Market Trends 2020: COVID-19 Ramifications in Loan Documents

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by *Michael Chernick* and Brittany Roger, Shearman & Sterling LLP

This practice note provides an overview of certain key provisions of credit agreements that will need to be reviewed to determine how the COVID-19 (coronavirus) crisis—and the economic turmoil in its wake—affects a borrower's ability to meet its ongoing obligations under such agreements and how borrowers and lenders may protect themselves going forward. It also considers provisions of credit agreements that may be utilized for cash preservation and liquidity purposes or to access alternative funding.

The COVID-19 pandemic crisis continues to adversely affect and impact the results of operations and financial condition of businesses across almost every industry and sector globally. As a result of this, borrowers and lenders will need to consider multiple issues under their existing loan documents and any new loan facilities. Below we describe these issues and how they relate to specific provisions of a credit agreement.

For additional guidance on the topics raised in this practice note, see:

- *Coronavirus (COVID-19) Resource Kit*
- *Amendments and Lender Voting Right Issues in Credit Agreements*
- *Amendments, Consents, and Waivers Resource Kit*
- *Representations and Warranties in Credit Agreements*

Introduction – Drawdown, Amend, or Enter a New Deal?

Since the beginning of the crisis, borrowers have taken different approaches to accessing liquidity. These can include drawing down on an existing facility, amending their facilities, or entering into new facilities taking into account the new landscape. As described below, each approach raises distinct, and in some cases overlapping issues.

Many borrowers have accessed their revolving facilities and other committed undrawn facilities, to maximize their liquidity position. The key conditions that a borrower must usually satisfy in order to borrow under these types of facilities are (1) there is no default or event of default and (2) that the representations and warranties are true and correct, in each case, on the date of, and after giving effect to, such borrowing. These representations and warranties may also need to be repeated by borrowers at the time of granting waivers by lenders or amending existing loan documents. Given the widespread and varied impacts of COVID-19 on businesses, certain borrowers may be apprehensive about bringing down representations without certain carve-outs for known or unknown impacts of COVID-19. The impacts on a particular borrower and the specific terms of the relevant representations in the loan documents will need to be considered in order to determine the approach to making such representations. See *Representations and Warranties in Credit Agreements*, *Tranches of Loans and Loan Mechanics in Credit Agreements*, and *Borrowing Notice (Credit Agreement)*.

In addition to concerns in the context of bringing down representations, many borrowers impacted by the COVID-19 pandemic have begun to seek amendments to their existing loan documents to provide covenant relief, covenant or amortization suspensions and/or increases in commitments or incremental facilities, and/ or have sought to obtain needed liquidity through new facilities. In this context, the terms of the applicable loan documentation will need to be considered carefully to accommodate the impact of COVID-19 on the borrower, while lenders facing their own fallouts from the impacts of COVID-19 also seek to protect their position and priority.

These issues are taken in turn below.

Representations and Warranties

The specific language of representations and warranties varies widely, but most credit agreements contain the below representations and warranties that may need to be considered by borrowers and lenders on a case by case basis. See *Representations and Warranties Clauses (Credit Agreement)*.

Material Adverse Effect

Most credit agreements contain some form of "material adverse effect" (or "material adverse change") representation. There have been numerous questions raised by borrowers and lenders alike about whether the current lockdown restrictions that have been widely imposed throughout the U.S. and in many other countries, and the resulting impact (in terms of closures and suspensions of many businesses and related drops in revenue), have caused a material adverse effect to occur that would allow lenders to refuse a drawdown or accelerate a loan. See *Material Adverse Change Definitions*.

What constitutes a material adverse effect is not specifically defined in any New York law statute and there is limited judicial guidance available under New York law interpreting whether a material adverse effect has occurred. Based on judicial interpretations of similar provisions in acquisition agreements (which are primarily governed by Delaware law, but New York courts have looked to the Delaware cases on this subject in providing guidance in interpreting these provisions), it is generally considered that for a material adverse effect to occur in relation to a borrower's business or financial condition:

- The adverse impact must be sufficiently material (e.g., a large reduction in revenue or EBITDA or assets (not substantially covered by insurance or available relief programs or offset by a corresponding reduction in costs)). –and–
- The adverse impact must be expected to last for a durationally significant period of time.

