider providing a notice to remote employees, including those that are only temporarily working remotely because of the COVID-19 pandemic, before being given access to confidential systems, that expressly acknowledges the sensitive nature of the company's confidential business information, encourages the employee to practice proper cyber-hygiene, and affirms that the employee will not engage in unauthorized dissemination of company trade secrets.

This will remind all employees who may find themselves working remotely to maintain the integrity of confidential business information, and in the event a misappropriation of trade secret occurs, provide evidence that can be used to prove a violation and, potentially, that an act in furtherance of the offense occurred in the United States.

In addition, any employee that is leaving the company should be asked to sign a certification acknowledging that they were aware of the obligation to maintain firm trade secrets, that they have complied and that they understand any future violation would be subject to action under the DTSA.

Finally, companies should be ready to act quickly, including possibly pursuing a seizure remedy, if they believe a trade secret has been jeopardized in some way by an employee or a cybercriminal.

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<sup>8</sup> *vPersonalize*, No. 2:18-CV-01836-BJR, 2020 WL 534505, at \*12-13.

<sup>9</sup> Additionally, unlike actions for patent infringement, DTSA causes of action are subject to the general venue provisions of 28 U.S.C. § 1391, meaning that venue is proper in any district court where personal jurisdiction exists.

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# Clients & Friends Memo

## COVID-19 Update: Practical Guide to Electronic Signatures

April 1, 2020

The COVID-19 pandemic has unexpectedly required lawyers and, in many circumstances, judges to attempt to operate in a remote work environment. This abrupt change has heightened the importance of relying on electronic signatures and notarization, in lieu of traditional “wet ink.” This article discusses the applicable laws and practical guidance for ensuring valid e-signatures and notarizations.

### Laws Validating E-Signatures

For a number of years, both federal and state laws have permitted the use of e-signatures. At the federal level, the **Electronic Signatures in Global and National Commerce Act (“ESIGN”)**, effective since 2000, “facilitate[s] the use of electronic records and signatures in interstate or foreign commerce.” 15 U.S.C. § 7001, *et seq.* It provides that a transaction or document “may not be denied legal effect, validity, or enforceability solely because an electronic signature or electronic record was used in its formation.” *Id.* Similarly, legislatures in nearly all the states and the District of Columbia have passed the **Uniform Electronic Transactions Act (“UETA”)**, which has substantially the same provisions regarding e-signatures as ESIGN. Although New York has adopted its own legislation, the **Electronic Signature and Records Act (“ESRA”)**, it similarly confers on electronic signatures the same validity and effect as a “signature affixed by hand.” *See* NYS Technology Law § 304(2) (2013). The net effect of these laws is that every jurisdiction in the United States has substantially the same rules for the use of electronic signatures.

### How to Affix An E-Signature

The e-signature laws do not specify any particular technology or method for affixing an electronic signature. The e-signature can be any “electronic sound, symbol or process, attached to or logically associated with a contract or other record and executed or adopted by a person with the intent to sign the record.” *See* 15 U.S.C. § 7006. The only other requirement is that the electronic record of the contract must be capable of being retained and reproduced. *See* 15 U.S.C. § 7001; UETA § 8. Accordingly, electronic signatures include signatures in emails, PDFs, and faxes and

digital signatures<sup>1</sup> provided by processes offered by commercial firms, such as DocuSign and Adobe Sign, so long as they are affixed to or associated with the relevant agreement with an intent to sign by the persons providing them.

### **Types of Documents that Can Be Signed Electronically**

Contracts are creatures of state law, and therefore the legal sufficiency and enforceability of a signature – whether wet or electronic – depends on the laws governing the contract, as well as the signature specifications within the contract, and the transaction type (*e.g.*, state statutes of frauds relating to real estate transfers). In the absence of language specifically prohibiting e-signatures, or an express exception, e-signatures are presumptively valid when executing a contract, letter or email correspondence. Practically speaking, it is advisable when drafting a contract to specify in the agreements that e-signatures are valid, with reference to the statutes permitting their use.

The e-signature laws have various carve-outs worth noting. The Federal ESIGN Act includes a limited number of exceptions—*e.g.*, wills, certain non-Article 2 UCC transactions, divorce decrees and the transfer of real property—in which e-signatures are not valid. The federal ESIGN law also lists official court documents as an exception (*see* 15 USC § 7003(b)(1)), however, federal and state courts have well-established electronic filing and access systems. These systems use electronic signatures and documents allowing for the filing of briefs, pleadings and other papers. Practitioners should check the local rules of the court to confirm the validity of an e-signature on official court documents, including, in particular, affidavits and stipulations. The UETA similarly contains exceptions for non-Article 2 UCC transactions, testamentary matters, and transactions subject to the Uniform Computer Information Transaction Act. In New York, the ESRA excludes e-signatures on certain estate planning documents, appointments of fiduciaries, and certain health-care related consents.<sup>2</sup>

### **Electronic Notarization**

The disruption caused by COVID-19 has prompted at least temporary measures allowing for electronic notarization in at least one state. In New York, effective March 22, 2020 until April 18, 2020, any notarial act that is required under New York state law is authorized to be performed utilizing audio-video technology provided that the following conditions are met:

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<sup>1</sup> Digital signatures are more secure versions of electronic signatures. A digital signature will usually contain algorithms or encryptions unique to both the document and the signor and will often be time-stamped. *See, e.g.*, Wash. Rev. Code Ann. § 19.34.020 (West). A valid digital signature will therefore authenticate the identity of the signor and ensure that the underlying document has not been altered.

<sup>2</sup> The ESIGN and UETA do not permit e-signatures for promissory notes governed by Article 3 of the UCC. The ESRA does not have the same broad exclusion for matters governed by the UCC. Local recording officers can elect to participate in the electronic recording of instruments affecting real property, which is referred to generally as e-Recording.

- The person seeking the Notary's services, if not personally known to the Notary, must present valid photo ID to the Notary during the video conference, not merely transmit it prior to or after the conference;
- The video conference must allow for direct interaction between the person and the Notary (*e.g.*, no pre-recorded videos of the person signing);
- The person must affirmatively represent that he or she is physically situated in the State of New York;
- The person must transmit by fax or electronic means a legible copy of the signed document directly to the Notary on the same date it was signed;
- The Notary may notarize the transmitted copy of the document and transmit the same back to the person; and
- The Notary may repeat the notarization of the original signed document as of the date of execution provided the Notary receives such original signed document together with the electronically notarized copy within thirty days after the date of execution.

See NY State Executive Order No. 202.7. According to guidance issued by the New York Department of State on March 25, 2020, if the notary and signatory are in different counties, the notary should indicate on the document the county in which each person is located. In addition, when performing remote notarization, the document should indicate that the notarization was made pursuant to Executive Order No. 202.7.

### Conclusion

Although e-signature laws have been in effect for a number of years, they may not have been commonly used by workers in offices. With a drastic shift to a remote working environment, the use of e-signatures is just one way to enhance efficiency and simplify work.

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# Clients & Friends Memo

## COVID-19 Update: Competitor Collaborations in the Time of COVID-19

April 1, 2020

The Antitrust Division of the U.S. Department of Justice (“DOJ”) and the Federal Trade Commission (“FTC”) [jointly announced](#) on March 24, 2020, an expedited antitrust review process for proposed collaborative efforts aimed at protecting the health and safety of Americans during the COVID-19 pandemic. The agencies have committed to reviewing all proposed collaborations submitted to the DOJ’s [Business Review Letter](#) procedure and the FTC’s [Staff Advisory Opinion](#) procedure within seven calendar days of receiving all necessary information (both processes generally take several months). The DOJ and FTC also pledged to expedite requests under the [National Cooperative Research and Production Act](#) for flexible treatment of certain standard development organizations and joint ventures. For more details regarding the joint announcement and the requirements for companies seeking to use this expedited procedure, please see Cadwalader’s recent summary.<sup>1</sup>

The agencies’ [joint statement](#) also provided substantive guidance for proposed collaborations to address the COVID-19 pandemic and examples of collaborative activities that would be consistent with antitrust laws. Based on this guidance, there are several possible outcomes for the review of proposed collaborations during the COVID-19 pandemic.

- **Direct facilitation of COVID-19 healthcare-related relief.** Although the agencies’ joint statement did not provide express “safe harbors” for any specific conduct, the agencies clearly intended to encourage the formation of certain COVID-19-related joint ventures. Collaborations formed to speed the production and/or distribution of products and services designed to treat COVID-19 patients likely would face a relatively low level of antitrust risk, assuming no anticompetitive effects (such as price/profit increases) are anticipated as a result of the joint venture. Obvious examples that would fit within this category would be production joint ventures to manufacture ventilators or physician joint ventures aimed at providing efficient medical coverage in a given area.

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<sup>1</sup> [COVID-19 Update: DOJ and FTC Launch Expedited Review Process for COVID-19-Related Collaborative Efforts](#), Peter Moll, Brian Wallach, Gregory Langsdale and Lindsay Barnes, Cadwalader, Wickersham & Taft LLP, March 26, 2020.

- **Collaboration aimed at joint preservation of parties.** Reduced demand for products and services throughout the economy has threatened the viability of many businesses. Companies at all points along the supply chain of many industries are affected, and there have been discussions along some of these supply chains, both vertically and horizontally, about whether companies may take collective action to stabilize their industries. The agencies' joint statement does not speak directly to these situations, and companies considering such proposals would do well to review the specific proposed conduct with antitrust counsel. If the parties are comfortable under the antitrust "rule of reason" analysis<sup>2</sup> that the collaboration is low risk, the parties may opt to proceed with their joint venture without seeking antitrust review. If, however, the parties are less comfortable with the antitrust risk posed by the collaboration, they may wish to consider the DOJ and FTC's new (and, as yet, untested) seven-day antitrust review procedures.<sup>3</sup>
- **Coordination to prevent ruinous fallout or market collapse due to COVID-19.** Collaborations where the primary effect is to coordinate on price or output as a means to prevent or remediate industry lost profits, decreased demand or higher costs associated with the COVID-19 pandemic likely would receive no special protection from the antitrust laws. Parties to such proposed joint ventures should evaluate with antitrust counsel whether the net procompetitive advantages of the collaboration are sufficiently compelling under a rule of reason analysis to apply for a Business Review Letter approval from the enforcement authorities under the new expedited review procedures.

#### How can Cadwalader help?

Cadwalader's antitrust team, located in key jurisdictions in the United States (New York, Washington, DC and Charlotte), is composed of specialists that offer 'end-to-end' advice on compliance, investigations and related litigation. Our practitioners are experienced in counseling on the full gamut of antitrust issues.

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<sup>2</sup> Restraints that are always (or almost always) so inherently anticompetitive and damaging to the market are condemned under the "*per se*" rule without further inquiry into their actual effects on the market or the existence of procompetitive justifications. *Per se* treatment under the antitrust laws is limited to certain hardcore antitrust violations, such as price fixing, customer allocations and market divisions. Conduct that restrains trade, but does not fit into the *per se* category, is analyzed under the so-called "rule of reason" test to determine if the practice is an unreasonable restraint of trade, based on economic factors. Rule of reason analysis is the default under modern antitrust case law.

<sup>3</sup> [COVID-19 Update: DOJ and FTC Launch Expedited Review Process for COVID-19-Related Collaborative Efforts](#), Peter Moll, Brian Wallach, Gregory Langsdale and Lindsay Barnes, Cadwalader, Wickersham & Taft LLP, March 26, 2020.

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# Clients & Friends Memo

## COVID-19 Update: Are You For Real? Due Diligence in the Age of Coronavirus

April 1, 2020

In the context of COVID-19, there are significant challenges involved in conducting due diligence: hard-copy documents are inaccessible, in-person meetings have moved online, and on-site visits may be impossible. Companies nonetheless can and should continue to comply with the law by adjusting policies and procedures, mitigating new risks that arise through the use of alternative diligence methods, and by staying abreast of changing regulatory expectations.

For compliance professionals, applying “enhanced” reviews to higher-risk scenarios necessarily requires direct human involvement: an experienced hand to assess the universe of available information and make sometimes difficult judgment calls. Certain aspects of this work can, with varying degrees of difficulty, be completed from the (in)convenience of the myriad home offices that have sprouted in response to the COVID-19 pandemic—assuming that the compliance professional is in possession of all required information. However, compliance teams and those who support them are finding that a major challenge arises in gathering the detailed information upon which compliance decisions are based. Physical documents are not accessible, travel is impossible, and in many cases, key information must be obtained from third parties who are themselves struggling to navigate the pandemic.

This article discusses the significant challenges to effective due diligence resulting from restrictions on international and domestic travel, stay-at-home orders, and general “social distancing” in response to COVID-19. It also considers strategies that corporations and financial institutions can adopt to remain in compliance with the law during the pandemic.

### The Way It Was

In the context of international business and finance, bodies of law that are top of mind for most compliance teams include the Foreign Corrupt Practices Act (“FCPA”), economic sanctions administered by the Office of Foreign Assets Control (“OFAC”), and anti-money laundering (“AML”) rules administered by the U.S. Treasury’s Financial Crimes Enforcement Network (“FinCEN”) and other financial regulators.

While specific due diligence efforts are not legally mandated by the FCPA or OFAC, they nevertheless form a key part of a company's system of internal controls. Companies routinely collect identifying and ownership information to understand any connections to government officials, sanctioned persons, and other potential risk factors. And companies often undertake more detailed reviews for higher-risk jurisdictions, as well as for activities like customs clearance, lobbying, and other interactions with government officials. These efforts may include background or reference checks that rely on local or regional networks for key business intelligence. In some cases, including mergers and acquisitions, companies undertake in-depth, on-the-ground due diligence reviews in multiple countries around the world, often working under tight deadlines (discussed further below).

Indeed, doing risk assessments, monitoring third parties, conducting in-country audits, and implementing a host of other internal controls are described in the DOJ's Evaluation of Corporate Compliance Programs as best practices business organizations should undertake to assure FCPA compliance. Similarly, OFAC emphasized the importance of due diligence and understanding third party relationships in its May 2019 Framework for Compliance Commitments.

U.S. AML rules under the Bank Secrecy Act ("BSA") require financial institutions to implement risk-based policies and procedures for identifying new customers, and for monitoring the transactions and other conduct of existing customers. Many financial institutions' know-your-customer ("KYC") policies and procedures, adopted pre-COVID-19, require enhanced due diligence for higher-risk customers. In addition, enhanced due diligence is mandated by regulation for foreign banks holding correspondent accounts with U.S. banks and for senior foreign political figures, or politically exposed persons ("PEPs"), using private banking services at U.S. banks.

To conduct enhanced AML KYC due diligence, financial institutions typically collect additional information to confirm the identity, beneficial owner(s), source of wealth, source of funds, and reputation of a new, higher-risk customer. Financial institutions also conduct more extensive and more frequent monitoring of the customer relationship. Reviewing hard-copy documents, meeting in person, and traveling to customer locations overseas is (or was) not unusual, and regulations and regulatory guidance have cemented these "physical" practices as best practice.

### **The Challenges of Due Diligence from Your Dining Room Table**

As many compliance professionals can now attest, the sudden switch from a physical to virtual work environment is jarring. The specific challenges to conducting due diligence in a mostly virtual environment generally relate to trust, credibility and the ability to verify information:

- **Inability to obtain original documents.** Many companies are currently unable to ensure that their employees personally view key original documents.

- **Inability to conduct on-site visits.** With borders closed and planes grounded, companies are unable to put head offices' boots on the ground in far-flung locales. This challenge may prove particularly acute for companies in the midst or on the cusp of a strategic transaction, such as a merger or acquisition. The DOJ's FCPA Enforcement Policy states that a company can earn the presumption of a declination from prosecution through timely due diligence of an acquisition target (among other requirements, including voluntary self-disclosure of identified misconduct). Historically, companies have sought to adhere to the aggressive 180-day due diligence review and self-reporting period described in the DOJ's Opinion Procedure Release 08-02, often entailing a flurry of detailed site visits in dozens of countries around the world.
- **Inability to meet in person.** Even where long-distance travel is not required, in-person meetings of any type, including interviews and background or reference checks, cannot safely be conducted under current circumstances.
- **Risk of abuse by third parties.** In addition to managing their usual workloads—not to mention troubleshooting home network outages, wrangling kids, and replenishing food stocks—compliance professionals must guard against efforts by unscrupulous customers or third parties to take advantage of the pandemic. In particular, some might dishonestly claim an inability to access identification papers, corporate documents, signed contracts, and other information in order to eschew costly or cumbersome due diligence requirements—possibly in furtherance of a scheme to engage in bribery, fraud, or other misconduct, or to hide the proceeds of their illegal activities.

