CARLTON FIELDS

COVID-19 and Credit Facilities

BUSINESS TRANSACTIONS | CORONAVIRUS | CREDITORS' RIGHTS AND BANKRUPTCY | MARCH 20, 2020


James Walker IV


Susan L. Spencer

Due to the COVID-19 pandemic and its uncertain impact on business operations and business continuity, many companies are reviewing their credit agreements with an eye toward their ability to borrow/re-borrow and potential default risks.

To assist in this process, we provide a brief list of the most common areas of focus with respect to credit agreements that are potentially impacted by the pandemic, together with some brief guidance with respect to issues that merit particular attention.

- Additional Borrowing/Re-Borrowing
    - With respect to facilities that are not fully drawn, many companies are assessing whether they are currently able to borrow additional funds and, if so, many are increasing their borrowings right now to enhance cash reserves due to future uncertainty.
        - Of course, in order to borrow, it is generally necessary to be in compliance with various requirements contained in loan documents.
        - At a minimum, it is generally required that (1) the representations and warranties contained in the loan documents be materially true and correct as of the date of any further credit extension; and (2) no default exists and that no default will result from the further credit extension or the associated use of proceeds.
    - Some companies are also assessing whether it is possible to increase the amount of their existing credit facilities and are approaching their lenders proactively in that regard.

- Compliance
    - In the new reality, companies are reassessing their ability to continue to comply with various credit agreement conditions that, if not satisfied, could trigger a default. A few items that are worth focusing on in connection with the COVID-19 pandemic are:
        - "Material Adverse Effect"
            - ▫ Under some credit agreements, a default can be triggered if a company suffers a "material adverse effect," which is always a defined term in a sophisticated credit agreement.
                - ▫ Sometimes, this term is defined to include only material and adverse effects on a borrower's ability to pay and perform its obligations under the loan agreement, which is a very high threshold that borrowers will hopefully be able to avoid triggering.
                - ▫ More often, this term is defined to include events that affect a borrower's business, financial condition, and results of operations materially and adversely, taken as a whole, which provision would be triggered if the entire enterprise were materially and adversely affected even if the borrower is able to keep paying on the loan.
            - ▫ Most credit agreements include affirmative covenants that require a borrower to notify its lenders in writing of the occurrence of a "material adverse effect," including what steps a borrower proposes to take to address the situation.
            - ▫ Because these definitions can vary, and the operation of the term itself can vary among credit agreements (simply incurring a material adverse effect may not be a default at all under any specific credit agreement), it is advisable at this time to review all credit agreements with an eye toward this issue.

- Covenants
  - ▫ Of course, various financial covenants, such as required leverage ratios and interest coverage ratios and various EBITDA-related covenants, could be affected on account of the economic impact of COVID-19.
    - ▫ Although compliance is generally measured retrospectively, it is important to be mindful that some credit agreements contain provisions requiring the borrower to notify the lender (or administrative agent) if a default under any such covenant is "reasonably expected" (and also, possibly, if the borrower has suffered or reasonably anticipates suffering a "material adverse effect").
  - ▫ Some credit agreements contain covenants that require borrowers to maintain insurance of a certain type or amount, or that is "typical" for their industry.
    - ▫ In light of COVID-19, borrowers should consider any such requirements, especially in light of any business interruption insurance that they had (or did not have) as of the beginning of the pandemic.
  - ▫ Credit agreement provisions can also exist that trigger an event of default if a borrower or a counterparty breaches one or more material contracts.
    - ▫ Because compliance with certain contracts can be difficult in light of COVID-19, it is important to review any such contracts to determine if performance can be excused due to force majeure or similar provisions (or, if not, whether a waiver of contract compliance should be sought from the counterparty).
    - ▫ If a credit agreement cross-defaults with other agreements or obligations then, obviously, those need to be analyzed as well.

Of course, credit agreements are complex documents and must be reviewed individually, so the above is simply a roadmap of certain issues that borrowers may want to focus on in light of the COVID-19 pandemic.

As a final note, we have been receiving some inquiries from borrowers asking whether lenders can simply "deem themselves insecure" and declare a default on that basis. Of course, the answer to that question would be a function of the language of the specific credit agreement in question. However, in our experience, these types of provisions are very uncommon in well-negotiated credit agreements so, leaving aside for a moment the practical question of whether a lender would invoke such a provision during a global pandemic, we would not expect such provisions to impact most sophisticated borrowers.