While there is no bright-line test, it is generally understood that lenders seeking to rely on the impacts of an economic downturn as a "drawstop" or default will have to meet a high burden of proof in evidencing that there has been a material adverse effect. Such determination must be made on a fact-specific basis, based on the wording in the credit agreement and the specific factors affecting the borrower. This is a difficult determination in light of the current uncertainty over how long lockdown restrictions may remain in place and their resulting impact on financial statements and balance sheets, and how quickly business operations will be able to resume as normal. Given this uncertainty, lenders in practice have been cautious of invoking the occurrence of a material adverse effect as an excuse not to fund a draw request as a lender that does not fulfill its obligations under a credit agreement faces the risk of litigation for a breach of contract claim and potential reputational damage.

The definition of what constitutes a material adverse effect will vary widely across credit agreements and should be reviewed carefully. Customarily, material adverse effect refers to materially adverse impacts on (1) the borrower's business or financial condition, (2) the borrower's obligations, and/or (3) the agent's rights and remedies. In some cases, one or more of these limbs may not apply, thereby limiting the scope of analysis. Other items to consider include the following:

- Does the definition cover all obligations of the borrower or is it limited to "payment obligations" only, which limits the scope of obligations to which the material adverse effect representation relates?

- Does the definition refer to "prospects" or contain a similar forward-looking element which is especially relevant in light of the uncertainty around how long lockdown restrictions that may continue to affect the borrower's business, its employees, and its supply chains?
- Does the definition apply an objective standard ("has caused") or a more subjective forward-looking standard ("could reasonably be expected to")?
- Does the credit agreement include carve-outs for any previous public disclosures or for other information provided by the borrower to the lenders? If so, are they drafted broadly enough to capture broadly drafted risk factors in securities offering documents or information included in periodic public reporting?

Generally, the more forward looking and subjective elements there are in the representation and the broader the scope of the obligations to which the representation applies, the greater difficulty a borrower may have in determining its ability to make the representation.

Notwithstanding the high bar for determining that a material adverse effect on a business has occurred, due to the significant, unprecedented, and ongoing nature of the COVID-19 pandemic and its aftermath, it has not been uncommon for borrowers to seek to carve out COVID-19's effects from bringing down "material adverse effect" representations in a drawdown, waiver, or amendment agreement, or more generally from the "material adverse effect" definition in its loan documents. Issues to consider for any such carve-out include:

- Whether the exclusion of the material adverse impacts on the financial condition of the borrower is limited to the effects of COVID-19 or extends to other viruses, flus, and pandemics
- Whether the limitation applies only to impacts disclosed to the lenders (including the scope and any cut-off date for such disclosures) or to general economic impacts of COVID-19 (including the scope and any durational limit of such impacts)
- Any limbs of the "material adverse effect" definition or specific representations to which the carve-out should not apply
- The period during which the carve-out applies
- Whether any specified ongoing event whose impact is not ascertainable at such time should be carved out

Examples of Carve-Outs in Publicly Filed Deals

The context and timing of the material adverse effect carve-out may make certain considerations more relevant than others. For instance, the period during which a carve-out applies may not need to be defined in a proviso to a one-off bring down representation made as of a drawdown date, whereas lenders may seek to specify a period during which the proviso applies if it is to apply to the material adverse effect representations and covenants under the loan documents generally. Some recent examples of both types of carve-out include:

Intest Corporation:

> *Material Adverse Change means (a) a material adverse change in the business, operations, results of operations, assets, liabilities or condition (financial or otherwise) of any Obligor . . . ; provided, however, that until the fiscal quarter ending September 30, 2020, and thereafter for such period or periods as may be agreed to in writing by the Bank in its sole discretion, the declaration on March 13, 2020, of the national emergency relating to COVID-19 and related measures and the financial impact thereof on the Borrower and the Obligors shall not constitute a material adverse change in the condition (financial or otherwise) or operations of the Borrower and the Obligors.*

Quorum Health Corporation:

> *"Material Adverse Effect" shall mean (a) a materially adverse effect on the business, assets, operations, financial condition or operating results of the Borrower and the Subsidiaries, taken as a whole, (b) a material impairment of the ability of the Loan Parties, taken as a whole, to perform their obligations under the Loan*