### Finding the New Normal

Companies are already seeing regulators shift deadlines, examination methods, and enforcement priorities in response to COVID-19. On the one hand, numerous agencies have announced various forms of regulatory relief. The SEC, for example, has issued a no-action letter extending deadlines for the Consolidated Audit Trail until mid-May.<sup>1</sup> Similarly, the SEC's Office of Compliance Inspections and Examinations has announced that its normally on-site examinations would be conducted virtually.<sup>2</sup>

At the same time, regulators have called upon companies to pay increased attention to their compliance obligations in the context of COVID-19. FinCEN has called upon financial institutions to be vigilant for fraud schemes related to COVID-19 and has requested that related suspicious activity reports ("SARs") be filed with a "COVID19" label in the report, presumably to permit FinCEN to prioritize investigations of pandemic-related financial crime.<sup>3</sup> For its part, the SEC's Division of Corporate Finance released guidance setting forth COVID-19-related disclosure

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<sup>1</sup> <https://www.sec.gov/divisions/marketreg/mr-noaction/2020/consolidated-audit-trail-reporting-031620.pdf>

<sup>2</sup> <https://www.sec.gov/ocie/announcement/ocie-statement-operations-health-safety-investor-protection-and-continued>

<sup>3</sup> <https://www.fincen.gov/news/news-releases/financial-crimes-enforcement-network-fincen-encourages-financial-institutions>

expectations for public companies, and reemphasizing the prohibition on insider trading.<sup>4</sup> The SEC has also said its enforcement teams continue to actively monitor for fraud, illicit schemes, and other misconduct.<sup>5</sup> In addition, the Attorney General has announced that “it is essential that the Department of Justice remain vigilant in detecting, investigating, and prosecuting wrongdoing related to the crisis.”<sup>6</sup>

Bearing in mind that some of the recently announced enforcement priorities relate directly to regulated companies, while others relate more to customers and counterparties, how can organizations navigate regulatory shifts and remain compliant with their due diligence obligations?

*First*, companies should closely monitor regulatory pronouncements both to take advantage of available relief, and to step up efforts in areas that regulators prioritize for enforcement.

*Second*, companies need to review their compliance policies and procedures to identify requirements that may prove challenging to satisfy under current circumstances. By doing so, companies will understand where potential shortfalls are most likely to arise, and they will be better able to craft effective alternatives and ensure that exceptions are carefully documented. Increased reliance on digitized documents, e-signatures, and remote meetings is all but inevitable—but firms should ensure such measures are consistent with legal requirements.

To the extent necessary, organizations may consider revising their policies and procedures to permit effective, alternative processes, either as a general matter, or in limited circumstances (*e.g.*, a widespread health emergency). For example, methods of obtaining documents or conducting interviews may need to be broadened to include newer forms of technology, provided that those technologies are sufficiently reliable and appropriate in the circumstances. Of course, companies under a monitorship agreement should take care to comply with any terms of the monitorship that require notice or pre-approval for changes to compliance policies and procedures. These modifications may be simple, yet instrumental in ensuring that companies commit to effective compliance programs that can be implemented even during an emergency such as COVID-19.

The following examples illustrate additional accommodations that organizations may need to adopt in response to the challenges listed above:

- **Develop protocols for digital documents.** If firms are unable to review certain original physical copies of documents, they will need a process to review secure and authentic digital versions. For example, banks have long accepted check deposits digitally scanned through the

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<sup>4</sup> <https://www.sec.gov/corpfin/coronavirus-covid-19>

<sup>5</sup> <https://www.sec.gov/sec-coronavirus-covid-19-response>

<sup>6</sup> <https://www.justice.gov/ag/page/file/1258676/download>

bank's smartphone app. This technology is reliable in part because the bank's control over the app, the camera, and, increasingly, the device's geolocation data provide the bank with sufficient assurances that the electronic image of the document has not been altered and that the user of the app is the customer. Companies could consider similar technology to remotely accept documents that previously needed to be viewed in person. Where the only copies of physical documents are located in an area subject to restrictions on movement, companies should consider whether anyone has safe access to the documents, whether suitable alternative documents or information are available, and whether an onboarding or transaction needs to be postponed. Similarly, contracts with third parties may need to be revised to require identification, transactional, and other information be provided electronically.

- **Develop protocols for locally-staffed or digital site visits.** While restrictions on international travel continue, companies planning site visits should consider whether local conditions may permit meetings to continue, either with local staff, or by partnering with a local, reputable provider of compliance or legal services. In some cases, video or telephonic meetings may be an adequate substitute. Indeed, the proliferation of video conferencing—both for business and personal use—is the conspicuous corollary to current demands for increased physical distance. Compliance professionals must work to adapt these tools to their due diligence efforts, just as they increasingly are doing for training and other activities.
- **Replace in-person meetings with virtual meetings.** In many cases, even local meetings may need to be conducted by phone or video call. Companies should bear in mind that one purpose of in-person meetings is to assess credibility; to the extent that compliance personnel grow confident using video calls, they may be comfortable making credibility determinations on the basis of virtual meetings. Depending on the goals of the meeting, geolocation data associated with a device being used for a video call may be helpful for verifying claims regarding an individual or entity's location or residency.
- **Prevent fraud and abuse.** Some individuals or entities may attempt to manipulate new remote diligence protocols to enable fraud and abuse. Companies should be mindful of this risk and adopt appropriate mitigation measures. For example, where a higher-risk customer or third party is on-boarded with less than the full panoply of a company's enhanced due diligence measures, consider subjecting the relationship to transaction limits and/or more extensive monitoring. In addition, ensure that any ad hoc modifications to a company's diligence of a higher-risk customer or third party are fully documented and promptly reviewed once exigent circumstances abate.

It is crucial that companies continue to follow their policies and procedures. A company that puts in place a well-designed compliance program but fails to effectively implement that program can quickly become a target for a regulatory enforcement action.

*Third*, companies should communicate with their regulators. If it is simply not possible to conduct legally required diligence and regulatory relief has not been announced, or if a company is unsure how a regulator might view a particular alternative procedure or other workaround, then a formal or informal inquiry may be warranted. For example, in July 2018, Deputy Assistant Attorney General Matthew Miner encouraged companies to make use of the Opinion Procedure Release process in connection with their FCPA compliance efforts.<sup>7</sup> If a company finds itself unable to meet the typical FCPA due diligence timeline for mergers and acquisitions due to the COVID-19 pandemic, requesting a DOJ opinion should be considered. Likewise, on March 16, 2020, FinCEN asked financial institutions that expect to miss filing or reporting deadlines due to the illness or unavailability of key staff to communicate those expectations to FinCEN as soon as possible.<sup>8</sup> When necessary, companies should take advantage of these invitations.

Although there are significant challenges involved in conducting due diligence in the COVID-19 era, companies can and should continue to comply with their legal obligations. To do so, companies need to make nimble use of personnel, technology, and outside partners to fulfill their diligence requirements. Companies should also closely track shifts in regulatory relief and enforcement priorities. In addition, companies may need to adjust their policies and procedures to account for new information collection methods, or the involvement of new service providers in diligence processes. Finally, companies should document any new risks that arise due to the use of alternative diligence methods, engage in appropriate mitigation measures both now and after the crisis, and consider whether there is a need to communicate any specific diligence challenges to regulators.

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<sup>7</sup> <https://www.justice.gov/opa/pr/deputy-assistant-attorney-general-matthew-s-miner-remarks-american-conference-institute-9th>

<sup>8</sup> <https://www.fincen.gov/news/news-releases/financial-crimes-enforcement-network-fincen-encourages-financial-institutions>

# Clients & Friends Memo

## Coronavirus Bill Radically Overhauls the Use of Video / Telephone Facilities in UK Criminal Proceedings

27 March 2020

### Summary

The Coronavirus Bill 2020 (the “**Bill**”) received Royal Assent and passed into law on Wednesday, 25 March 2020. Amongst a wide range of emergency measures, the Bill includes urgently-needed provisions allowing for the greater use of video and telephone communication in UK criminal court proceedings. The Bill updates several pieces of legislation including the Criminal Justice Act 2003, the Crime and Disorder Act 1998 and the Criminal Procedure Rules (“**CrimPR**”).

The criminal courts have historically been hesitant to embrace modern technology and allow for the possibility of remote hearings. The unprecedented challenges presented by the Coronavirus crisis are forcing a rapid adjustment in working practices and are essential to ensure that, “*the Courts can continue to function and remain open to the public, without the need for participants to attend in person*”.<sup>350</sup>

The criminal courts have allowed the use of audio and video facilities (referred to as “live link”) in limited circumstances for some time. These reforms greatly expand the availability of live link in criminal proceedings and allow for the possibility of full video and audio hearings, with the exception of jury trials. They also allow the public to participate in court and tribunal proceedings through audio and video in certain circumstances.

Although the new practices are stated to be temporary, their effects are likely to be long lasting and represent a fundamental overhaul of how criminal hearings are conducted. These changes will transform how the 77 Crown and 161 Magistrates’ courts operate and potentially stand to benefit all parties and greatly increase the efficiency of criminal procedure.

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<sup>350</sup> Department of Health & Social Care, *What the Coronavirus Bill will do*, available at <https://www.gov.uk/Government/Publications/Coronavirus-Bill-What-It-Will-Do/What-the-Coronavirus-Bill-Will-Do>.

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**Video and Audio Hearings Are Now a Possibility in a Wider Range of Circumstances**

The criminal courts have allowed witnesses to give their evidence via video link for some time. Video facilities have also been available to allow attendance by defendants remanded in prison awaiting trial and live link between the court and police stations is also in use for first hearings in the Magistrates Courts.<sup>351</sup> Following recent investment in the court IT systems, criminal cases are also now largely digital.

The radical overhaul introduced by the Bill will now permit all parties involved in a hearing to attend remotely – including the court itself, defendants, counsel and members of the public and press. The use of video and audio calls should assist with management of the court's limited resources by improving efficiency. It will also improve access and reduce travel time for people who wish to (or are obligated to) participate but are in other jurisdictions.

The Lord Chief Justice has ordered the courts to “*continue as many hearings as possible remotely*”. Jury trials have been suspended “*for a short time to enable appropriate precautions to be put in place*”. Other Crown Court and Magistrate hearings “*should continue, providing they can do so lawfully*”.

The Supreme Court and Judicial Committee of the Privy Council have already announced that all cases will be heard, and all judgments delivered, via video conferencing until further notice. The first Supreme Court case to be entirely conducted by video conferencing was held on Tuesday<sup>352</sup> with the first judgment handed down remotely on Wednesday.<sup>353</sup> The Supreme Court building is temporarily closed and members of the public and press will be able to follow live proceedings online.

The courts have announced plans to use, make publicly accessible and greatly expand the licences for existing video / audio systems (Justice Video Service and BT Meet Me) alongside the use of Skype for Business.

**Updates to Key Legislation**

Under section 51 of the Criminal Justice Act 2003 (“CJA”) and sections 57A to 57G of the Crime and Disorder Act 1998, the courts may allow a participant, including someone who is to give evidence, to take part by live link in a trial, a criminal appeal to the Crown Court or other hearings as

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<sup>351</sup> For further information and guidance, see: The Law Society, *Virtual court first hearings*, available at <https://www.lawsociety.org.uk/Support-Services/Advice/Practice-Notes/Virtual-Courts/>.

<sup>352</sup> *Fowler v. Commissioners for Her Majesty's Revenue and Customs* UKSC 2018/0226.

<sup>353</sup> *Elgizouli v. Secretary of State for the Home Department* [2020] UKSC 10.

listed in section 51(2) of the CJA. The court may make such a direction which includes any or all of the participants, including the court itself.<sup>354</sup>

Proceedings are regarded as taking place at the location where the member or members of the court takes part in the proceedings and joining via video or audio live link will be considered as complying with any obligation for a person to attend court. A hearing may now be conducted entirely as a video or audio hearing (subject to certain prohibitions and limitations) and a participant may take part by live link from any place in the world.

The Magistrate and Crown Court hearings covered by sections 57A to 57G of the Crime and Disorder Act 1998, include a pre-trial hearing (preliminary hearing), a sentencing hearing or hearing relating to the enforcement of a fine or other orders for payment (enforcement hearing).

For a court to give a live link direction, they have to be satisfied that hosting the hearing by live audio or live video link is in the interests of justice and that the parties to the proceedings have also been given the opportunity to make representations regarding the use of live link (section 51(4) of the CJA). The court is also required to take into account various circumstances when giving or rescinding a live link direction, including the importance of a witness's evidence, the availability of a person to attend, the suitability of the facilities and also whether the person will be able to participate effectively via live link. Under section 51(9) of the CJA, a single justice of the magistrates' court will be able to give a live link direction and require or permit a person to attend by live link.

The main exception, as previously announced by the Lord Chief Justice on Monday, is that no juror may participate by live link (section 51(1B) of the CJA). Another relevant exception to note is that under section 51(10) of the CJA, a court may not refuse or revoke bail for a person if any person (other than someone giving evidence) attends proceedings via a live audio link and that person also objects to the refusal or revocation.<sup>355</sup>

Part 18 of the CrimPR has been amended and is now titled "*Measures to assist a Witness, Defendant or other person to give evidence and participate*".<sup>356</sup> A key amendment, can be found at 18.1(e) where the court is now empowered to grant a direction to permit a "*defendant or other person to give evidence or to attend a hearing when not giving evidence by live link*". Previously, this solely applied to witnesses giving evidence to the court. It is clear that the aim of these

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<sup>354</sup> Section 53(1) of Criminal Justice Act 2003 states that "*The court may sit for the purposes of the whole or any part of the proceedings at any place at which such facilities are available*".

<sup>355</sup> Criminal Justice Act 2003 Section 51(11) contains an exception to this rule: "*But subsection (10) does not apply if section 4 of the Bail Act 1976 does not apply to P*".

<sup>356</sup> The underlining denotes additions to the title.

amendments is to assist parties, the public and courts themselves with continuing normal operations. As set out below, under 18.23(2)(b) the court may not give live link directions in certain circumstances where limitations are imposed by the Crime and Disorder Act 1998 and the Criminal Justice Act 2003. The court, under 18.23(3), when “*everyone taking part in a hearing must do so by live link*” may now require for the hearing to be broadcast to the public or instead recorded.

### Potential Issues

It remains to be seen how jury trials can be accommodated in the present reality. The live event of a jury trial includes numerous safeguards designed to protect the rights of defendants. Unscheduled private consultation between lawyers and clients, the ability to observe and react in real time to developments in court and the ability for the jury to physically get together and debate amongst others. There is, however, an urgent need to get the wheels turning again as the backlog of cases in the Crown Court has already reached a two year high. At the end of December 2019, there were 37,434 cases waiting to be heard at Crown Courts which is a 13% increase on the previous year and the highest level reached since 2017.<sup>357</sup>

It will also be interesting to see how these new procedures interact with the principle of open justice. The criminal courts have previously aggressively restricted recording of court proceedings (for example, Stephen Yaxley Lennon - who goes by the name Tommy Robinson – was sentenced to 9 months for contempt of court for live-streaming and aggressively confronting defendants outside Leeds Crown Court along with also breaching reporting restrictions). It is not clear how the courts could continue to maintain these restrictions in an era of public video transmission.

As always with such fundamental reforms, the devil will be in the detail. Communications need to be both secure and stable and it remains to be seen how the existing live link platforms will function under real-world conditions.

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The Guardian, *Number of outstanding crown court cases reaches two-year high*, 26 March 2020, available at <https://www.theguardian.com/world/2020/mar/26/number-outstanding-crown-court-cases-reaches-two-year-high-covid-19-crisis>.

# Clients & Friends Memo

## The UK Government and Regulators Respond to the COVID-19 Pandemic

30 March 2020

### Background

On 25 March 2020, the UK Government published a letter sent by the Chancellor of the Exchequer, the Governor of the Bank of England and the CEOs of the UK Prudential Regulation Authority (“**PRA**”) and the UK Financial Conduct Authority (“**FCA**”) to leaders of UK banks (the “**Joint Letter**”), addressing the impact of COVID-19 on the UK economy and bank lending. The letter highlighted action taken in concert between the UK Government, the regulators and banks to address the economic impact of the COVID-19 pandemic. In particular, the letter mentions the key measures taken so far, including:

- The COVID Corporate Financing Facility (“**CCFF**”), designed to support larger and investment grade businesses through the crisis;
- The Corona Business Interruption Loan Scheme (“**CBILS**”), a lending scheme delivered by the government-backed British Business Bank (“**BBB**”), designed to support small and medium sized businesses (“**SMEs**”);
- Measures taken by PRA and the FCA, including the relaxation of some regulatory capital standards, and measures to protect UK financial services consumers in financial difficulty; and
- Tax measures including permitting the deferral of Value Added Tax (“**VAT**”) payments.

This memorandum addresses the CCFF, CBILS, and the key tax and regulatory measures taken so far. We expect that the UK Government, the regulators and the banks may need to take further unprecedented measures in the coming months in order to address the extreme economic dislocation produced by the COVID-19 pandemic. In particular, the Joint Letter makes clear that the UK authorities will require the financial sector to “maintain and extend lending despite the uncertain economic conditions”.

We also briefly describe the guidance, issued by the FCA, Financial Reporting Council (“**FRC**”) and PRA on 26 March 2020, on reporting obligations in the current climate, including the FCA’s announcement that it will permit an extra 2 months for listed companies to file their audited financial statements (which otherwise would have been required within 4 months of financial year end).

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**CCFF**

CCFF launched on 23 March 2020 and is operated by the Bank of England (“**BoE**”) via a special purpose vehicle, COVID Corporate Financing Facility Limited (“**CCFFL**”). CCFFL will purchase commercial paper (“**CP**”) issued by firms making ‘a material contribution to the UK economy’ (as described below).