> *Document to which they are or will be a party or (c) a material impairment of the rights and remedies of or benefits available to the Lenders under the Loan Documents, other than, in each case, as a result of the events leading up to, and following the commencement of a proceeding under Chapter 11 and the continuation and prosecution thereof, including circumstances or conditions resulting from, or incidental to, such events, commencement, continuation and prosecution, which shall not, individually or in the aggregate, constitute a Material Adverse Effect; provided that no effect on the business, assets, operations, financial condition or operating results of the Borrower and the Subsidiaries as a result of the Coronavirus Disease 2019 (COVID-19) shall constitute a Material Adverse Effect under clause (a) of the definition thereof.*

Marriot International Inc.:

> *. . . The Company additionally represents and warrants (which representations and warranties shall survive the execution and delivery hereof) to the Administrative Agent and the Lenders that: . . . No Material Adverse Change has occurred since December 31, 2019; provided, that the impacts of COVID-19 on the business, condition (financial or otherwise), operations or properties of the Company or any of its Subsidiaries will be disregarded; . . .*
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> (Note: This proviso applied to the material adverse effect representation in the amendment agreement only. The Material Adverse Change definition in the loan documents was not modified in this amendment.)

Keurig Dr. Pepper Inc.:

> *"Material Adverse Change" means any material adverse change in the business, business operations, property or financial condition of the Borrower and its Subsidiaries taken as a whole; provided that the impacts of COVID-19 on the business, business operations, property or financial condition of the Borrower or any of its Subsidiaries that occurred and were disclosed in the Borrower's Prospectus Supplement filed on April 9, 2020 or the transcripts of investor calls posted to the Lenders on April 10, 2020 will be disregarded.*

United Fire Group Inc.:

> *"Material Adverse Effect" . . . provided, however, that current financial and market conditions engendered by the COVID-19 pandemic shall not be given effect in determining whether a Material Adverse Effect has occurred with respect to the Borrower and its Subsidiaries unless such conditions result in a meaningful decline after the Closing Date specific to the Borrower's business.*

No Default

This representation typically pertains to defaults under the loan documents as well as defaults or termination events under other material agreements. This representation could be relevant where a company's performance under third-party contracts (including supply and commercial contracts) is materially adversely affected by the COVID-19 outbreak.

Disputes

Depending on the facts and circumstances of a particular borrower, the representations relating to litigation and judgments may need to be reviewed. In particular, careful review should be made for businesses that are subject to litigation as a result of the failure to perform under material contracts (for instance, litigation relating to assertion that COVID-19 constitutes a force majeure event under the relevant contract).

Solvency

Borrowers may also need to bring down their solvency representation in connection with a new borrowing. Borrowers and lenders will need to check the credit agreement to confirm whether such representation needs to be brought down to each borrowing date or is it limited to just the closing date. Solvency representations may vary among credit agreements but in general they require a borrower to certify:

- The fair value of its assets exceeds the total amount of its debt and other liabilities
- The present fair saleable value of its property is greater than the amount that will be required to pay the probable liabilities of its debt and other liabilities
- It is not engaged in business for which it has unreasonably small capital
- It will be able to pay its debts and liabilities as they become due

See *Solvency Certificates*, *Solvency Certificate (Pro-Borrower)*, and *Solvency Certificate (Pro-Lender)*.

Reporting Obligations

The impact of the pandemic and the resulting economic downturn, coupled with the borrower's need to draw under a facility, may trigger ongoing reporting requirements under a credit agreement. Reporting and notification obligations to lenders vary between credit agreements but typically include, among other things:

- Periodic financial statements and related financial information, and, where applicable, accompanying auditors reports
- Compliance certificates and/or borrowing base certificates
- Notices of defaults and events of default
- Matters relating to litigation and material contracts and/or developments expected to have a material adverse effect
- Catch-all requirements for other information requested by lenders

Borrowers and lenders will need to monitor compliance with these ongoing obligations to provide notices under their debt documents and any deadlines by which the borrower is required to deliver any required information and notices. Even where a grace period applies, a notice may still be required.

It is anticipated that lenders will receive requests for extensions of deadlines (or waivers for missed deadlines) due to the impact on operations caused by ongoing lockdown restrictions in many locations and by the subsequent general downturn. For instance, many borrowers may be unable to meet deadlines for obligations to deliver annual audited financial statements and accompanying auditor reports because their auditors have been unable to complete audit procedures (in particular those that require site visits) on their clients' financial statements on a timely basis.

Lenders will need to consider the length of an extension and how to address any knock-on impact on calculations of financial covenants and negative covenants in credit agreements that may occur as a result of any delay in delivery of financial information. The basis for any calculations and/or requirements for interim or supplemental reporting obligations may be included as terms or conditions in any such waiver. For example, in the *FS Energy & Power Fund amendment*, the lenders granted a waiver as a result of a failure of the borrower and its subsidiaries to deliver audited consolidated financial statements for the year ended December 31, 2019 (among waivers of other specified defaults).

Lenders may also seek to impose additional interim reporting obligations during any applicable waiver period, for instance, to monitor the borrower's liquidity.

See *Reporting Requirements, Field Examinations, and Appraisals*.

Financial Maintenance Covenants

Lenders and borrowers will need to assess the impact of the COVID-19 pandemic and its aftermath on borrowers' ability to comply with their financial covenants, which usually are either a leverage ratio test or an interest or fixed charge coverage test, measured at the end of each fiscal quarter. In covenant-lite deals, many borrowers may need to test "springing" financial covenants as of the end of any applicable fiscal quarter in the event that the springing trigger occurred by such dates due to revolver drawings above the applicable threshold made prior to quarter end. Each of these tests typically measure *EBITDA* over a last four fiscal quarter period so, as a result, the negative impact of the COVID-19 pandemic on a borrower's ability to comply with financial maintenance covenants could last well into 2021. See Financial Covenants and EBITDA Calculations in Credit Agreements.

To the extent that a borrower engages in discussions with its lenders for covenant relief (which may take several different forms, including a covenant suspension for a period of time or resetting the covenant to provide additional cushion), lenders will need to consider what credit enhancements they should seek in return as a condition and whether such changes should apply only during a certain period. Based on several recent filings, borrowers have obtained covenant relief in exchange for a myriad of concessions, including:

- Increased pricing
- Alternative maintenance tests, such as debt to capitalization ratios, interest coverage ratios, and/or minimum liquidity tests
- Capping and/or tightening ratios for incurrence and restricted payments baskets (e.g., by restricting pari passu and/or secured debt incurrence, liens, junior debt payments and other opportunities for priming, and limiting investments (including to unrestricted subsidiaries) and asset dispositions to limit value leakage)
- Mandatory prepayment, cash sweep, and/or other cash control requirements
- Additional guarantees and collateral
- Additional reporting requirements, including supporting certifications and/or opinions
- Additional use of proceeds restrictions

There are an increasing number of examples and formulations of such trade-offs. A cursory cross-section of examples includes the following:

- Marriott International Inc. amended its existing credit agreement to suspend its leverage through Q1 2021, which resets the covenant with additional headroom and step-downs once the covenant is reinstated. During the waiver period, pricing is increased and tied to credit ratings, a $400 million liquidity covenant will be tested monthly, and certain new covenants limiting debt, disposals, investments, and discretionary capital expenditures will apply. Other amendments tightening certain covenants relating to liens, dividends, share repurchases, and distributions will continue to apply after the waiver period. The amendment is *here*.
- Spirit AeroSystems amended its secured credit agreement to permit it to incur second priority secured debt and to provide covenant flexibility (including its financial covenants) through Q4 2022. During the relaxation period, the existing financial covenants are loosened and a new first-lien leverage ratio applies. The company is also required to maintain a minimum liquidity of $1 billion through Q4 2021. The amendment is *here*.
- United Airlines entered into a new $2 billion 364-day term loan a facility with step-up pricing increasing from LIBOR plus 2.0% to LIBOR plus 2.5% after 270 days and requires the company to maintain unrestricted cash and cash equivalents and unused commitments available under all revolving credit facilities aggregating not less than $2 billion and to maintain a minimum ratio of appraised value of collateral to outstanding obligations under the credit agreement of 1.6x. The credit agreement is *here*.

The approach to amending documentation may depend on the required lender consent for such amendments. Borrowers and pro rata and/or revolving lenders that are parties to covenant-lite credit agreements may be reluctant to make changes that may require consent of term lenders that could extend the negotiation process and expense. Borrowers may instead seek alternative sources of funding or cash preservation methods (as discussed in *Cash Preservation, CARES Act Funds, and Alternative Sources of Financing* below).