It is not necessary for a company to have any prior experience of issuing CP to access CCFF funding, but it must:

- Make a ‘material contribution’ to the UK economy. While the BoE retains discretion, firms will generally be accepted where they: are UK-incorporated (irrespective of their parent’s place of incorporation) with a genuine business in the UK; have significant employment in the UK; or are headquartered in the UK. The BoE will also consider whether a company generates significant revenues, serves a large number of customers or has a number of operating sites in the UK.
- Be able to demonstrate sound financial health prior to the economic fallout of the COVID-19 pandemic. Companies with investment ratings must have been rated as investment grade at 1 March 2020; other companies should consult the BoE’s [advice pages](#) which set out alternative measures for evidencing financial health.
- Not operate in financial sectors regulated by the BoE or the FCA. Leveraged investment vehicles and companies within groups that primarily operate in the regulated financial sector will also be ineligible.

Any CP to be purchased under CCFF must have the following properties:

- A maturity period of one week to twelve months.
- A credit rating of A-3 / P-3 / F-3 / R-3 from at least one of Standard & Poor’s, Moody’s, Fitch and DBRS Morningstar as at 1 March 2020 (where available).
- Issued directly into Euroclear and/or Clearstream.
- Absence of non-standard features such as extendibility and subordination.

CP will be bought in the primary market at a spread above a reference rate, based on the sterling overnight index swap rate. In the secondary market, CCFFL will buy CP at the lower of (i) amortised cost from the issue price and (ii) the price given using the method for primary market purchases. A fee (currently 5bps) will be charged for use of the secondary facility.

CCFF funding is now live and will be available for at least twelve months, but as long as necessary to ease cash flow strains on firms. Six months’ notice will be given prior to any withdrawal of CCFF funding.

**CBILS**

CBILS provides funding for small- to medium-businesses in the UK whose cashflows are disrupted by lost or deferred revenues following the COVID-19 pandemic. Funding may take the form of term facilities, overdrafts, asset-financing facilities and invoice-financing facilities, provided by government-accredited lenders and guaranteed by HM Government.

Funding under CBILS has the following characteristics:

- Facilities of up to £5 million, available on repayment terms for a period of up to six years (three years in the case of overdrafts and invoice-financing facilities).
- 80% government guarantee against the outstanding facility balance (capped per lender).
- No access or guarantee fees for borrowers: lenders will pay a fee to access the scheme and may charge borrowers their own fees such as exit fees.
- First 12 months' interest and fees paid for by the Government: the borrower will nevertheless remain liable for the full amount of the debt at all times.
- Security: funding up to £250,000 may be unsecured. Above this, security is required unless the lender establishes a lack of assets prior to the borrower using CBILS.

Financing under CBILS will be made available to borrowers that:

- Have a maximum £45 million turnover per annum.
- Have a borrowing proposal which cannot be financed on normal commercial terms but which the lender would ordinarily consider viable, and which the lender believes will enable the business to trade out of short-to-medium term difficulties.
- Do not operate in restricted sectors, at present, these are, financial institutions including insurers and reinsurers (but not insurance brokers); the public sector; employer, professional, religious or political organisations and trade unions.

The CBILS programme is now live. Further information for [borrowers](#), [lenders](#), and [prospective lenders](#) is available from the BBB's webpage.

**Regulatory Responses to the COVID-19 Crisis**

The PRA and the FCA have also been very active in responding to the crisis.

The BoE/PRA have taken the following prudential and policy measures, available [here](#), in respect of UK banks and building societies:

- Cancellation of the 2020 stress test for the eight major UK banks and building societies.

- The BoE's Financial Policy Committee ("**FPC**") announced a reduction of the UK countercyclical capital buffer rate to 0% of banks' exposures to UK borrowers with immediate effect from March 11, 2020. The FPC has indicated that it expects to maintain the 0% rate for at least 12 months. In a separate statement, the PRA made clear that its firm expects banks not to increase dividends and other distributions in response to this reduction and will monitor firms' distributions against this expectation.
- The PRA [wrote](#) to the CEOs of authorised banks providing guidance on the interpretation of IFRS 9 requirements on forward-looking expected credit loss estimates, capital requirements and loan covenant breaches.
- The BoE and the PRA have altered their work plans for the supervision of firms and financial market infrastructures (such as clearing houses). In particular, the PRA will suspend or otherwise delay non-critical data requests, on-site visits and deadlines, including s.166 FSMA skilled person's reports due to be conducted this year. The PRA is also reviewing its approach for considering and processing bank and insurer Senior Manager Function applications to reduce the burden on firms and the regulator.
- The BoE and the PRA have extended their deadline for open consultations on outsourcing and operational resilience until 1 October 2020.
- The PRA has extended the period for implementing the EBA IRB roadmap of regulatory products with the aim of reducing unwarranted variability in the risk-weighted assets calculated using IRB models. The PRA has delayed the following aspects until 1 January, 2022:
  - Proposals related to the definition of default, probability of default and loss given default estimation;
  - The requirement to move to hybrid IRB models; and
  - In addition, banks using the standardised approach to credit risk will also benefit from a delay to changes they need to make as part of guidelines on definition of default.

The FCA has also taken action in a number of areas, including that set out in the following statements and guidance:

- The FCA has set out its expectations in respect of contingency and business continuity planning, and a number of other areas, to help FCA regulated firms navigate the crisis. This information is contained on a new FCA COVID-19 page, which can be found [here](#).
- For firms authorised by the FCA (rather than banks and insurers authorised by the PRA), it has set out its [expectations](#) in respect of firms in relation to regulatory capital and financial resources during the crisis, explaining that it expects firms to use capital and liquidity buffers where

appropriate, and to keep the FCA informed regarding financial difficulties or any plans by firms to exit the market.

- The FCA has [extended](#) the closing dates for its open consultations and calls for input to 1 October 2020.
- The FCA has issued a [statement](#) on property fund suspensions, recognising valuers have determined that there is currently material uncertainty over the value of commercial real estate (“**CRE**”). Where a fair and reasonable valuation of CRE funds cannot be established, the FCA considers it appropriate for managers of open-ended CRE funds to suspend dealing in units of these funds, and recognises this as being likely to be in the best interests of investors.
- The FCA has published [guidance](#) for banks, other lenders and mortgage administrators on their treatment of residential mortgage customers during the COVID-19 pandemic. The guidance provides help for firms to interpret Principle 6 of the FCA’s Principles for Businesses and MCOB 2.5A.1R, which relate to treating customers fairly and acting in the best interests of customers respectively. Although these statements are nominally guidance, the FCA has made clear that in an enforcement context, a firm is likely to be found to have contravened Principle 6 and MCOB 2.5A.1R if it acted in a manner inconsistent with this guidance.

The new guidance makes clear that firms should:

- Grant customers a payment holiday for an initial period of 3 months, where customers experience payment difficulties as a result of the COVID-19 pandemic and where they have indicated they wish to receive one. A firm should not refuse such a request unless it can demonstrate it is reasonable and in the customer’s best interest. A firm may decide to put in place an option other than a 3 month payment holiday, if it is appropriate to do so in the individual circumstances of the case and the firm reasonably considers it as being in the best interests of the customer;
- Ensure that there is no additional fee or charge (other than additional interest) as a result of the payment holiday; and
- Take steps to ensure the overall effect of the payment holiday on monthly payments and the term of the mortgage is fully explained to the borrower, including where the firm arranges to capitalise these amounts. The information given should be provided in good time before any capitalisation takes place, and make clear that the customer could pay more over the lifetime of the mortgage as a result of capitalisation, compared to an alternative means of repaying these amounts, such as in a lump sum.

The FCA has also made it clear that during the pandemic, it does not consider that repossession will be in the best interests of the customer. As a result, repossession should not be commenced or continued with unless the firm can demonstrate clearly that the customer has agreed it is in their best interest.

- The FCA has published [guidance](#) on FCA regulated firms participating in CBILS, noting that loans of up to £25,000 to sole traders and unincorporated enterprises can fall within the scope of FCA regulation of consumer credit. During the current crisis, the FCA has indicated that it will loosen some of the consumer credit rules relating to affordability; the fact that the customer may, at the time of the application, be temporarily experiencing exceptional financial pressures does not mean that the firm is prevented from making the loan. The guidance also indicates that firms should be willing to exercise forbearance in some circumstances; for example, where forecast income to repay the loan does not arise, lenders should consider deferring repayments until it does.
- In line with ESMA's decision to delay Securities Financing Transaction Regulation ("SFTR") reporting, the FCA [confirmed](#) that it will not prioritise supervisory activity towards firms' compliance with the SFTR reporting obligation between 13 April 2020 and 13 July 2020.
- The FCA published a [statement](#) on the impact of the COVID-19 pandemic on firms' preparation for LIBOR transition. Although the FCA did not alter its central assumption that firms cannot rely on LIBOR being published after the end of 2021, it recognised that the pandemic has impacted the transition programmes of many firms. The FCA recognised that in some markets where the transition from LIBOR is still at a relatively early stage, some of the intended milestones set by the FCA and the Working Group on Sterling Risk-Free Reference Rates (the "**Working Group**") could be missed. The FCA, the Working Group and BoE have undertaken to monitor and assess the impact of COVID-19 on transition timelines and are expected to update the market again soon.

### UK Company Reporting and Audit Obligations

In a [joint statement](#) on 26 March 2020 from the FCA, FRC and PRA, these agencies acknowledge that in these extraordinary circumstances, previous market practice relating to timing and content of financial information and related audit work must change. They emphasize, however, the ongoing

importance of the capital markets in providing finance to business as an aid to economic recovery, and that capital markets rely on timely, accurate information.

Key points from this statement include<sup>358</sup>:

- *2 Month Delay of Annual Reporting Deadline for Listed Companies.* As a temporary measure during the extreme disruption of the coronavirus pandemic, the FCA will forbear from suspending the listing of any company that fails to meet the Transparency Directive deadline to publish audited financial statements (4 months from financial year end) if they publish those financial statements within 6 months from financial year end.
- *3 Month Delay to Companies House Accounts Filing Obligations.* All UK registered companies separately have an obligation to file their accounts at Companies House within 6 months (for public companies) or 9 months (for private companies) from financial year end. Companies House has [announced](#) it will grant a 3 month extension for filing of accounts to any applicant that cites issues around COVID-19. For example, this will permit applications for delayed filing of financial statements for subsidiary companies of listed entities.
- *Preliminary Statements of Account.* The [previously-announced](#) moratorium on preliminary financial statements will end on 5 April 2020. However, the FCA reiterates its belief that the practice of issuing preliminary financial statements well in advance of the deadline for final financial statements adds unnecessary pressure to companies and auditors, and they are hopeful of a shift in market practice.
- *Obligation to Disclose Inside Information Unchanged.* Companies' obligations under the Market Abuse Regulation remain in force, and companies must carefully consider what information constitutes inside information, recognising that the global pandemic and policy responses to it may alter the nature of information that is material to a business's prospects. Companies the global pandemic and policy responses to it may alter the nature of information that is material to a business's prospects.

The FRC has issued guidance for companies dealing with unprecedented uncertainty about their prospects. They advise boards to focus on:

- Reviewing control and reporting procedures, to ensure that they remain effective, noting that what has worked in the past may not be effective in the current circumstances;
- Determining how to secure reliable and relevant information from their organization; and

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<sup>358</sup> The joint statement references several other recent publications by these entities including an [FCA Policy Statement](#), [Guidance for Companies](#) and [Guidance for Auditors](#) from the FRC

- Paying attention to capital maintenance, in particular ensuring sufficient reserves for payment of dividends exist at the time the dividend is paid (not just proposed).

The guidance notes that investors are seeking key information on liquidity, viability and solvency of companies and that companies must articulate their expectations of possible impacts on their specific business. They provide guidance on likely reporting issues companies are facing now, reiterating that disclosure must be specific to the entity, including:

- Viability Statement. The FRC notes that fuller disclosure is paramount, and gives some specific guidance for companies in describing the assumptions and qualifications, limits of predictions and level of confidence underlying their statement that they have a “reasonable expectation” that the company will be able to continue in operation and meet its liabilities as they fall due over a period of assessment.
- Going Concern and Material Uncertainties. IAS 1 requires financial statements to be prepared on a going concern basis unless management either intends to liquidate the entity or to cease trading or has no realistic alternative but to do so. The FRC thinks it is likely that more companies will disclose “material uncertainties” to going concern in current circumstances, and gives guidance for considering and disclosing the uncertainty and likely success of any realistically possible mitigating actions.
- Significant Judgments and Estimation Uncertainty. Companies must disclose significant judgments, including those made in applying accounting policies. Companies are encouraged to provide as much context as possible, and note that relevant judgments and assumptions may include (i) availability and extent of government support measures, (ii) availability, extent and timing of sources of cash and (iii) duration of social distancing measures and their impacts. The FRC recognises that the assumptions of companies on COVID-related matters will likely be different, and therefore stresses the need for full disclosure.
- Events After the Reporting Date. There is a general consensus that the outbreak of COVID-19 in 2020 was a condition that arose after the balance sheet date (a non-adjusting event) for the vast majority of UK companies preparing financial statements for periods ended 31 December 2019. For subsequent reporting dates this will be highly dependent on the reporting date, the specific circumstances of the company’s operations and the particular events under consideration
- Guidance for Auditors. The FRC has issued guidance to auditors including a non-exhaustive list of factors to be considered in carrying out audit engagements in the current circumstances, including guidance on how they may be addressed. It will issue additional guidance as the situation progresses, and will withdraw the guidance when circumstances return to normal. The guidance reiterates the fundamental importance of high quality, independently assured information, and that in order to be able to give an audit opinion that is not subject to a

disclaimer or qualification due to a scope limitation, the auditor must always obtain sufficient, appropriate audit evidence.

- Replacement of Auditors and Audit Partners. In the current climate, companies are encouraged to consider delaying planned tenders for new auditors, including by applying the FRC to extend the mandate when mandatory rotation is due). In addition, while key audit partners are required to rotate every 5 years, where there are good reasons, for example to maintain audit quality in current circumstances, the rotation can be extended to no more than 7 years. This needs to be agreed with the audit committee of any affected entity and does not need to be cleared with or approved by the FRC.
- Reduction of FRC demands on companies and audit firms. The FRC will, where possible, delay or extend the deadlines for consultations; it has paused for at least one month writing new letters to companies following its review of their annual reports and accounts; it is considering how it can adjust its audit quality review work to reduce demands on audit firms; and it will pause for at least one month requests to firms on supervisory initiatives, such as operational separation of audit practices.

### **UK Taxation Measures**

A number of important tax measures form part of the UK Government's program to deal with the economic impact of the COVID-19 pandemic.

As regards UK VAT, quarterly VAT payments will be deferred for all UK businesses from 20 March 2020 until 30 June 2020. This is an automatic offer made by the Government to all UK businesses, with no applications required to the UK tax authorities. Furthermore, the Government has announced that taxpayers will be given until 31 March 2021 to pay any liabilities that accumulate during the deferral period. VAT refunds and reclaims will, however, be paid by the Government as normal during the deferral period.

Payments of income tax, due from self-employed individuals on the 31 July 2020, can be deferred until 31 January 2021. This is another automatic offer made by the UK Government, with no need for self-employed individuals to apply to benefit from the income tax deferral. No penalties or interest for late payment will be charged on any income tax deferred until January 2021.

The UK Government has not yet announced any changes to the payment schedules for corporation tax applicable to UK companies.

Other tax-related stimulation measures might follow, however, in the short term, as have been seen in a number of other jurisdictions.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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# Clients & Friends Memo

## Key Provisions of the Coronavirus Aid, Relief, and Economic Security (CARES) Act

March 30, 2020

On March 27, 2020, the President signed the Coronavirus Aid, Relief, and Economic Security (CARES) Act (the “**Act**”) into law following the Act’s approval by both chambers of Congress. The Act is aimed at reducing the economic impact of the novel coronavirus 2019 (“**COVID-19**”) pandemic and authorizes \$2.1 trillion in aid to various sectors of the economy. This memorandum summarizes several aspects of the Act that may be of interest to our clients and friends, including:

- paycheck protection program provisions;
- loans, loan guarantees and other investments for eligible businesses, states and municipalities;
- business and individual tax provisions;
- certain retirement and pension related provisions;
- bank regulatory provisions;
- credit protection, mortgage loan and residential property provisions;
- student loan provisions; and
- patent and trademark provisions.

### **Paycheck Protection Program Provisions**

The Act amends Section 7(a) of the Small Business Act to include a new guaranteed, unsecured loan program (the “**Paycheck Protection Program**”). The Paycheck Protection Program is an expansion of the Small Business Administration (the “**SBA**”) Economic Injury Disaster Loan program. The program provides for \$349 billion to support loans to a broader segment of small businesses than those that would otherwise be eligible to receive SBA 7(a) loans. The key terms of the program are as follows:

- **Term of Program.** The program will apply retroactively from February 15, 2020 until June 30, 2020. Any 7(a) loan made during this time to an eligible borrower will be considered a “**covered loan.**”
- **Authorized Lenders.** Loans under the program will be immediately available through existing SBA-certified lenders, including banks, credit unions and other financial institutions. In addition, the authority to make loans will be expanded to include additional private sector lenders determined by the SBA and the Treasury to have the necessary qualifications. This opens the door for additional financial services firms to become eligible SBA lenders, including FinTech companies.
- **Eligible Borrowers.** In addition to businesses that previously met SBA size standards, the program will be available to any business, nonprofit organization, veterans organization or tribal business with 500 employees or fewer, as well as individuals who operate under a sole proprietorship or as an independent contractor and eligible self-employed individuals. Also, the SBA will relax rules on affiliation, allowing some entities previously deemed too large (such as any individual franchises and any business in the NAICS Sector 72 (Accommodations and Food Services)) to qualify for this program.
- **Use of Proceeds.** The program will expand the allowable uses of SBA loans to include payroll costs, costs related to continuation of group health care benefits, employee salaries and commissions, interest payments on mortgage obligations, rent, utilities and interest on debt obligations incurred before the commencement of the program. A covered loan may also be used to refinance an existing 7(a) loan taken out on or after January 31, 2020 and received before loans under this program became available.
- **Maximum Loan Size.** Loans made under the program generally would be capped at the lesser of (i) \$10 million and (ii) the sum of (x) 250% of an employers’ average monthly payments for payroll costs incurred during the 1-year period before the date on which the loan is made, subject to exceptions for seasonal employers, and (y) the outstanding amount of any loan under the SBA’s Disaster Loan Assistance Program made during the period

beginning on January 31, 2020 and ending on the date on which loans are made available to be refinanced under the program.