EBITDA and Consolidated Net Income Add-Backs and Exceptions

The difficulty imposed by COVID-19 has also cast a light on the definitions underlying financial covenants, as borrowers and their counsel analyze these provisions to find some leeway to meet the ratios while lenders conversely may look for ways to tighten these add-backs. Lenders and borrowers will need to scrutinize these financial definitions (such as "consolidated net income" and "consolidated EBITDA" and similar terms) in loan documents. Such definitions are highly negotiated and will vary widely between different credit agreements; however, parties may need to consider the impact of certain add-backs, pro forma calculations, and borrower-friendly drafting on financial covenant compliance and access to ratio baskets or EBITDA-based growers resulting from decreased net income or EBITDA as a result of the COVID-19 (see Financial Covenants and EBITDA Calculations in Credit Agreements). For example, an additional add-back to EBITDA may increase the incremental debt available to the borrower, which lenders should be careful of (see *The Client Asks: How Do We Exercise an Incremental Facility?*). The areas to focus on include:

- Add-backs for extraordinary, unusual, and nonrecurring expenses (often uncapped in covenant-lite credit agreements)
- Add-backs for lost earnings or revenues
- Add-backs for cost savings, synergies, restructurings, and business optimization activities
- Add-backs for insurance proceeds expected to be received
- "Of the type" or "business judgement" add-backs or similarly broad language
- Length of look-forward periods for prospective cost-savings and amounts not yet realized (including for insurance proceeds)

While changes to EBITDA calculations will be heavily negotiated and fine-tuned, lenders may consider tightening calculations by capping add-backs for synergies, restructuring, and decreased revenues; limiting add-backs to amounts actually realized; tightening broad language; and/or requiring certifications or third-party opinions with respect to such add-backs. One-off COVID-19 add-backs limited to specific actions, periods, and/or amounts may also be included. Below are examples of how these are handled in selected publicly filed amendments. These demonstrate borrower-friendly add-backs but with caps to protect lenders.

Columbia Sportswear Company:

> *"EBITDA" means, as of the end of a quarter, Borrower's consolidated net income after taxes for the twelve months ending with such quarter plus . . . . (ii) plus, for purposes of determining Borrower's compliance with the financial covenants set forth in Article VIII (and not for determining Applicable Rate), and solely to the extent deducted in the calculation of Borrower's net income, Restructuring Expenses, less (iii) . . .*
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> *"Restructuring Expenses" means all costs, expenses, losses and charges arising out of or related to COVID-19, including, without limitation, costs, expenses and losses relating to restructures, scaling of operations, modification of cost structures, any cost, expenses and charges for terminations, severance, furloughs, catastrophic paid leave, store closings, lease cancellations, and contract modifications and terminations, in an aggregate amount not to exceed $50,000,000, in each case to the extent paid prior to the Closing Date or within twelve (12) months after the Closing Date and approved by Administrative Agent in its reasonable discretion.*

Ruth's Hospitality Group, Inc.:

> *"Consolidated EBITDA" in Section 1.1 of the Credit Agreement is hereby amended in its entirety to read as follows: . . . (ix) nonrecurring costs and expenses in connection with permanent restaurant closures and lease terminations in an aggregate amount not to exceed $10,000,000 during such period . . .*

Blonder Tongue Laboratories, Inc.

"Permitted EBITDA Add-Back Amount" means . . . plus (vi) one-time restructuring charges (including severance payments) incurred by Borrower that are associated with the implementation of cost reduction programs from June 30, 2019 through Fiscal Year 2020, so long as incurred on or prior to March 31, 2021 and in an aggregate amount not exceeding $600,000, . . .

Lenders should be aware that adjustments to financial definitions will likely have implications beyond financial covenant compliance, including step-downs for asset sale and excess cash flow mandatory prepayment provisions (see *Repayment and Prepayment Provisions in Credit Agreements*) and ratio-based covenant baskets (such as additional debt and lien incurrences, investments, restricted payments, and restricted debt payments) which may grow as EBITDA increases. Therefore, even where there is a wholesale financial covenant suspension, treatment of EBITDA calculations for periods during the suspension period may need to be considered as well since calculations for such quarters could impact adjusted calculations that include such prior quarters which are made following the suspension period. For example:

- Live Nation Entertainment disclosed that the amendments to its credit agreement (to facilitate increased incremental revolver capacity) permit an EBITDA substitution, "allowing the company the flexibility to manage its business through the disruption it will experience in 2020." Additionally, following a financial covenant waiver period (during which a minimum liquidity covenant applies), for the purposes of calculating the consolidated net leverage ratio covenant for Q4 2020 through Q2 2021, consolidated EBITDA from Q2 and Q3 2019 will be used for the corresponding quarters in 2020. The press release is *here*.
- Marriott International's amended credit agreement provided that once the financial covenant waiver period expired that EBITDA would be calculated on an annualized basis for the first three fiscal quarters the financial covenant was tested. The amendment is *here*.
- Under Six Flags' amended credit agreement, once its financial covenant is reestablished following a suspension period during 2020, the borrower may use its quarterly consolidated adjusted EBITDA from Q2, Q3, and Q4 2019 to replace the EBITDA for the corresponding quarters of 2020. The 8-K describing this amendment is *here*, and the press release is *here*.

Events of Default

The foregoing amendment provisions will be enough to keep many companies going through the worst of this period, until they can resume close-to-normal operations. However, this temporary relief will inevitably not be enough for all borrowers. A breach of any covenant (after the expiry of any applicable grace periods), including financial and notification covenants, or the failure of any representation to be correct in all material respects when made, could trigger an event of default under the relevant loan documents. Lenders and their counsel should anticipate borrower requests for waivers of such events of default. See *Borrower Default and Lender Next Steps* and *Event of Default Provisions in Credit Agreements*.

The following customary events of default may be particularly relevant in the context of the COVID-19 crisis:

- **Payment defaults**. A borrower's failure to pay principal, interest, and fees when due will generally trigger an immediate event of default (with respect to failures to pay principal) or have very short cure periods.
- **Cross-defaults**. Loan documents also typically contain a cross-default in respect of events of default and/or failures to make payments under other indebtedness above a certain threshold. Borrowers and their lenders, therefore, should be aware of the relevant terms and thresholds across their loan documents and such borrowers' other debt instruments. Additionally, some loan documentation may contain business-specific cross-defaults relating to defaults or suspension in respect of performance under material third-party contracts. See *Cross-Default vs. Cross-Acceleration in Credit Agreements*.
- **Insolvency**. Borrowers and lenders should also carefully review the applicable provisions for the "bankruptcy event of default" as there may be circumstances other than an actual bankruptcy proceeding that could cause there to be an event of default. For instance, certain loan documents provide that if the borrower admits in writing its inability to pay its debts, such event would constitute an event of default. Another

example is that in certain loan documents "insolvency proceedings" may include negotiations with creditors. Companies with non-U.S. subsidiaries should be especially vigilant about the risk that local subsidiary bankruptcies would be triggered by balance sheet insolvencies.

Applicable *grace periods* would need to be considered for all events of default. In some cases, the event of default may have no grace period. Lenders and borrowers should also be aware that the notification requirements may be triggered when the grace period commences rather than at its expiry (see *Reporting Obligations* above).

See *Events of Default Resource Kit*.

Cash Preservation, CARES Act Funds, and Alternative Sources of Financing

Preservation of Cash and Assets

As discussed in various sections above, lenders should anticipate borrower requests under their existing loan documents for payment and covenant holidays, deferral of amortization payments or mandatory prepayment of excess cash flow or asset sale proceeds, and/or requests for conversion of cash interest payments into capitalized payment-in-kind payments, as additional ways of preserving or creating liquidity. Borrowers and lenders under asset-based lending (ABL) facilities may also need to consider the impact of potential defaults or late payments by customers (or borrower inability to pay suppliers) and suspensions or disruptions to its supply chain on its borrowing base and reserves. Borrowers may request waivers of or suspensions of certain eligibility criteria. For example, the FS Energy & Power Fund *amended credit agreement* provides relief regarding the delivery of assets to be included in the "collateral pool" and the calculation of the borrowing base. Similarly, the *amendment to the credit agreement* of Hersha Hospitality Trust relaxes the "borrowing base conditions" as they relate to COVID-19. See *Asset-Based Lending Resource Kit*.

Availability under Existing Baskets

In addition to drawing funds under its revolving facility, companies may want to seek alternative sources of funding to enhance their liquidity position. Credit agreements of non-investment grade borrowers will generally have restrictive covenants that will, among other things, limit a borrower's and certain of its subsidiaries' ability to incur debt and liens, make investments, and transfer or otherwise dispose of assets. These covenant packages can vary widely and are highly negotiated. However, over the past few years, the baskets negotiated in a substantial number of transactions have loosened significantly.

Even with a material degradation of a borrower's business, using availability under some common baskets, a borrower and its subsidiaries (including subsidiaries that are not guarantors) may be able to incur indebtedness, grant liens on their assets (which may include assets that are not required to be part of the existing lenders' collateral package), make investments in, and transfer assets to, non-guarantor subsidiaries, and prepay certain types of junior debt or buy back loans on the secondary market. See *Negative Covenants in Credit Agreements* and *The Client Asks: How Can We Finance This Transaction?*

Many companies may seek to utilize debt basket capacity for receivables financing and securitization financing and/or seek to utilize supply chain financing as ways of providing additional liquidity to shore up any temporary shortfalls in revenue caused by the COVID-19 crisis that cannot be covered by other permitted debt or equity financing.

Borrowers may also seek to raise incremental (or incremental equivalent) debt and/or upsize their incremental capacity permitted by their existing loan documents. For incurrences under incremental debt baskets, borrowers will need to consider whether pricing or other features of the incremental debt would trigger "*most favored nation*" (MFN) protections for lenders under the original debt and/or whether it falls within any exceptions to such provisions. In order to avoid triggering MFN provisions, borrowers may be able to structure new debt outside such provisions, such as by incurring such debt using general debt and liens baskets (if there is available capacity to do so) and/or by non-loan parties. See *Recent Trends in Incremental Loan Facilities* and *The Client Asks: How Do We Exercise an Incremental Facility?*

CARES Act Loans and Other Stimulus-Based Proceeds

Borrowers that are eligible for loans or other relief proceeds under the Coronavirus Aid Relief and Economic Security (CARES) Act (such as Paycheck Protection Program loans (PPP Loans) or the Main Street Lending Program) or other stimulus based loans or relief funds (Relief Proceeds) may need to consider whether such Relief Proceeds are permitted under or otherwise conflict with its existing loan documents. See *First Analysis: CARES Act Paycheck Protection Program Summary*.

Lenders should anticipate requests from such eligible borrowers in order to waive or amend loan document restrictions to permit incurrence of or waive terms that might otherwise apply to Relief Proceeds. Issues to consider in any such waiver or amendment include:

- Use of proceeds requirements for such Relief Proceeds, including whether PPP Loan proceeds are limited only to "forgivable" uses under the CARES Act
- Whether such Relief Proceeds should be excluded from mandatory prepayments of cash proceeds or similar concept
- Addressing conflicting provisions between the terms of the Relief Proceeds and senior loan documents (for instance, PPP Loans may require prepayments of proceeds from asset disposals or restrictions on certain distributions and payments)
- Whether caps on debt or lien incurrences related to Relief Proceeds are appropriate
- The impact of Relief Proceeds or forgiveness thereof on financial covenant calculations, including consolidated net income and EBITDA calculations, netting, and cancellation of debt income
- Segregation of Relief Proceeds amounts into a separate account or a controlled account
- Reporting obligations in respect of applications for, receipt of, and use of Relief Proceeds
- Subordination of any repayments (if applicable)
- Cross-default provisions (if applicable)

Other exceptional amendments for COVID-19 relief may need to be made to permit disposals related to relief efforts, such as a carve-out in Crocs' facility amendment permitting the company to donate up to $10 million in inventory to the healthcare industry in response to the COVID-19 pandemic. The Crocs amendment is *here*.

The following are examples of the how loan documents are handling loan parties' receipt of Relief Funds:

- The *Columbia Sportswear Company credit agreements* includes a debt basket for CARES Act loan programs.
- The *Zagg amendment* is more extensive in its treatment of PPP Loans, including carve-outs of those loans from leverage ratio calculations, permitted repayments of the PPP Loans, permitted.
- The *Quantum amendment* similarly allows for PPP Loan indebtedness but attaches several conditions to such allowance (such a permitted use of PPP Loans and compliance with CARES Act provisions).
- The *Blonder Tongue Laboratories amendment* has a simple but capped allowance for PPP Loans. –and–
- The *Tyson Foods credit agreement* excludes "COVID-19 Relief Funds" from net cash proceeds and allows the incurrence of such amounts as indebtedness.