- Interest Rate. The interest rate on a loan made pursuant to the program may not exceed 4% per annum.
- Federal Guarantee. The covered loans will be 100% federally guaranteed. After the application of any loan forgiveness, the remaining balance of the covered loan will continue to be 100% federally guaranteed for a term not to exceed 10 years.
- Personal Guarantees, Recourse and Collateral Requirements. No personal guarantee will be required for any loan made under the program, nor will any collateral be required. Furthermore, the SBA will have no recourse against any individual shareholder, member or partner of an eligible business for non-payment, except to the extent such person uses the loan proceeds for an unauthorized purpose.
- Fees and Penalties Waived. There will be no penalties for prepaying a covered loan and the SBA will waive the standard guarantee fee usually charged to 7(a) borrowers.
- Payment Deferral. Lenders will be required to provide complete payment deferment relief for impacted borrowers for a period of not less than six months and not more than one year. All borrowers that were in existence on February 15, 2020 are deemed “impacted” and thus eligible for payment deferral.
- Secondary Market Trading of Covered Loans. Loans made under the program are eligible to be sold in the secondary market consistent with the process for selling other 7(a) loans. The SBA may not collect any fee for any guarantee sold into the secondary market. Until June 30, 2020, if a secondary market purchaser declines to approve a deferral requested by a lender, the SBA will exercise its authority to purchase the loan so that the impacted borrower may receive such a deferral.
- Loan Forgiveness. Borrowers would be eligible for loan forgiveness in an amount, not to exceed the principal amount of the loan, equal to the sum of payroll costs (excluding employees compensated at an annual rate above \$100,000), interest on mortgages, rent and utilities payments incurred or paid during the eight-week period commencing on the date of the loan. The amount of loan forgiveness will be reduced by the (1) total drop in employment at the borrower (compared to either February 15, 2019 – June 30, 2019 or January 1, 2020 – February 29, 2020, as selected by the borrower) and (2) reduction in wages/salary of each employee (excluding employees compensated at an annual rate above \$100,000) of greater than 25% compared to the most recent full quarter such employee was employed. There are exceptions for any such employment or compensation

reductions occurring during the covered period if such reduction is eliminated no later than June 30, 2020. The SBA will purchase at par from the applicable lender the amount of each covered loan that is forgiven.

- Reimbursement for Loan Processing. The SBA will reimburse a lender authorized to make a covered loan at a rate, based on the balance of the financing outstanding at the time of disbursement of the covered loan: 5% for loans up to \$350,000, 3% for loans above \$350,000 and below \$2 million, and 1% for loans above \$2 million.
- Regulatory Capital Requirements. For purposes of risk-based capital requirements applied by federal banking agencies and the National Credit Union Administration (“**NCUA**”), loans made under the program will receive a risk weight of 0%. Under Section 4013, the federal banking agencies are required to suspend the requirements under U.S. GAAP applicable to banking institutions with respect to any loan modification “related to” the COVID-19 pandemic, if such loan modification would otherwise be categorized as a troubled debt restructuring (“**TDR**”). Any such COVID-19 related modified loan would not be considered a TDR for accounting purposes, including with respect to the banking institution’s capital calculations. The provisions of Section 4013 apply to only those loan modifications made with respect to loans that were not more than 30 days past due on December 31, 2019. Section 4013’s suspension of TDR requirements apply to loan modifications made between March 1, 2020 and the earlier of December 31, 2020, or 60 days following the termination date of the national emergency concerning the COVID-19 outbreak declared by the President on March 13, 2020 under the National Emergencies Act (the “**COVID-19 Emergency**”), but persist for the duration of the particular loan modification.
- Express Loans. The maximum loan amount for Express Loans, which provide borrowers with revolving lines of credit for working capital purposes, has been increased from \$350,000 to \$1 million.

### **Loans, Loan Guarantees and Other Investments for Eligible Businesses, States and Municipalities**

The Act provides \$500 billion to the Secretary of the Treasury (the “**Treasury Secretary**”) to make loans, loan guarantees and other investments in support of eligible businesses, states and municipalities. An “**eligible business**” is defined as an air carrier or a U.S. business that has not otherwise received adequate economic relief in the form of loans or loan guarantees provided under the Act. The \$500 billion is allocated among the following:

- Loans and Loan Guarantees to Specified Businesses (the “Specified Business Loans”).
  - \$25 billion for (i) passenger air carriers, (ii) eligible businesses that are certified and approved to perform inspection, repair, replacement or overhaul services for air transportation and (iii) ticket agents for air transportation;
  - \$4 billion for cargo air carriers; and
  - \$17 billion for businesses critical to maintaining national security.
- Federal Reserve Programs and Facilities. \$454 billion, as well as any amounts available but not used for the purposes above, for loans, loan guarantees and investments in programs or facilities established by the Federal Reserve for the purpose of providing liquidity to eligible businesses, states and municipalities.

### General Terms and Conditions

The loans, loan guarantees and other investments are to be made on such terms and conditions as the Treasury Secretary determines are appropriate. The Treasury Secretary will publish procedures and minimum requirements no later than 10 days after the Act is enacted.

- Prohibition on Loan Forgiveness. The principal amount of any obligation issued by an eligible business, state or municipality under a program described above may not be reduced by loan forgiveness.
- Tax Treatment. Any loan made or guaranteed by the Treasury would be treated as debt for U.S. tax purposes.

### Requirements for Specified Business Loans

Specified Business Loans are subject to the following requirements:

- Eligibility.
  - Credit must not be reasonably available to the borrower at the time of the transaction;
  - The borrower’s obligation must be prudentially incurred; and
  - The borrower must have incurred or must be expected to incur covered losses such that the continued operations of the business are jeopardized.

- Duration of the Loan or Loan Guarantee. The duration of the loan or loan guarantee must be as short as practicable and not longer than five years.
- Interest Rate. The loan or loan guarantee must be sufficiently secured or made at a rate that reflects the risks of the loan or loan guarantee and is, to the extent practicable, not less than an interest rate based on market conditions prior to the outbreak of COVID-19.
- Protection of Collective Bargaining Agreements. Loans or loan guarantees to businesses may not be conditioned on entering into negotiations regarding pay or other terms and conditions of employment in collective bargaining.
- Obligations of the Borrower. The agreement for the loan or loan guarantee must include the following terms:
  - Prohibition on Buybacks and Dividends. Until the date 12 months after the date of the loan or loan guarantee is no longer outstanding, (1) neither the borrower nor its affiliates may purchase any equity security listed on a national securities exchange of the borrower or any parent company of the borrower, except to the extent required under a contractual obligation in effect prior to the enactment of the Act, and (2) the borrower may not pay dividends or make other capital distributions with respect to its common stock.
  - Employment Levels. The borrower must maintain its employment levels as of March 24, 2020 until September 30, 2020, to the extent practicable, and not reduce its employment level by more than 10%.
  - U.S. Entity. The borrower must certify that it was created or organized in the U.S. or under the laws of the U.S. and has significant operations in, and a majority of its employees based in, the U.S.
- Employee Compensation Limits. Eligible businesses that receive a loan or loan guarantee from the Treasury (or a loan made available under a program providing financing to lenders that make direct loans to eligible businesses, as further described below) must agree, from the date that the loan or loan guarantee agreement is executed until the date that is one year after the date on which the loan or loan guarantee is no longer outstanding, that:
  - No officer or employee of the business whose total compensation exceeded \$425,000 in calendar year 2019 (other than an individual whose compensation is determined through a collective bargaining agreement executed prior to March 1,

2020) will receive (1) total compensation which exceeds, during any 12 consecutive months of such period, the total compensation received during calendar year 2019 or (2) severance pay or other benefits upon termination which exceeds twice the maximum total compensation received during calendar year 2019.

- No officer or employee of the business whose total compensation exceeded \$3 million in calendar year 2019 may receive total compensation which exceeds, during any 12 consecutive months of such period, the sum of (x) \$3 million and (y) 50% of the excess over \$3 million of the total compensation received in calendar year 2019.
- "Total compensation" includes salary, bonuses, awards of stock and other financial benefits.

Air carriers and related contractors participating in certain of the new financial assistance programs are subject to additional limitations on employee compensation.

- Warrant, Equity Interest or Senior Debt Instrument Requirement. The Specified Business Loans must be accompanied with one of the following:
  - If the borrower is listed on a national securities exchange, then the Treasury Secretary must receive a warrant or equity interest in the borrower.
  - If the borrower is not listed on a national securities exchange, then the Treasury Secretary must receive, in the discretion of the Treasury Secretary, a warrant or equity interest in the borrower or a senior debt instrument issued by the borrower.

The terms and conditions of the warrant, equity interest or senior debt instrument will be set by the Treasury Secretary and must meet the following requirements:

- Purposes. The terms must be designed to provide for the reasonable participation by the Treasury Secretary in equity appreciation or reasonable interest rate premium, as applicable.
- Authority to sell, exercise or surrender. The Treasury Secretary must be able to sell, exercise or surrender the warrant or senior debt instrument. The Treasury Secretary may not exercise voting power with respect to any shares of common stock acquired.

- Sufficiency. If the Treasury Secretary determines that the borrower cannot feasibly issue warrants or other equity interests as required, the Treasury Secretary may accept a senior debt instrument in an amount and on such terms as the Treasury Secretary deems appropriate.

*The warrant, equity interest or senior debt requirement has similarities to provisions of the Troubled Asset Relief Program (“TARP”) implemented during the financial crisis of 2008-2009. Similar to the Act, TARP allowed the Treasury Secretary to receive warrants or equity interests in participating institutions. Under TARP, the Treasury Secretary generally invested in non-voting common or preferred stocks if the participating institution was publicly traded or in a senior debt instrument if the participating institution was not publicly traded in order to bolster the capital position of the financial institution receiving the investment, whereas the Act provides for loans to be made to participating businesses. However, the TARP investments were, and the loans made under the Act will be, generally accompanied by warrants or other equity investments in order to provide upside potential to Treasury.*

### Requirements for Federal Reserve Programs and Facilities

The Act allocates \$454 billion, as well as any amounts available but not used for the Specified Business Loans, for loans, loan guarantees and investments in programs or facilities established by the Federal Reserve for the purpose of providing liquidity to eligible businesses, states and municipalities.

The requirements of Section 13(3) of the Federal Reserve Act would apply to any program or facility. This would include requirements relating to loan collateralization, taxpayer protection and borrower solvency. In addition, a program or facility must have “broad-based eligibility” and not be directed at any specific company or companies. In response to the COVID-19 pandemic, the Federal Reserve has already announced several facilities pursuant to its Section 13(3) authority, including the Commercial Paper Funding Facility, the Primary Dealer Credit Facility, the Money Market Mutual Fund Liquidity Facility, the Term Asset-Backed Securities Loan Facility, the Primary Market Corporate Credit Facility<sup>1</sup> and the Secondary Market Corporate Credit Facility.<sup>2</sup> The latter two facilities, which were announced before the Act,

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<sup>1</sup> This facility is open to investment grade companies and will provide bridge financing of four years. The Federal Reserve will finance a special purpose vehicle (“SPV”) to make loans from the Primary Market Corporate Credit Facility to companies. The Treasury, using the Exchange Stabilization Fund, will make an equity investment in the SPV.

<sup>2</sup> The Secondary Market Corporate Credit Facility will purchase in the secondary market corporate bonds issued by investment grade U.S. companies and U.S.-listed exchange-traded funds whose investment objective is to provide broad exposure to the market for U.S. investment grade corporate bonds. The

expressly exclude from coverage those “companies that are expected to receive direct financial assistance under pending federal legislation.”

Under the Act, a program or facility in which the Treasury Secretary makes a loan, loan guarantee or other investment may only purchase obligations or other interests (either directly from the issuer or in secondary markets, but not including securities that are based on an index or that are based on a diversified pool of securities) from, or make loans or other advances to, businesses that are created or organized in the U.S. or under the laws of the U.S. and that have significant operations in and a majority of its employees based in the U.S.

The Treasury Secretary may make loans, loan guarantees or other investments as part of a program or facility that provides direct loans. A “**direct loan**” is a bilateral loan agreement entered into directly with the borrower and may not be a syndicated loan, a loan originated by a financial institution in the ordinary course of business, or a securities or capital market transaction. To qualify, the borrower must agree:

- Prohibition on Buybacks and Dividends. Until the date 12 months after the date on which the direct loan is no longer outstanding, (1) not to purchase an equity security of the eligible business or any parent company of the eligible business while the direct loan is outstanding, except as required under an agreement in effect as of March 27, 2020 and (2) not to pay dividends or make other capital distributions with respect to its common stock.
- Employee Compensation Limits. Until the date that is one year after the date on which the loan or loan guarantee is no longer outstanding, that:
  - No officer or employee of the business whose total compensation exceeded \$425,000 in calendar year 2019 (other than an individual whose compensation is determined through a collective bargaining agreement executed prior to March 1, 2020) will receive (1) total compensation which exceeds, during any 12 consecutive months of such period, the total compensation received during calendar year 2019 or (2) severance pay or other benefits upon termination which exceeds twice the maximum total compensation received during calendar year 2019.
  - No officer or employee of the business whose total compensation exceeded \$3 million in calendar year 2019 may receive total compensation which exceeds, during any 12 consecutive months of such period, the sum of (x)

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Treasury, using the Exchange Stabilization Fund, will make an equity investment in the SPV established by the Federal Reserve for this facility.

\$3 million and (y) 50% of the excess over \$3 million of the total compensation received in calendar year 2019.

- "Total compensation" includes salary, bonuses, awards of stock and other financial benefits.
- Waiver by the Treasury Secretary. These requirements may be waived by the Treasury Secretary upon a determination that such a waiver is necessary to protect the interests of the federal government.

*As authorized by the Act, the Federal Reserve's direct loans to corporations (rather than to banks and other financial institutions) is particularly notable, as such credit was not extended by the Federal Reserve during the last financial crisis.*

#### **Assistance for Mid-Sized Businesses**

The Treasury Secretary will also endeavor to seek the implementation of a program or facility that provides financing to lenders that make direct loans to eligible businesses including, to the extent practicable, nonprofit organizations, with between 500 and 10,000 employees, with such direct loans being subject to an annualized interest rate not higher than 2%.<sup>3</sup> For the first six months after the loan is made (or longer, as determined by the Treasury Secretary), no principal or interest will be due or payable. Borrowers must make the following certifications:

- Eligibility.
  - The uncertainty of the economic conditions makes necessary the loan request to support the borrower's ongoing operations;
  - The borrower is domiciled in the U.S. with significant operations and employees in the U.S.;
  - The borrower is not a debtor in a bankruptcy proceeding; and

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<sup>3</sup> Any financing provided for such businesses is separate and distinct from assistance that could be offered under the Main Street Business Lending Program. That program, which would support lending to eligible small-and-medium sized businesses and complement efforts by the SBA, is expected to be formally announced by the Federal Reserve soon.

- The borrower is created or organized in the U.S. or under the laws of the U.S. and has significant operations in and a majority of its employees based in the U.S.
- Prohibition on Dividends. The borrower will not pay dividends with respect to the common stock of the eligible business, or repurchase an equity security that is listed on a national securities exchange of the borrower or any parent company of the recipient while the direct loan is outstanding, except to the extent required under a contractual obligation in effect as of March 27, 2020.
- Workforce Levels. The funds will be used to retain at least 90% of the borrower's workforce, at full compensation and benefits, until September 30, 2020.
- Restoration of Workforce, Compensation and Benefits. The borrower intends to restore not less than 90% of the borrower's workforce that existed as of February 1, 2020, and to restore all compensation and benefits to the workers of the recipient no later than four months after the termination date of the COVID-19 Emergency.
- Prohibition on Outsourcing. The borrower will not outsource or offshore jobs for the term of the loan and two years after completing repayment of the loan.
- Protection of Collective Bargaining Agreements. The borrower will not abrogate existing collective bargaining agreements during the term of the loan and for two years after repayment, and will remain neutral in any union organizing effort for the term of the loan.

### Government Participants

The Treasury Secretary will also endeavor to seek the implementation of a program or facility that provides liquidity to the financial system that supports lending to states and municipalities.

### Conflicts of Interest

The Act prohibits an entity in which a "covered individual" directly or indirectly holds at least a 20% interest from participating in any transaction described above. The term "**covered individual**" is defined to include the President, the Vice President, the head of an executive department or a member of Congress, as well as the spouse, child, son-in-law or daughter-in-law, as determined under applicable common law, of the foregoing individuals.

### **Special Inspector General and Oversight Commission**

- Special Inspector General. The Act establishes the Office of the Special Inspector General for Pandemic Recovery led by a Special Inspector General for Pandemic Recovery (the “**Special Inspector General**”) appointed by the President, by and with the advice and consent of the Senate. The Special Inspector General will conduct, supervise, and coordinate audits and investigations of the making, purchase, management and sale of loans, loan guarantees and other investments made by the Treasury Secretary under any program established under the Act, and the management by the Treasury Secretary of any program established under the Act.
  - Duration. The Office of the Special Inspector General terminates five years after the enactment of the Act.
  - Subpoena Authority. The Special Inspector General has authority to request information for its reviews, including through subpoena.
  - Quarterly Reports. Not later than 60 days after the date on which the Special Inspector General is confirmed, and once every calendar quarter thereafter, the Special Inspector General will submit to the appropriate committees of Congress a report summarizing the activities of the Special Inspector General. The reports must include detailed statements of all loans, loan guarantees, other transactions, obligations, expenditures and revenues associated with any program established by the Treasury Secretary.
- Congressional Oversight Commission. The Act also establishes a Congressional Oversight Commission to oversee implementation of the Act by the Treasury and the Federal Reserve.
- Reports and Testimony. Treasury and the Federal Reserve are required to provide detailed reports and disclosures to Congress and the public on various transactions and financial assistance provided under the Act. In addition, the Treasury Secretary and the Federal Reserve Chairman must appear, on a quarterly basis, before the Senate Banking Committee and the House Financial Services Committee to testify on their obligations and transactions entered into under the Act.

### **Business and Individual Tax Provisions**

The Act includes several provisions intended to provide tax relief to both businesses and individuals, including by rolling back some measures implemented by the Tax Cuts and Jobs Act of 2017 (the “**2017 Tax Act**”).

- Business Tax Provisions.
  - Temporarily Repeal Excess Business Loss Limitation. Section 461(l), enacted as part of the 2017 Tax Act, generally precludes non-corporate taxpayers from deducting net business losses in excess of \$250,000 (adjusted for inflation) in any taxable year before 2026. The Act repeals this limitation for 2018 and 2019.
  - Temporarily Increase Business Interest Deduction Limitation. Section 163(j), enacted as part of the 2017 Tax Act, generally precludes taxpayers from deducting interest expense in excess of business interest income plus 30% of EBITDA (or of EBIT, beginning in 2022). The Act raises the 30% EBITDA threshold to 50% for 2019 and 2020 and allows taxpayers to elect to use 2019 EBITDA for taxable years beginning in 2020.
  - Temporarily Ease NOL Limitations. The 2017 Tax Act prohibits most corporate taxpayers from carrying back net operating losses (“NOLs”) to offset a previous year’s taxable income and limits the NOLs that can be deducted in any year to 80% of taxable income (calculated before giving effect to the NOLs). By contrast, before the 2017 Tax Act, NOLs generally could be carried back up to two years and could offset up to 90% of taxable income. The Act permits taxpayers to carry back 2018, 2019, and 2020 NOLs for up to five years, and to offset 100% of their income with NOLs in taxable years beginning before 2021.

*Corporate taxpayers will welcome the Act’s temporary repeal of the 2017 Tax Act’s ill-conceived limits on deductions and NOL usage. However, it remains to be seen whether and to what extent these changes will generate immediate cash savings. Most corporations operate on a calendar-year basis, and many did not have significant losses in recent years. Accordingly, many corporations may have to wait until 2021 to calculate their 2020 losses, carry them back and file for refunds. Moreover, the ability to carry back NOLs might not be as valuable for companies with offshore operations because reductions in a company’s U.S. taxable income could increase the company’s tax bill in respect of global intangible low-tax income.*

- Preclude Government Investment from Causing a Section 382 Ownership Change. Section 382 strictly limits the amount of net operating losses and built-in losses a corporation can use after it undergoes an ownership change. As with the TARP program implemented in response to the last financial crisis, the Act requires Treasury to provide guidance to the effect that the government’s investment in a company in accordance with the Act “does not result in an ownership change for purposes of section 382.” The Act is silent as to the consequences of a subsequent sale of an acquired interest.

- Accelerate Corporate AMT Credit Recovery. Before its repeal, the corporate alternative minimum tax (“**AMT**”) generated tax credits that could be used against a corporation’s regular tax in future years. The TCJA repealed the corporate AMT and provided that these credits could be taken as refundable credits over several years, with 100% of any remainder being paid out in 2021. The Act makes any remaining AMT tax credits fully refundable for the 2019 taxable year.
- Individual Tax Provisions.
  - Provide Cash Payments to Individuals. The Act provides for direct cash payments of up to \$1,200 per adult individual, plus \$500 per child, with phase-outs beginning at \$75,000 of taxable income for individuals (and a complete phase-out at \$99,000).
  - Expand the Charitable Contribution Deduction. The Act (1) allows non-itemizing taxpayers to deduct up to \$300 of cash contributions in 2020, (2) allows itemizing taxpayers to take charitable deductions on cash contributions in 2020 without regard to the 60% of adjusted gross income limitation and (3) allows corporations to take charitable deductions on cash contributions in 2020 up to 25% of their taxable income (instead of 10% under current law).
  - Exclude Certain Employer Student Loan Payments from Employee Income. The Act excludes from an employee’s taxable income the first \$5,250 of student loan payments made by his or her employer after the enactment of the Act and before 2021.

### **Certain Retirement and Pension Related Provisions**

- Delay in Funding of Single-Employer Pension Plans. Under the Act, the minimum required contributions that would otherwise be due in 2020 can be delayed until January 1, 2021. However, any amount so delayed is increased by interest accruing between the original due date and the payment date, at the effective rate of interest for the plan for the plan year which includes the payment date.
- Relief Related to Retirement Plans for Individuals.
  - Waiver of 10% Early Withdrawal Penalty Tax on Early Distributions from Eligible Retirement Plans. The Act waives the 10% penalty tax on early distributions for distributions up to \$100,000 in 2020 made to an individual (i) who is diagnosed with COVID-19, (ii) whose spouse or dependent is so diagnosed or (iii) who experiences adverse financial consequences as a result of being quarantined, furloughed, laid off, having work hours reduced due to the virus, or closing or reducing hours of a business owned or operated by the individual due to the virus.

- Inclusion in income is spread over 2020, 2021 and 2022, unless otherwise elected.
- For the three-year period beginning on the date after the distribution is received, the participant can contribute up to the amount received as a coronavirus-related distribution to a plan to which the participant could make an eligible rollover contribution (and if so contributed, the distribution will be treated as a nontaxable eligible rollover distribution).
- Increased Loan Amount from Qualified Plans. The Act has increased the limit on loans from qualified employer plans to be the lesser of (x) \$100,000 (instead of \$50,000) and (y) the present value (instead of ½ the present value) of the employee's nonforfeitable accrued benefit under the plan (or, if greater, \$10,000). The Act also delays the due date for outstanding loans from qualified employer plans that would otherwise be due in 2020 for one year.
- Temporary Waiver of Required Minimum Distributions. Required minimum distributions are waived during 2020 for defined contribution retirement plans, therefore permitting a further deferral of taxes and allowing account balances to rebound.

### **Bank Regulatory Provisions**

- Temporary Liquidity Guarantee Authority Expanded to Cover Certain Deposits.
  - The Act expands the authority under the Temporary Liquidity Guarantee Authority (“**TLGA**”), which was created during the last financial crisis by Section 1105 of the Dodd-Frank Act. That authority permits the Federal Deposit Insurance Corporation (“**FDIC**”) to establish a guarantee program for debt obligations of solvent insured depository institutions or depository institution holding companies (and their affiliates), upon a joint determination by FDIC and the Federal Reserve that a “liquidity event” has occurred, and subject to coverage limits adopted by the FDIC. Under Section 4008 of the Act, the existing TLGA authority of the FDIC is modified to allow the FDIC to guarantee the deposits of solvent insured depository institutions held in noninterest-bearing business transaction accounts. A similar expansion of deposit insurance coverage existed under the Dodd-Frank Act (until 2012), but was unlimited in coverage amount and was made under separate authority. The FDIC’s expanded TLGA authority (and any expanded coverage) would expire on December 31, 2020.
  - Separately, Section 4008 authorizes the NCUA’s Board to authorize unlimited share insurance coverage on noninterest-bearing transaction accounts at a federally insured credit union. This authority (and any expanded coverage) expires December 31, 2020.

- OCC Authority to Waive Lending Limits. The Act expands the authority of the Office of the Comptroller of the Currency (“**OCC**”) to grant exemptions from the National Bank Act’s lending limits under 12 U.S.C. § 84. Specifically, Section 4011 permits the OCC to grant a waiver of lending limits for a loan made by a national bank to any nonbank financial company, if approved by the OCC. Previously, the OCC’s authority was limited to a national bank’s loans made to financial institutions (or financial institution in receivership). In addition, the OCC is permitted to exempt any transaction from the lending limits if the OCC determines the exemption is in the public interest and consistent with the lending limits’ purposes. This provision expires either on the termination date of the COVID-19 Emergency or December 31, 2020, whichever is sooner.
- Reduced Community Bank Leverage Ratio. Section 4012 of the Act requires the federal banking agencies to adopt an interim rule relaxing certain requirements applicable to the capital requirements of a “qualifying community bank,” as defined in the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018. This interim rule would reduce the Community Bank Leverage Ratio to 8%, and confer a reasonable grace period for restoring compliance with respect to a community bank that falls below the new 8% threshold. This provision expires on the termination date of the COVID-19 Emergency or December 31, 2020, whichever is sooner.
- Suspension of TDR Requirements. Under Section 4013, the federal banking agencies are required to suspend the requirements under U.S. GAAP applicable to banking institutions with respect to any loan modification “related to” the COVID-19 pandemic, if such loan modification would otherwise be categorized as a TDR. Any such COVID-19-related modified loan would not be considered a TDR for accounting purposes, including with respect to a banking institution’s capital calculations. Section 4013 applies to loan modifications for loans that were not more than 30 days past due on December 31, 2019. Suspension applies for loan modifications made between March 1, 2020 and the earlier of (i) December 31, 2020 and (ii) 60 days following the termination date of the COVID-19 Emergency, but extend for the duration of the particular loan modification.
- Temporary Relief from CECL Standards. Section 4014 provides that no depository institution, bank holding company, or any affiliate thereof, is required to comply with the FAS 2016-13 (Measurement of Credit Losses on Financial Instruments), including the current expected credit losses (“**CECL**”) methodology for estimating allowances for credit losses included in FAS 2016-13. The suspension of CECL requirements for financial organizations expires on the termination date of the COVID-19 Emergency or December 31, 2020, whichever is sooner.

- Expansion of the NCUA's Central Liquidity Facility. Section 4016 of the Act expands the funding available to credit unions to apply for funds from the NCUA Central Liquidity Facility. The Act sets aside the existing restriction that a credit union seeking to borrow from that facility cannot have the intent to expand its portfolio of loans and investments. Section 4016 also increases the borrowing cap for the Facility.

### **Credit Protection, Mortgage Loan and Residential Property Provisions**

- Credit Protection. Section 4021 of the Act amends Section 623(a)(1) of the Fair Credit Reporting Act ("**FCRA**") to provide credit protection during the COVID-19 Emergency to borrowers affected by the COVID-19 Emergency.
  - "Accommodations" to Consumers. If a furnisher (as that term is used in the FCRA) makes an "accommodation" with respect to one or more payments on a credit obligation or account of a consumer (excluding any credit obligation or account of a consumer that has been charged-off), and the consumer makes the payments or is not required to make one or more payments pursuant to the accommodation, the furnisher is required to report the credit obligation or account as current; or if the credit obligation or account was delinquent before the accommodation (i) to maintain the delinquent status during the period in which the accommodation is in effect and (ii) if the consumer brings the credit obligation or account current during the accommodation period, to report the credit obligation or account as current.
  - Key Definition. The term "**accommodation**" includes an agreement to defer one or more payments, make a partial payment, forbear any delinquent amounts, modify a loan or contract, or any other assistance or relief granted to a consumer who is affected by the COVID-19 pandemic during the covered period, defined to mean the period beginning on January 31, 2020 and ending on the later of 120 days after the date of enactment of this subparagraph or 120 days after the date on which the COVID-19 Emergency terminates.
- Forbearances – Federally Backed Mortgage Loans. During the covered period, a borrower with a Federally backed mortgage loan (as defined below) experiencing a financial hardship due, directly or indirectly, to the COVID-19 Emergency may request forbearance on the Federally backed mortgage loan, regardless of delinquency status, by submitting a request to the borrower's servicer, and affirming that the borrower is experiencing a financial hardship during the COVID-19 Emergency.
  - Duration; Fees. Upon request by a borrower, a forbearance is required to be granted with no additional documentation required other than the borrower's attestation to a financial hardship caused by the COVID-19 Emergency, for up to 180 days, and such

forebearance is required to be extended for an additional period of up to 180 days at the request of the borrower. During a period of forbearance, no fees, penalties or interest beyond the amounts scheduled or calculated as if the borrower made all contractual payments on time and in full under the terms of the mortgage contract, are permitted to accrue on the borrower's account.

- Foreclosure Moratorium. Except with respect to a vacant or abandoned property, a servicer of a Federally backed mortgage loan may not initiate any judicial or non-judicial foreclosure process, move for a foreclosure judgment or order of sale, or execute a foreclosure-related eviction or foreclosure sale for not less than the 60-day period beginning on March 18, 2020.
- Key Definition. The term “**Federally backed mortgage loan**” includes any loan which is secured by a first or subordinate lien on residential real property (including individual units of condominiums and cooperatives) designed principally for the occupancy of from one to four families that is (i) insured by the Federal Housing Administration under Title II of the National Housing Act (12 U.S.C. § 1707 *et seq.*), (ii) insured under Section 255 of the National Housing Act (12 U.S.C. § 1715z-20), (iii) guaranteed under Section 184 or 184A of the Housing and Community Development Act of 1992 (12 U.S.C. §§ 1715z-13a, 1715z-13b), (iv) guaranteed or insured by the Department of Veterans Affairs; (v) guaranteed or insured by the Department of Agriculture, (vi) made by the Department of Agriculture or (vii) purchased or securitized by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association.
- Forbearances – Federally Backed Multifamily Mortgage Loans. During the covered period, a multifamily borrower with a Federally backed multifamily mortgage loan (as defined below) experiencing a financial hardship due, directly or indirectly, to the COVID-19 Emergency may request a forbearance, provided such borrower was current on its payments as of February 1, 2020. Such borrower may submit an oral or written request for forbearance to the borrower's servicer affirming that the multifamily borrower is experiencing a financial hardship during the COVID-19 Emergency.
  - Forbearance Period. Upon receipt of request for forbearance from a multifamily borrower, a servicer is required to document the financial hardship, to provide the forbearance for up to 30 days, and to extend the forbearance for up to two additional 30-day periods upon the request of the borrower, provided that the borrower's request for an extension is made during the covered period (as defined below) and at least 15 days prior to the end of the applicable forbearance period.
  - Renter Protections during Forbearance Period. A multifamily borrower that receives a forbearance may not, for the duration of the forbearance, (i) evict or initiate the eviction

of a tenant from a dwelling unit located in or on the applicable property solely for nonpayment of rent or other fees or charges or (ii) charge any late fees, penalties or other charges to a tenant for late payment of rent. Furthermore, the multifamily borrower may not require a tenant to vacate a dwelling unit located in or on the applicable property before the date that is 30 days after the date on which the borrower provides the tenant with a notice to vacate, nor may it issue a notice to vacate until after the expiration of the forbearance.

- Covered Period. For the purposes of the forbearance provisions, the term “**covered period**” means the period beginning on March 27, 2020, and ending on the earlier of the termination date of the COVID-19 Emergency or December 31, 2020.
- Key Definition. For the purposes of this provision, the term “**Federally backed multifamily mortgage loan**” includes any loan (other than temporary financing such as a construction loan) that (A) is secured by a first or subordinate lien on residential multifamily real property designed principally for the occupancy of five or more families, including any such secured loan, the proceeds of which are used to prepay or pay off an existing loan secured by the same property and (B) is made in whole or in part, or insured, guaranteed, supplemented or assisted in any way, by any officer or agency of the federal government or under or in connection with a housing or urban development program administered by the Secretary of Housing and Urban Development or a housing or related program administered by any other such officer or agency, or is purchased or securitized by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association.
- Temporary Moratorium on Eviction Filings. During the 120-day period beginning on March 27, 2020, the lessor of a covered dwelling (as defined below) may not: (i) make, or cause to be made, any court filing to initiate a legal action to recover possession of the covered dwelling from the tenant for nonpayment of rent or other fees or charges, (ii) charge fees, penalties or other charges to the tenant related to such nonpayment of rent, (iii) may not require the tenant to vacate the covered dwelling unit before the date that is 30 days after the date on which the lessor provides the tenant with a notice to vacate and (iv) may not issue a notice to vacate until after the expiration of the 120-day period referred to above.
- Key Definitions. This provision applies to covered dwellings on covered properties. A “**covered dwelling**” is a dwelling that is occupied by a tenant pursuant to a residential lease, or without a lease or with a lease terminable under state law that is on a covered property. A “**covered property**” means any property that (i) participates in a covered housing program (as defined in Section 41411(a) of the Violence Against Women Act of 1994 (34 U.S.C. § 12491(a))), (ii) participates in the rural housing voucher program under Section 542 of the Housing Act of 1949 (42 U.S.C. § 1490r) or (iii) has a

Federally backed mortgage loan or a Federally backed multifamily mortgage loan. While the definition of Federally backed multifamily mortgage loan in this provision is identical to the definition in the Federally backed multifamily forbearance provision, the definition of Federally backed mortgage loan differs slightly by, among other things, excluding temporary financing, such as construction loans, but including loans made to prepay an existing loan secured by the same property in such definition.