Equity Cures

To the extent its credit agreement permits equity cure rights, a borrower and its owners may consider preemptive injections of equity to ensure covenant compliance and designate the same proceeds as cure amounts to equity cure a covenant breach. The long-term adjustment impacts by equity cures may be limited however as such cures are typically limited to a maximum during the life of the facility (usually four or five times) and in some cases cannot be used in consecutive quarters. See *Market Trends 2018/19: Equity Cure Rights*.

Liquidity Facilities

Certain lenders might be willing to provide additional liquidity to borrowers in the form of a 364-day facility or other alternative form of loan or note. This may in certain cases trigger a pricing *MFN* provision under existing credit agreements. Given that pricing in this distressed market may be higher than when the borrower entered into the existing facility, this may prove to be a costly option. However, that may be acceptable to borrowers if such a facility can be documented on a relatively fast timetable without requiring a marketing element and provide liquidity until less expensive options can be accessed. *Disney* (LIBOR applicable margin ranging from 0.875% to 1.5%), *Cigna* (LIBOR applicable margin ranging from 1.125% to 1.625%), and *Honeywell* (LIBOR applicable margin ranging from 0.750% to 1%), among others, have recently entered into such 364-day term facilities. Other facilities entered into during the COVID-19 crisis include *Textron*, *United Fire & Casualty Company*, *Tyson Foods*, and *Becton, Dickinson and Company*.

Several non-investment grade borrowers have accessed syndicated markets for additional liquidity and had to offer investors favorable call protection and had to pay a significant premium compared to prior financings. The following are examples:

- Everi's $125 million term loan was launched alongside an amendment to the company's credit agreement, priced at LIBOR plus 10.5%, with a 1% LIBOR floor and *OID* of 98. The credit agreement is *here*.
- Landry's $300 million senior secured term loan issued to a wholly owned unrestricted subsidiary priced at LIBOR plus 12%, with a 1% LIBOR floor and OID of 96.

Loan Buybacks

The sharp decline in the market prices of loans in the secondary markets may cause borrowers to consider debt repurchases. Prior to the 2008 financial crisis, most credit agreements did not contemplate or permit borrowers or their affiliates to purchase the borrower's loans. However, it is now common to allow such buybacks (usually limited to term loans). See *Loan Buyback Provisions in Credit Agreements*, *Market Trends 2017/18: Borrower and Affiliate Loan Buybacks*, and *The Client Asks: Can We Pay Down Our Debt?*

Although the terms of a particular credit agreement may vary, loan documents generally provide that a borrower may carry out a buyback through open market purchases or voluntary discounted prepayments (known as *Dutch Auction* procedures) so long as no event of default exists and no proceeds from the borrower's revolving credit facility are used to make such purchases. Any loans bought back are then cancelled.

Affiliates of the borrower are also generally permitted to purchase loans of such borrower subject to a cap (generally 25% to 30% of the loans), and such affiliates will have limitations on their access to information and "lender only" meetings, voting rights, and certain rights in bankruptcy proceedings. The limitation often doesn't apply to "debt fund affiliates" (i.e., debt funds that are affiliated with the sponsor). However, credit agreements will often limit the aggregate voting rights of such debt fund affiliates to 49.9% of the vote.

It should be noted however that loan buybacks do raise a number of issues. For guidance related to this issue, see *First Analysis: Debt Buyback and Liability Management Considerations*.

Perfection and Certifications – Delivery Challenges

As amendments, waivers, credit agreements, and other related loan documents are signed, borrowers and lenders will need to be prepared for logistical difficulties and delays due to closures and disruptions, such as the following:

- Perfection requirements for collateral (in particular possessory collateral or collateral requirement particular stamps) due to closures and disruptions caused by COVID-19 may need to be extended (including if such perfection is required for eligibility of collateral under ABL facilities or draw-downs). For an example of this, see the *FS Energy & Power Fund amendment*'s handling of "collateral pool" (specifically a suspension of delivery requirements as a result of the pandemic).

- Certain transactions may need to close without the usual good standing certificates if not received on time, with a representation as to good standing and a post-closing obligation for the certificate to be delivered.
- Documents that require original signatures will need to be coordinated well in advance, including putting appropriate authorizations in place if needed.

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