### **Student Loan Provisions**

- Suspension of All Payments on Federal Student Loans through September 30, 2020. Under the Act, the Secretary of the Department of Education will suspend all payments due for federal student loans made under the William D. Ford Federal Direct Loan Program and the Federal Family Education Loan Program (that are held by the Department of Education) through September 30, 2020. Interest will not accrue on these loans during the period of this suspension.
- Payments Will Be Deemed to Have Been Made for Certain Purposes. The Secretary of the Department of Education will deem each month for which a loan payment is suspended as if the borrower of the loan had made a payment for the purpose of any loan forgiveness program or rehabilitation program authorized under the Higher Education Act of 1965. The Secretary of the Department of Education must also ensure that, for the purpose of reporting information to a consumer reporting agency, any payment that has been suspended is treated as if it were a regularly scheduled payment made by a borrower.
- Suspension of Involuntary Collections. During the period in which the Secretary of the Department of Education suspends payments on a loan, the Secretary of the Department of Education will also suspend all involuntary collection related to the loan, including wage garnishment, reduction of a tax refund, reduction of any other federal benefit payment by administrative offset and any other involuntary collection activity by the Secretary of the Department of Education.

### **Patent and Trademark Provisions**

- Deadlines. In order to address a concern raised by patent and trademark owners, the Act gives temporary authority to the Director of the U.S. Patent and Trademark Office (“USPTO”) in “tolling, waiving, adjusting or modifying a timing deadline” under the relevant patent and trademark statutes. The Director must determine if the COVID-19 pandemic “materially affects the functioning” of the USPTO, “prejudices the rights” of those appearing before the USPTO, or “prevents” such persons from appearing before the office from filing a document or fee. If the Director determines that relief from pending deadlines is justified, he must publish a notice with his decision. The Director has been given wide

latitude to suspend pending deadlines, as the Act allows the Director to suspend deadlines for a “period exceeding 120 days” as long as he submits an appropriate report to Congress. This authority will last for 60 days after the end of the COVID-19 Emergency. The Director’s power to suspend deadlines in view of the COVID-19 pandemic will sunset two years following the enactment of the bill.

*These provisions represent a win for patent and trademark owners because the USPTO previously indicated that did not have legal authority to extend statutory deadlines absent a further act of Congress. See USPTO, Relief Available to Patent and Trademark Applicants, Patentees and Trademark Owners Affected by the Coronavirus Outbreak (Mar. 16, 2020). Workarounds, such as the USPTO waiving fees for applications seeking to revive patent and trademark applications that were abandoned due to missed deadlines, were criticized as insufficient. Thus, in addition to safeguarding patent and trademark owners against collateral damages brought on by the COVID-19 pandemic, these provisions of the Act send a strong signal that Congress will take proactive steps to protect the intellectual property rights central to the U.S. economy.*

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# Clients & Friends Memo

## Patent Rights in the COVID-19 Pandemic: How will Industries and Governments Respond?

March 27, 2020

As the world scrambles to address an ever-expanding wave of COVID-19 infections, new and urgent needs for medical supplies, diagnostics and treatments arise. Shortages of such supplies are plaguing hospitals and care-givers, while doctors and nurses put their lives at risk in their desperate efforts to save COVID-19 patients. Many of these vital supplies, however, are protected by valuable patent rights. The essence behind patents rights is to exclude others from making, using, or selling a patented invention, except by authorization of the patent holder in carefully negotiated license agreements to ensure proper compensation for the efforts and costs invested in developing the patented invention.<sup>1</sup> On the other hand, the U.S. government has rights to forcibly license a patented invention during times of need, in particular when there is a threat to public safety.<sup>2</sup> Will the government resort to use of these available, yet rarely used, compulsory licensing provisions? How patent owners are responding to the current COVID-19 pandemic is revealing that benevolence may, in some cases, have a place in commercial business without the government needing to exercise its compulsory licensing rights.

In the face of the COVID-19 pandemic, several large companies have come forward with offers to manufacture medical supplies such as masks and respirators. Manufacturers, such as the auto makers General Motors, Ford and Tesla, are offering to repurpose production lines to help manufacture and increase the supply of ventilators and other much needed medical equipment.<sup>3</sup> Fashion and cosmetic companies, such as Louis Vuitton, L'Oréal and Coty, are also pitching in and offering to re-allocate their resources to produce hand sanitizers, while fashion designers, like Christian Siriano and Brandon Maxwell, are offering to mobilize their teams to produce masks and

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<sup>1</sup> See 35 U.S.C. § § 154, 271.

<sup>2</sup> See, e.g., 28 U.S.C. § 1498(a), 35 U.S.C. § 203.

<sup>3</sup> See <https://www.usatoday.com/story/money/cars/2020/03/22/coronavirus-ventilator-shortage-gm-tesla-covid-19/2895190001/>.

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hospital gowns.<sup>4</sup> Even the beer company giant, ABInBev will use its facilities to manufacture and distribute hand sanitizer.<sup>5</sup>

On the patent front, the drug manufacturer AbbVie has taken a bold public health stance by suspending enforcement of its global patent rights on all formulations of the HIV medication, Kaletra (Aluvia) while the drug is being evaluated as a candidate to treat COVID-19 in several clinical trials. AbbVie's bold stance would allow generic versions of Kaletra to be made by others without fear of repercussion based on patent infringement. This would allow countries to purchase generic versions of Kaletra, if it is found effective in treating COVID-19, and would help alleviate possible drug supply shortages. AbbVie is the first drug-maker to take such a strong public health stance amid the COVID-19 pandemic. However, whether AbbVie's decision to suspend its patent rights to Kaletra is an act of pure benevolence, mounting public pressures, or because at least one clinical trial already suggested Kaletra may not be effective in treating COVID-19, AbbVie's strong public health stance is at the very least a comforting thought and may hopefully sway other drug-makers, like Gilead Sciences Inc. ("Gilead"), to do the same.

On the other end is the drug-maker Gilead who recently halted emergency access to its COVID-19 candidate drug, Remdesivir, except for pregnant women and children with severe symptoms.<sup>6</sup> In suspending access to Remdesivir, Gilead issued a company statement<sup>7</sup> on March 22, 2020 citing "overwhelming demand" and "exponential increase" in requests which "flooded [its] emergency treatment access system." However, Gilead's restrictions to Remdesivir come on the heels of it being granted "orphan" drug status<sup>8</sup> by the U.S. Food and Drug Administration ("FDA") on February 23, 2020 and on the heels of a Chinese drug-maker, BrightGene Bio-Medical Technology ("BrightGene"),<sup>9</sup> filing for patent protection in China for a combination drug therapy to treat COVID-19 using the active ingredients of Remdesivir. The 1983 Orphan Drug Act<sup>10</sup> allows a seven-year market exclusivity period for pharmaceutical companies developing treatments for a "rare disease" and also provides tax credits. Gilead's strategic move to obtain orphan drug status

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<sup>4</sup> See <https://www.d.com/fashion-news/fashion-scoops/fashion-designers-make-masks-hospital-gown-hand-sanitizer-to-fight-coronavirus-1203545006/>.

<sup>5</sup> See <http://longisland.news12.com/story/41926769/anheuserbusch-to-make-hand-sanitizer-in-response-to-coronavirus-pandemic>

<sup>6</sup> See *Id.*

<sup>7</sup> <https://www.gilead.com/purpose/advancing-global-health/covid-19/emergency-access-to-remdesivir-outside-of-clinical-trials>.

<sup>8</sup> See <https://www.ibtimes.com/coronavirus-treatment-gileads-potential-covid-19-treatment-labeled-orphan-drug-could-2945353>.

<sup>9</sup> See <https://time.com/5782633/covid-19-drug-remdesivir-china/>.

<sup>10</sup> Orphan Drug Act of 1983. Pub L. No. 97-414, 96 Stat. 2049.

for Remdesivir blocks generic drug manufacturers from supplying the drug and thus further limiting access.

Remdesivir has been previously used to treat the Ebola virus, Middle Eastern Respiratory Syndrome (MERS) and Severe Acute Respiratory Syndrome (SARS), but these infections did not cause a sustained global crisis to earn Gilead a sizable or continued financial revenue stream and other more successful experimental therapies existed.<sup>11</sup> If Remdesivir is found to be effective for combating COVID-19, a patent protecting such a use may stand to earn a high and continued stream of global revenue for the patent owner. As new combination drug patents or method patents for new uses of known drugs may be separately patentable, repurposing Remdesivir as a combination drug patent or for treating COVID-19 may prove to be a blockbuster hit for its patent owner. Thus, while Gilead has cited overwhelming demand as the reason to restrict access to Remdesivir, one can't help but wonder whether patent rights and the associated commercial revenue are Gilead's underlying concern.

Gilead is not the only patent holder invoking a protectionist stance and seemingly attempting to profit from the global pandemic through the patent system's exclusionary principle. Labrador Diagnostics LLC ("Labrador")—a company backed by its major investor SoftBank and who bought patents from a failed blood-testing start-up called Theranos—recently filed a patent infringement lawsuit against BioFire Diagnostics ("BioFire"), a health start-up who launched three COVID-19 tests.<sup>12</sup> Labrador also requested an injunction demanding BioFire to stop using the technology covered by the Theranos patents.<sup>13</sup> However, since filing the lawsuit and seemingly after public backlash, Labrador issued a press release<sup>14</sup> stating it would allow third parties to use its Theranos patents to develop COVID-19 tests with a royalty-free license, but that it is continuing its lawsuit against BioFire for activities over the past six years not related to COVID-19 testing.

Similarly, in Italy, a patent holder of a special respirator valve used in respiratory machines allegedly threatened a patent infringement lawsuit against two engineers who volunteered to use their 3-D printing technology to manufacture the patented valves for a hospital in Brescia, Italy without obtaining permission or a license from the patent holder.<sup>15</sup> However, in a follow-up statement, both the patent holder and the two engineers stopped short of calling the communications a threat, and

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<sup>11</sup> See <https://www.statnews.com/2020/03/16/remdesivir-surges-ahead-against-coronavirus/>.

<sup>12</sup> See <https://www.theverge.com/2020/3/18/21185006/softbank-theranos-coronavirus-covid-lawsuit-patent-testing>; see also, <https://www.businessinsider.com/theranos-patents-fortress-labrador-diagnostics-lawsuit-biofire-coronavirus-tests-2020-3>.

<sup>13</sup> See *Id.*

<sup>14</sup> See <https://www.businesswire.com/news/home/20200316005955/en/>.

<sup>15</sup> See <https://www.law360.com/articles/1255547/3d-printing-as-indirect-patent-infringement-amid-covid-19>.

instead characterized them as merely a refusal of the patent holder to assist or collaborate with the engineers.<sup>16</sup>

While some patent owners are choosing to suspend their global patent rights and others are taking a more protectionist stance, the U.S. government also has the right to take action by forcing patent owners to grant compulsory licenses when there is a threat to public safety. A compulsory license refers to the government's authority to grant permission to a party seeking use of another's patented invention without the consent of the patent owner, and is provided broadly by 28 U.S.C. § 1498. Several multilateral international agreements also address compulsory patent licenses.<sup>17</sup> Other U.S. laws also allow for compulsory licenses in certain circumstances. For example, march-in rights is a provision of the Bayh-Dole Act of 1980 and is codified in 35 U.S.C. § 203. March-in rights allow the federal government the right to grant patent licenses to other parties or take licenses for themselves if the patented invention was researched and developed with the help of federally funded dollars.<sup>18</sup>

March-in rights may be a perfectly poised vehicle for increasing access to COVID-19 related therapeutic drugs and vaccines. To fight the global pandemic, the Biomedical Advanced Research and Development Authority ("BARDA"), a division of the U.S. Department of Health and Human Services ("HHS"), has partnered with several drug manufacturers, including Johnson & Johnson, Sanofi and Regeneron Pharmaceuticals, to fund the development of treatments and vaccines for COVID-19.<sup>19</sup> However, some members of Congress have expressed concern as to the affordability and access should such drugs be found safe and effective, especially since federal funds are being provided.

No U.S. federal agency has ever exercised its power to march-in and license patent rights to others. For example, advocacy groups have long petitioned the National Institute of Health ("NIH") to exercise march-in rights for HIV/AIDS related drugs, but have been rejected by the NIH contending that high drug prices are an insufficient reason to break a patent. However, in the face of a global pandemic, "health or safety needs" may provide a strong basis for the exercise of march-in rights and grant of a compulsory license if more patent owners, like Gilead, take a protectionist patent stance. On the other hand, if more companies like AbbVie take a more socially conscious approach, there may not be need for government intervention in terms of compulsory patent licenses. Nevertheless, the availability of this measure may at least provide some comfort and may motivate companies to voluntarily suspend their patent rights during this global public health

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<sup>16</sup> See <https://www.theverge.com/2020/3/17/21184308/coronavirus-italy-medical-3d-print-valves-treatments>.

<sup>17</sup> See Convention of Paris for the Protection of Industrial Property, 13 I.S.T. 25 (1962), Art. 5(A)(2) ("Paris Convention"); See Agreement on Trade-Related Aspects of Intellectual Property Rights, April 15, 1994, Art. 31. ("TRIPS Agreement").

<sup>18</sup> See 35 U.S.C. § 203.

<sup>19</sup> See <https://crsreports.congress.gov/product/pdf/LSB/LSB10422>.

emergency in order to avoid government march-in, or maybe as a pure act of benevolence showing that social responsibility has a place in commercial business.

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# Clients & Friends Memo

## SEC Guidance on Shareholder Meetings and Filing Deadline Extensions in Light of COVID-19 Concerns

**March 26, 2020**

In light of the recent COVID-19 global outbreak, on March 13, 2020, the Securities and Exchange Commission provided guidance to assist issuers, shareholders and other market participants affected by COVID-19 with meeting their obligations under the federal proxy rules. Additionally, on March 4, 2020, the SEC issued an order that, subject to certain conditions, provides publicly traded companies with an additional 45 days to file certain disclosure reports that otherwise would have been due between March 1 and April 30, 2020. On March 25, 2020, the SEC issued an order modifying the filing deadline extensions to cover filings due on or before July 1, 2020.

### Changing the Shareholder Meeting

The SEC recognizes that issuers are contemplating possible changes in the date, time or location of their annual shareholder meetings because of COVID-19 concerns. The SEC's guidance provides that, subject to the conditions described below, an issuer that has already filed and mailed its definitive proxy materials can notify shareholders of the change of its shareholder meeting without amending its proxy materials (and subsequently filing such amended materials on EDGAR and also posting them to a publicly-accessible, non-EDGAR website), as is generally required under Rule 14a-6(h) of the Securities Exchange Act of 1934. Specifically, the issuer must: (1) issue a press release announcing such change to their annual shareholder meeting; (2) file such announcement as definitive additional soliciting material on EDGAR; and (3) take all reasonable steps necessary to inform other intermediaries in the proxy process and other relevant market participants of such change. The SEC encourages those issuers that have not yet mailed and filed their definitive proxy materials to consider whether to include disclosures regarding the possibility that the date, time or location of the annual meeting will change because of COVID-19.

**“Virtual” Shareholder Meeting**

Because the spread of COVID-19 has affected the ability to hold in-person meetings due to health and transportation issues, many issuers are contemplating conducting a “virtual” shareholder meeting in lieu of an in-person meeting.<sup>1</sup>

An issuer’s ability to hold a “virtual” shareholder meeting depends on its governing documents and the laws of the state in which the issuer is incorporated. For example, under Delaware law, if an issuer’s organizational documents do not require holding the annual meeting at a physical location, the issuer’s annual meeting can be held “virtually.”<sup>2</sup> If the issuer has time to give its stockholders at least ten days’ notice of the new “virtual” meeting, the issuer should distribute a new notice to its stockholders by physical mail or e-mail.<sup>3</sup> The new notice should include, among other information, the time and date of the “virtual” meeting, as well as instructions on how to join the meeting and the means by which stockholders may be deemed present in person and vote at such “virtual” meeting. On the other hand, if the issuer has fewer than ten days to notify its stockholders of the “virtual” meeting, the issuer could adjourn the meeting to a “virtual” location, since notice of an adjourned annual meeting ordinarily is not required.<sup>4</sup>

The SEC urges those issuers planning to conduct a “virtual” shareholder meeting to notify its shareholders and other market participants of such plans in a timely manner and disclose clear directions with respect to the logistical details of such meeting. Specifically, the SEC’s guidance provides that those issuers that have not yet filed their definitive proxy materials should include such disclosure in their definitive proxy statement and other soliciting materials. Those issuers that have already filed their definitive proxy materials would not need to amend such materials if they satisfy the same conditions for announcing a change in the meeting date, time or location, as discussed above.

For issuers facing a contested shareholder meeting, the use of a “virtual” meeting raises additional issues that would need to be considered by issuers and their advisors, including the process for matters to be presented by shareholders, the ability of shareholders making proposals to speak at the meeting, the timing and mechanics for voting at the “virtual” meeting (including via a legal proxy) and the process for any challenges initiated by a shareholder. In addition, issuers will need to confirm with their “virtual” meeting service providers whether they can provide “virtual” meetings for contested solicitations. Issuers may want to consider permitting the proponents of contested matters and their advisors to be present in person to make statements as well as to deliver proxies and ballots in order to avoid later challenges over the conduct of the meeting. Relatedly, because of

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<sup>1</sup> Starbucks Corporation held a “virtual-only” annual shareholder meeting on March 18, 2020.

<sup>2</sup> See Delaware General Corporation Law § 211(a)(1).

<sup>3</sup> See Delaware General Corporation Law § 222(b).

<sup>4</sup> See Delaware General Corporation Law § 222(c).

shareholders' restricted abilities to attend shareholder meetings in person and the expected increase in the number of "virtual" meetings, the SEC's guidance encourages issuers to provide shareholder proponents with the ability to present their Rule 14a-8 proposals through alternative means, such as by telephone.

### **Filing Deadline Extension**

The SEC understands that COVID-19 may present challenges to issuers and persons in timely meeting their filing obligations under the federal securities laws. Many of those affected "may include U.S. companies with significant operations in the affected areas, as well as companies located in those regions."<sup>5</sup> The SEC order provides that, subject to certain conditions, any registrant or person required to make filings under certain sections, rules and regulations of the Securities Exchange Act of 1934<sup>6</sup> may be afforded an additional 45 days to file such reports (had such reports otherwise been due between March 1 and April 30, 2020). In order to take advantage of this deadline extension, the filer must satisfy the following conditions:

- The filer is unable to meet the filing deadline because of circumstances related to COVID-19;
- Any registrant relying on the SEC order furnishes to the SEC a Form 8-K (or Form 6-K, if applicable)<sup>7</sup> by the later of March 16, 2020 or the original filing deadline stating:
  - that it is relying on the SEC order;
  - a description of the reasons why it could not file such report on time;<sup>8</sup>
  - the estimated date by which the report is expected to be filed;
  - if appropriate, a risk factor explaining, if material, the impact of COVID-19 on its business; and
  - if the reason the report cannot be filed timely relates to the inability of any person to furnish any required opinion, report or certification, the Form 8-K (or Form 6-K) shall attach as an exhibit a statement signed by such person stating the reasons why such person cannot furnish the documentation on or before the original deadline.

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<sup>5</sup> Securities Exchange Act Release No. 34-88318 (March 4, 2020).

<sup>6</sup> Securities Exchange Act Sections 13(a), 13(f), 13(g), 14(a), 14(c), 14(f) and 15(d); Securities Exchange Act Regulations 13A, 13D-G (except for those provisions mandating the filing of Schedule 13D or amendments to Schedule 13D), 14A, 14C and 15D; and Securities Exchange Act Rules 13f-1 and 14f-1.

<sup>7</sup> In the order issued on March 25, 2020, the SEC noted that registrants relying on the exemption must furnish a Form 8-K (or Form 6-K, if applicable) for each delayed filing.

<sup>8</sup> As of March 17, 2020, 20 companies had taken advantage of the 45-day extension afforded by the SEC order. A majority of the reasons why these companies could not timely file their reports are travel-related and logistical (*e.g.*, delays in on-site audits, closures of offices by local order, inability to access physical documents, travel restrictions, etc.).

- The filer files the report with the SEC no later than 45 days after the original deadline; and
- The filer discloses on such report that it is relying on the SEC order and states the reasons why it could not file such report on a timely basis.

Additionally, the SEC order exempts registrants and persons from furnishing proxy statements, annual reports, information statements and other soliciting materials to shareholders who have a mailing address located in an area where, as a result of COVID-19, the common carrier has suspended delivery service of the type used by the registrant making the solicitation.

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# Clients & Friends Memo

## Thoughts on Force Majeure and Impossibility of Performance

March 26, 2020

Force majeure clauses are provisions in contracts that either defer or release parties from contractual obligations due to specific circumstances beyond the control of the breaching party. Such clauses allocate the risks of certain unforeseeable events that might result in a party's nonperformance and in each case are (or at least should be) highly tailored to the nature of the transaction. Qualifying events that constitute force majeure, the contractual obligations to which the clause is applicable, as well as the rights and obligations of the parties upon the occurrence of such an event in order to invoke a force majeure defense, are specifically defined in and limited by the agreed upon terms of the force majeure clause. Some common examples of what might constitute force majeure include acts of God, war, riots, strikes, labor disputes, casualty, terrorism, civil commotion, earthquakes, floods, shortages of, delays in obtaining or an inability to obtain labor, utilities or materials, and generally any event beyond the control of the relevant party. Typically, parties will agree that force majeure is applicable to only certain types of breaches, such as a borrower's obligation to restore its collateral after a casualty or to complete the construction of improvements by a date certain pursuant to a construction loan. In some documents, force majeure may apply to any breach of the agreement without limitation. However, many agreements provide for a limit or "cap" on the period of time that a force majeure may apply, such as ninety days. In addition, it is typical that lack of funds is carved out as an event that is beyond the control of a party seeking to invoke force majeure. Typically, a force majeure provision will NOT apply to an obligation to pay rent or an obligation to pay debt service.

In the absence of a looming natural disaster or pandemic, force majeure clauses are sometimes treated as boilerplate language and the implications are easily overlooked. However, the increasing economic effects of the coronavirus (COVID-19) have underscored the potential significance of force majeure clauses, especially with respect to commercial real estate lending. Over the past week, in an effort to slow the spread of COVID-19, multiple governors have issued state-wide orders closing all non-essential businesses, and in some states, governors have issued "shelter-in-place" orders mandating residents to stay inside. At this rate, it is not difficult to imagine scenarios in which some borrowers may no longer have adequate cash flow to pay the monthly debt service

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on their loans or may be in breach of other non-monetary obligations or covenants as a result of tenants whose businesses have been shut down and are no longer able to pay rent. In these cases, borrowers may begin to look to force majeure clauses for protection from what is hopefully a temporary condition.

Even if the specific language of a contract or lease would arguably give rise to a claim of force majeure, the claim must satisfy the following:

- the event must be beyond the reasonable control of the applicable party;
- the applicable party must have been prevented from performing its obligation;
- the applicable party must have taken all reasonable steps to avoid its non-performance and have satisfied its duty to mitigate damages as a result thereof; and
- applicable and timely notice must have been given to the counterparty in accordance (and usually in strict accordance, time being of the essence) with the relevant agreement.

Whether a borrower can successfully invoke force majeure will depend on the language of the force majeure clause itself and the nature and cause of the breach. For example, if the breach in question is the borrower's failure to pay the monthly debt service and the force majeure clause specifically excludes breaches for failure to satisfy monetary obligations, then the force majeure clause may not provide the borrower any relief. However, if the borrower's failure to pay its monthly debt service is the direct result of the government mandate requiring its tenants to shut down and the definition of force majeure includes governmental restrictions without any exclusion as to monetary breaches, then the protection of the force majeure clause may apply.

In the absence of a qualifying event that is ancillary to COVID-19 and can be identified as the cause of a borrower's breach, such as a government mandated shutdown of a tenant's business operation, it is not clear whether and in what circumstances the COVID-19 outbreak alone would successfully provide the basis for a borrower to claim force majeure. As previously stated, the bargained-for language of the clause would first determine whether the clause is applicable to COVID-19 at all. Assuming the force majeure clause contains language such that it applies to "pandemics," "epidemics," "disease," or similar events and the specific breach in question is subject to the force majeure clause, the borrower would still have to show that its failure to perform was caused by COVID-19. It is unclear when a pandemic rises to the level of interfering with performance of contractual obligations, especially monetary obligations. Further, to the extent that a borrower's non-performance is the result of its tenants voluntarily shutting down as a preventative measure, the virus is unlikely to be viewed as the direct cause of the breach.

In addition to force majeure provisions, there remains the doctrine of impossibility of performance, which is applicable to all contracts and may excuse performance in limited circumstances. Generally speaking, impossibility of performance of a contract would require that the event in

question was not the fault of either party to the contract, the event occurred after creation of the contract, and that there was an intervening event, which was both unforeseeable and destroyed either the subject matter of the contract or the means of performance. This doctrine is applied narrowly and the current case law specifically states that the performance of a contract is not excused where impossibility or difficulty in performance is caused by financial difficulty or economic hardship, even in the case of bankruptcy or insolvency.

These are unprecedented times and with each passing day, they become more unprecedented. While it is common knowledge that under New York and Federal law, courts will generally enforce as written commercial agreements entered into between sophisticated parties represented by counsel and will not “read into” an agreement a force majeure provision to relieve a party from its obligation to perform, it remains unclear what a court might hold given a dramatic set of facts such as the ones we are currently experiencing. Additionally, force majeure provisions are strictly construed, which means that the specific language will need to be analyzed to determine if the facts and events will give rise to relief from the applicable obligation. However, even if the language of a force majeure clause does not contain the specific words “pandemic,” “epidemic” or “COVID-19,” the language still needs to be examined to determine whether the current pandemic or its effects fall within language such as a “governmental restriction,” “an act of God” or some other catch-all such as “events outside of the reasonable control” of the applicable party. It remains unclear whether the current pandemic would satisfy such a provision.

While a tenant or borrower can always make a claim that it is absolved from its obligations due to force majeure or the doctrine of impossibility of performance regardless of the language in its documentation, claims of that sort are very difficult to prevail upon absent extraordinary facts and circumstances, which may weigh upon the discretion of the courts. Given the unprecedented nature of the events we are living through, I would suggest that many of these claims and issues will be resolved through good old-fashioned negotiations between reasonable parties who are cognizant of the severity of the facts at hand.

Finally, there have been and will no doubt continue to be governmental proposals, executive orders and regulations promulgated to address some of the distress impacting tenants and borrowers. Please see the following links to recent publications outlining some of these relief measures: [New York Governor Issues Executive Order on Forbearance Actions](#); [DFS Releases Emergency Regulation on Forbearance Actions](#).

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# Clients & Friends Memo

## DOJ and FTC Launch Expedited Review Process for COVID-19-Related Collaborative Efforts

March 26, 2020

The Antitrust Division of the U.S. Department of Justice (the “Division”) and the Federal Trade Commission (“FTC”) have jointly announced an expedited process for the review of proposed collaborative efforts to deal with the COVID-19 pandemic. The March 24 joint statement recognizes that addressing the spread of the virus will require “unprecedented cooperation . . . among businesses to protect America’s health and safety.” Both agencies are “committed to providing individuals and businesses in any sector of the economy that are responding to this national emergency expeditious guidance about how to ensure their efforts comply with the federal antitrust laws.”

The Division’s Business Review Process and the FTC’s Advisory Opinion process “generally take several months[.]” The newly announced COVID-19 process will drastically shorten that time period. The Division and the FTC will “respond expeditiously to all COVID-19-related requests, and to resolve those addressing public health and safety within **seven (7) calendar days** of receiving all necessary information.” (Emphasis added.) The agencies will accelerate these evaluations for the sake of “the many individuals and businesses . . . trying to address a rapidly evolving crisis as quickly as possible.” The agencies also pledged to “expeditiously process filings under the National Cooperative Research and Production Act” for joint ventures designed “to bring goods to communities in need, to expand existing capacity, or to develop new products or services[.]”

The Division and the FTC committed not only to faster turnaround, but also to considering “exigent circumstances in evaluating efforts to address the spread of COVID-19 and its aftermath.” In their joint statement, the agencies recognized that these “exigent circumstances” go beyond the health care industry. For example, businesses “may need to temporarily combine production, distribution, or service networks to facilitate production and distribution of COVID-19-related supplies they may not have traditionally manufactured or distributed.”

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Companies seeking to use this expedited procedure should submit a request by email to [ATR.COVID19@USDOJ.GOV](mailto:ATR.COVID19@USDOJ.GOV). The request should include:

- an explanation of how the proposed collaborative action relates to COVID-19;
- a description of the nature and rationale of the proposal, including: participants, products or services covered, expected customers, and any proposed contractual or other arrangement;
- copies of all contracts and other relevant documents submitted by email with the request; and
- any available information regarding the competitive significance of other provider(s) of the product(s) or service(s) to be offered.

Opinions issued by the Division or the FTC through this expedited process will be effective for one year.

The joint Division/FTC action comes the same week their transatlantic counterparts announced similar exceptions for COVID-19-related cooperation. The EU's European Competition Network stated that it would not "actively intervene" where companies are working together to take "necessary and temporary measures" to ensure "fair distribution of scarce products to all consumers." Likewise, the UK's Competition and Markets Authority said it would exempt companies' COVID-19-related coordination so long as those efforts are "appropriate and necessary, clearly in the public interest, contribute to the benefit and wellbeing of consumers, deal with critical issues that arise as a result of the pandemic and last no longer than necessary."

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# Clients & Friends Memo

## Restrictions on Short Selling in the UK and European Union

25 March 2020

### Background on the Short Selling Regulation

European Union (“EU”) national regulators have regulated the short selling of shares and certain aspects of credit default swaps (“CDS”) since 1 November 2012, under the EU Short Selling Regulation<sup>1</sup> (“SSR”). The SSR applies to any person undertaking short selling of shares, sovereign debt, sovereign CDS and related instruments that are admitted to trading or traded on an EU trading venue. It also prohibits the entry into uncovered sovereign credit default swaps. The SSR does not relate to repos, securities lending, corporate and convertible bonds, although note that national regulators have powers (under Articles 18 to 21 of the SSR) to impose short selling restrictions on any financial instrument, if there is a serious threat to financial stability or to market confidence.

The SSR requires holders of net short positions in shares or sovereign debt to make notifications once certain thresholds have been reached, as well as applying a blanket ban on uncovered short sales in shares.

Article 20 of the SSR also provides powers to national regulators to suspend short selling or limit transactions where “exceptional circumstances” (meaning “adverse events or developments which constitute a serious threat to the financial stability or to market confidence”) exist. If an EU national regulator decides to impose such a temporary ban on short selling, that regulator is required to notify other EU regulators, the UK Financial Conduct Authority (“FCA”) and the European Securities and Markets Authority (“ESMA”). National regulators will then consider whether to apply that temporary ban in their own jurisdiction. The intention is to avoid short selling activity linked to particular shares moving to other jurisdictions where these shares are also traded.

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<sup>1</sup> Regulation (EU) No 236/2012

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There are a number of secondary and implementing regulations to the SSR<sup>2</sup>, as well as an ESMA Q&A<sup>3</sup>.

### ***Application of the SSR to the UK***

When introduced, the SSR and the delegated regulations applied directly in the UK (and other EU member states) without the need for implementation in national law. Certain aspects of the SSR either afford discretion to national regulators, or require those regulators to establish operational procedures to enable matters to be dealt with under national law. In the UK, these additional provisions were implemented by secondary legislation and changes to the FCA Handbook.

The UK withdrew from and ceased to be a member state of the EU on 31 January 2020. The negotiated withdrawal agreement entered into between the UK and the EU provides for a transition period, commencing on 31 January 2020 and ending on 31 December 2020, unless extended (such period, the “**transition period**”). The withdrawal agreement provides EU law such as the SSR, will be applicable to, and in the UK during the transition period. The UK also intends to “onshore” the SSR into UK national law, with the UK version of the SSR applying after the end of the transition period.

### **Temporary Prohibition on Short Sales in Certain EU Listed Securities**

The COVID-19 pandemic has resulted in extreme volatility in equity markets across the EU. In response, a number of market regulators across the EU have taken action, using powers under Article 20 of the SSR to temporarily ban short selling in certain securities. As at the date of publication of this memorandum, the following actions have been taken by EU national regulators:

#### ***Austria***

On 18 March 2020, the Austrian Financial Market Authority (“**FMA**”) issued a temporary prohibition on short sales of all shares that are admitted to trading on the Regulated Market of the Vienna Stock Exchange. The prohibition will stay in effect for an initial period of one month and started on 18 March 2020. The FMA's press release and resolution are available [here](#).

#### ***Belgium***

Belgium's Financial Services and Markets Authority (“**FSMA**”) issued a temporary prohibition for 17 March 2020, of the short selling of the shares of 18 issuers admitted to trading on the Belgian Euronext market. FSMA's resolution and the list of affected shares are available [here](#).

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<sup>2</sup> Commission Delegated Regulation (EU) 826/2012, 918/2012, 919/2012, as well as Commission implementing Regulation 827/2012

<sup>3</sup> [https://www.esma.europa.eu/sites/default/files/library/esma70-145-408\\_ga\\_on\\_ssr.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-145-408_ga_on_ssr.pdf)

**France**

The Autorité des Marchés Financiers (“**AMF**”) the French financial regulator, issued a temporary prohibition on the short sales in relation to the shares of 90 issuers on the Paris exchange, commencing on 17 March 2020. AMF's resolution and a list of the shares subject to the prohibition is available [here](#).

**Greece**

The Hellenic Cap Markets Commission (“**HCMC**”) issued a temporary prohibition on short selling of all shares admitted to trading on the regulated market of the Athens Stock Exchange. The measure came into force on 18 March 2020 and will last until 24 April 2020. The HCMC announcement of the temporary prohibition is available [here](#).

**Italy**

The temporary measure by the Commissione Nazionale per le Società e la Borsa (“**CONSOB**”), the Italian regulator, prohibits short selling applies to all the traded shares on the Italian regulated market, from 18 March 2020 until 18 June 2020. CONSOB's decision is available [here](#).

**Spain**

The Comisión Nacional del Mercado de Valores (“**CNMV**”) has issued temporary prohibition on short selling of shares of equities admitted to trading on all Spanish trading venues (the Madrid, Barcelona, Valencia and Bilbao Exchanges, and the Mercado Alternativo Bursátil), lasting for an initial period of one month, from 17 March 2020 until 17 April 2020. CNMV's decision is available [here](#).

**ESMA**

Under Article 27 of the SSR, within 24 hours of receiving a notification of a short selling prohibition from a national regulator, ESMA is required to issue an opinion on whether it considers the measure, or proposed measure, is necessary to address the exceptional circumstances identified by the national regulator. As at the date of this memorandum, the ESMA have issued a positive opinion in respect of all of the prohibitions described above.

**The UK Position**

The FCA issued a statement (the “**FCA Statement**”) on these short selling prohibition on 17 March 2020. The FCA noted that when considering whether to use its short selling powers following action by another EU regulator, its standard policy has been to assist that regulator in enforcing the prohibition. The FCA further noted, however, that it has never used the relevant banning powers given to it under the SSR and that while it would not rule out such action in exceptional circumstances, it sets a high bar for imposing such a measure. The FCA Statement can be found [here](#).

On 23 March 2020, the FCA issued a further statement on short-selling, which can be found [here](#). In this further statement, the FCA provided more detail on why it has not introduced a short selling ban to date:

*"The FCA continues closely to monitor market activity, including short selling activity. Aggregate net short selling activity reported to FCA is low as a percentage of total market activity and has decreased in recent days. It will continue to fluctuate, but there is no evidence that short selling has been the driver of recent market falls.*

*A great many investment and risk management strategies rely on the ability to take 'long' and 'short' positions. These benefit a wide range of ordinary investors including the pension funds for employees of companies and local government. We also note that short selling is a critical underpinning of liquidity provision. The loss of these benefits would need to be carefully balanced before determining that any intervention to prevent short selling was appropriate."*

#### **Lowering of the Disclosure Threshold**

ESMA published a decision (ESMA70-155-9546, available [here](#)) on 16 March 2020 that temporarily requires the holders of net short positions in shares traded on an EU regulated market to notify the relevant EU or UK national regulator, if the position reaches or exceeds 0.1% of the issued share capital after the entry into force of the decision. The standard threshold for disclosure to a regulator under SSR was previously 0.2% of the issued share capital, with a threshold for public disclosure of the net short position set at 0.5%.

These reporting obligations apply to any natural or legal person, irrespective of their country of residence. They do not apply to shares admitted to trading on a EEA or UK regulated market where the principal venue for the trading of the shares is located in a third country, or to market making or stabilisation activities.

The decision entered into force on 16 March 2020 and will last until 16 June 2020.

ESMA explained that the lowering of the reporting threshold is a precautionary measure to allow EU regulators to better monitor developments in markets under the exceptional circumstances linked to the impact of the ongoing 2019 COVID-19 pandemic, which ESMA describes as constituting a serious threat to market confidence in the EU.

The FCA Statement indicated that it will apply this temporary change to the reporting thresholds, but that this would involve changes to its systems. Until the FCA has made these changes, it has indicated that it expects firms providing reports in respect of UK listed shares to use the previous, 0.2% threshold.

**Market Implications and Jurisdictional Scope**

While the long-term effectiveness of the short selling prohibitions in stabilising prices is very much open to question, these measures are a clear indication that EU regulators have substantial concerns about financial stability being affected by the COVID-19 pandemic.

Some in the EU have been calling on ESMA to go further, by exercising emergency powers under Article 28 of the SSR to ban short-selling for a temporary period across all of the EU. These powers were controversial at the time of introduction of the SSR and were unsuccessfully challenged by the UK Government in the Court of Justice of the EU (based on arguments that ESMA had been vested with powers that it could not have according to the EU Treaties). Given this background, and the reluctance of many other EU national regulators to impose prohibitions under Article 20, it looks unlikely at this time that an EU-wide ban will be imposed.

The SSR notification obligations (and the overarching restriction on holding an *uncovered* short position) will apply to any person holding a net short position, regardless of where they are established. The SSR requires EU countries to establish rules on penalties and administrative measures for infringements of the SSR which are "effective, proportionate and dissuasive". In practice, most EU countries have a regime where breaches of the notification requirement can be punished through fines levied under administrative law in the relevant member state. EU regulators have in the past sought to penalize non-EU persons for breaches of the Short Selling Regulation and under the EU's market abuse regime.

The emergency prohibitions made by EU regulators similarly apply to all short-sellers, including those in the US, where the relevant shares are traded in the EU. For these purposes, it is possible that the calculation of what constitutes a short position may vary somewhat among jurisdictions. In Spain for example, the CNMV have clarified that in the context of the prohibition, net short positions will include derivatives and other synthetic short positions relating to a share or any other financial instrument, which should also include short positions in relation to ADRs. This is not always made clear in the other prohibitions, although our understanding is that local regulators will enforce the prohibition to include ADRs, GDRs, derivatives and other methods providing a synthetic exposure to an EEA listed equity.

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# Clients & Friends Memo

## DFS Releases Emergency Regulation on Forbearance Actions

March 25, 2020

The New York State Department of Financial Services (“DFS”) has issued an [emergency regulation](#) on Governor Andrew Cuomo’s Executive Order No. 202.9 from March 21 (the “Executive Order”). As discussed in our [memorandum](#) from March 23, the Executive Order temporarily requires, among other things, that banks subject to the jurisdiction of the DFS grant 90-day forbearance relief to “any person or business who has a financial hardship as a result of the COVID-19 pandemic.” The Executive Order has sparked a fury of questions within the lending market as to the scope of parties and products covered by its terms.

The new regulation, which was issued by the DFS on March 24, requires that “New York regulated institutions” provide residential mortgage forbearance on property located in New York for a period of 90 days to any individual residing in New York who demonstrates financial hardship as a result of the COVID-19 pandemic, subject to the safety and soundness requirements of the regulated institutions. Importantly, under the regulation: (i) forbearance is required only in respect of residential mortgages of individuals; (ii) commercial mortgages and other loans are expressly excluded; and (iii) mortgage loans made, insured or securitized by any U.S. government instrumentality, government-sponsored enterprise or Federal Home Loan Bank, or the rights and obligations of any lender, issuer, servicer or trustee of such obligations, including servicers for Ginnie Mae, are excluded.

For purposes of the regulation, a New York regulated institution is “any New York regulated banking organization as defined under New York Banking Law and any New York regulated mortgage servicer entity subject to the authority of the [DFS].” The regulation does not apply to national banks located in New York (as they are chartered under federal law) or to the New York branches of foreign banks (as they do not fall within the term “banking organization” under Section 2(11) of the New York Banking Law, which includes “all banks, trust companies, private bankers, savings banks, safe deposit companies, savings and loan associations, credit unions and investment companies,” and which has not been interpreted to otherwise encompass branches of foreign banks for purposes of the regulation).

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The regulation outlines the qualifying criteria for individuals affected by the COVID-19 pandemic to apply for forbearance relief and the procedures that New York regulated institutions shall follow in processing applications and communicating to applicants. According to the regulation, institutions that make “prudent and reasonable efforts to grant forbearance of any payment on a residential mortgage” will not be criticized by the DFS in supervisory examinations.

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Cadwalader is actively monitoring legal and regulatory developments related to the COVID-19 pandemic and its lawyers are available to assist with any questions that you may have. For additional information regarding this memorandum, please contact the following Cadwalader partners:

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# Clients & Friends Memo

## New York Governor Issues Executive Order on Forbearance Actions

March 23, 2020

On March 21, New York State Governor Andrew Cuomo signed an [executive order](#) declaring that, in light of the COVID-19 pandemic, any bank that is subject to the jurisdiction of the New York State Department of Financial Services (“DFS”) shall be deemed to be engaging in an “unsafe and unsound business practice” under Section 39 of the New York Banking Law if the bank fails to grant a 90-day forbearance to any person or business with a financial hardship as a result of the pandemic. The executive order is already effective and extends through April 20, 2020.

The executive order, by its terms, does not require a forbearance except with respect to a “bank” that is subject to DFS jurisdiction, which would include all state-chartered banks. While not specifically addressed, state-chartered branches and agencies of foreign banks are regulated by the DFS as if they are New York chartered banks, and thus the DFS could view the executive order as applying to New York state-chartered branches and agencies of foreign banks. National banks, as well as federal branches and agencies of foreign banks, should not be subject to the executive order, as such institutions are licensed or organized under federal law and are not subject to Section 39 of the Banking Law.

Separately, with respect to consumer mortgages, the executive order directs the DFS Superintendent to ensure that “any licensed or regulated entities provide to any consumer in the State of New York an opportunity for a forbearance of payments for any mortgage for any person or entity facing a financial hardship due to the COVID-19 pandemic.” The executive order also requires the DFS Superintendent to issue “emergency regulations” to require that applications for forbearance relief be made widely available for affected consumers, and that such applications be granted in “all reasonable and prudent circumstances solely for the period of such emergency.” With regard to fees (including for ATMs, overdraft fees, and credit card late fees), the executive order empowers, but does not explicitly require, the DFS Superintendent to issue regulations to the effect that such fees may be restricted or modified, solely for the period of the emergency, taking into account the financial impact on the New York consumer, the safety and soundness of the licensed or regulated entity, and any applicable federal requirements.

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The executive order follows [guidance](#) by the DFS on March 19 urging “all regulated and exempt mortgage servicers” to alleviate the adverse impact caused by COVID-19 on those mortgage borrowers who demonstrate that they are unable to make timely payments, including taking reasonable and prudent actions, and, subject to the requirements of any related guarantees or insurance policies, to support those adversely impacted mortgagors by:

- forbearing mortgage payments for 90 days from their due dates;
- refraining from reporting late payments to credit rating agencies for 90 days;
- offering mortgagors an additional 90-day grace period to complete trial loan modifications, and ensuring that late payments during the COVID-19 pandemic does not affect their ability to obtain permanent loan modifications;
- waiving late payment fees and any online payment fees for a period of 90 days;
- postponing foreclosures and evictions for 90 days;
- ensuring that mortgagors do not experience a disruption of service if the mortgage servicer closes its office, including making available other avenues for mortgagors to continue to manage their accounts and to make inquiries; and
- proactively reaching out to mortgagors via app announcements, text, email or otherwise to
- explain the above-listed assistance being offered to mortgagors.

By mandating forbearance, the executive order goes beyond recent guidance at the federal banking agency level. For example, on March 22, the banking agencies issued [guidance](#) on loan modifications and encouraged banks to work with affected customers, including by offering payment accommodations and waiving fees.

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Cadwalader is actively monitoring legal and regulatory developments related to the COVID-19 pandemic and its lawyers are available to assist with any questions that you may have. For additional information, please contact the Cadwalader partner with whom you usually work.

If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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# Clients & Friends Memo

## The Effects of COVID-19 on U.S. Antitrust Merger Clearance and Potential Delays in Transaction Closings

March 23, 2020

As businesses and government agencies continue to take measures in response to the new coronavirus, one area of notable change is the federal merger clearance process. On March 13, the Department of Justice (“DOJ”) and the Federal Trade Commission (“FTC”) implemented a temporary e-filing system for premerger notification documents and announced that, beginning on March 16, (1) they no longer would accept hard-copy filings and (2) early termination would not be granted for any filing as long as the e-filing system remained in place.<sup>1</sup> As part of these efforts to limit the further spread of the coronavirus, the FTC also canceled a workshop on its vertical merger guidelines.<sup>2</sup>

Four days later, the Department of Justice announced that it was asking companies with pending merger reviews for an additional 30 days to look over deal documents, with the possibility that they will revisit timing agreements further in light of any new developments. (The European Commission went one step further and “encouraged” all companies to delay filing merger notifications indefinitely, absent a clear justification for making a filing in the current environment.) Additionally, the DOJ stated that all meetings are shifting to phone or video conferences, and all currently scheduled depositions are postponed and will be rescheduled to take place via videoconference.<sup>3</sup> The FTC simultaneously announced additional steps it had taken, including having most employees begin working remotely, suspending non-critical travel, suspending unplanned visitor access to FTC facilities, and shifting to telephone and videoconference for almost all internal and external meetings indefinitely.<sup>4</sup>

While the DOJ and the FTC remain resolute in their enforcement efforts and in continuing the review process with as few disruptions as possible, clients should expect possibly substantial

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<sup>1</sup> [Premerger Notification Office Implements Temporary e-Filing System](#), FTC, Mar. 13, 2020.

<sup>2</sup> [Federal Trade Commission Cancels March 18 Workshop on Draft Vertical Merger Guidelines](#), FTC, Mar. 13, 2020.

<sup>3</sup> [DOJ Seeking Extra Month to Check Mergers As Virus Spreads](#), Bryan Koenig, Law360, Mar. 17, 2020.

<sup>4</sup> [FTC Outlines Agency's Response to Coronavirus Challenges](#), FTC, Mar. 17, 2020.

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delays and other hiccups as the government adjusts to the brand-new e-filing system, reschedules postponed depositions, adapts to having the vast majority of their employees working remotely, and otherwise takes steps to contain the coronavirus.

Parties to merger transactions should be aware that these combined delays (along with similar issues at other regulatory agencies, and any other slowdowns the parties themselves are experiencing due to the effects of the coronavirus on their business or the economy at large) are likely to affect the timelines for the closing of transactions. For certain industries that are especially susceptible to the virus' effects, such as airlines and cruise lines, an extended period of time to satisfy regulatory closing conditions could increase deal uncertainty and create opportunities for buyers to establish, over a more significant period of time, that a material adverse effect ("MAE") has occurred on the target business under the terms of the relevant agreement. Sellers, by contrast, may seek to include provisions in new agreements with MAE clauses that exclude the effects of pandemics. In short, parties should be aware that the longer these delays and disruptions persist, the more uncertain closings become, at least until M&A activity adjusts to this new normal in the coming weeks and months.

We will continue to monitor these events and apprise you of any further developments.

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# Clients & Friends Memo

## Federal Reserve Launches TALF (Again)

**March 23, 2020**

Today, the Federal Reserve announced that it was restarting the Term Asset-Backed Securities Loan Facility (“TALF”) to support the issuance of asset-backed securities (“ABS”) collateralized by consumer and commercial loans. Established under Section 13(3) of the Federal Reserve Act, with the approval of the U.S. Treasury Secretary, the TALF will serve as a funding backstop to facilitate the issuance of eligible ABS on or after March 23, 2020 until September 30, 2020, unless extended.

The Federal Reserve Bank of New York will commit to lend to a special purpose vehicle on a recourse basis. Each loan under the TALF will have a maturity of three years, will be nonrecourse to the borrower, and will be fully secured by eligible ABS and be made to eligible borrowers (any U.S. company that owns eligible collateral and maintains an account relationship with a primary dealer is eligible to borrow under the TALF).

Eligible collateral includes U.S. dollar denominated cash (that is, not synthetic) ABS that have a credit rating in the highest long-term or the highest short-term investment-grade rating category from at least two eligible nationally recognized statistical rating organizations (“NRSROs”) and do not have a credit rating below the highest investment-grade rating category from an eligible NRSRO. All or substantially all of the credit exposures underlying eligible ABS must have been originated by a U.S. company.

Eligible collateral must be ABS where the underlying credit exposures are one of the following:

- auto loans and leases;
- student loans;
- credit card receivables (both consumer and corporate);
- equipment loans;
- floorplan loans;

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- insurance premium finance loans;
- certain small business loans that are guaranteed by the Small Business Administration; or
- eligible servicing advance receivables.

According to a term sheet released by the Federal Reserve, the “feasibility of adding other asset classes to the [TALF] will be considered in the future.”

The pledged eligible collateral will be valued and assigned a haircut according to a schedule based on its sector, the weighted average life, and historical volatility of the ABS. This haircut schedule will be published in the detailed terms and conditions and will be roughly in line with the haircut schedule used for the TALF Facility established in 2008. For eligible ABS with underlying credit exposures that do not have a government guarantee, the interest rate will be 100 basis points over the 2-year LIBOR swap rate for securities with a weighted average life less than two years, or 100 basis points over the 3-year LIBOR swap rate for securities with a weighted average life of two years or greater. The pricing for other eligible ABS will be set forth in the detailed terms and conditions.

More detailed terms and conditions will be provided at a later date, primarily based off of the terms and conditions used for the TALF program created by the Federal Reserve in 2008 during the last financial crisis. Please reach out to us if you are considering a TALF loan.

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Cadwalader is actively monitoring legal and regulatory developments related to the COVID-19 pandemic and its lawyers are available to assist with any questions that you may have.

If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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