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ALERT MEMORANDUM

COVID-19 – Liquidity and Other Considerations for Borrowers

March 17, 2020

As companies around the globe consider the impact of the COVID-19 outbreak on their businesses and ongoing liquidity needs, they are increasingly focused on the availability of revolving credit facilities and continued compliance with their credit agreements generally. Below are certain considerations for companies to bear in mind in connection with that analysis.

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Revolver Borrowings

— Conditions to Borrowing. As a condition to borrowing under revolving credit facilities, companies are typically required to confirm that no default or event of default has occurred or will occur as a result of the borrowing and to bring down the representations and warranties in the credit agreement.

- ***No Default***. To confirm the condition as to no default or event of default, companies should review the covenants and events of default in their agreements carefully, as there are several provisions that could be implicated as a result of recent events, including covenants as to compliance with material contracts and financial reporting, financial covenants and the cross-default provision. Companies should identify covenants or events of default that are at risk of being tripped and consider whether to seek an amendment or waiver to the relevant agreement to address them when needed.
- ***No MAC; Solvency***. Similarly, credit agreements include various representations that could be implicated as a result of the outbreak. Companies should pay particular attention to the representations as to no material adverse change or effect ("MAC") and solvency:
  - Relevant case law suggests that the standard for declaring a MAC is very high and, in order for a MAC to be deemed to have occurred, the event in question must be highly significant and expected to last for a lengthy period of time. Ultimately, the determination as to whether a MAC has occurred will be based on the specific facts and circumstances for each company, as well as the precise wording of the provision.

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- While some revolving credit facilities have solvency representations that speak only as of the initial closing date, others require that a borrower confirm that it will be "solvent" after giving effect to each borrowing.

— Reporting Requirements. Public reporting companies should consider whether the amount of the revolving credit facility borrowing is material enough to trigger a public announcement and/or Form 8-K reporting requirement.

Force Majeure / Defaulting Lenders

Credit agreements do not typically excuse performance by lenders on the basis of force majeure. Nevertheless, companies may be concerned that lenders will try to claim extra-contractual rights to assert a force majeure and refrain from funding revolving loans or simply that a lender will fail to fund. In any event, lenders that are required but fail to fund in most cases would be deemed "Defaulting Lenders" under the credit agreement and the company would have certain protections and rights vís-a-vís those lenders (including the ability to replace them). Whether or not the other lenders in the syndicate are required to "front" such defaulting lender's portion of the revolver draw, however, will depend on the wording in the agreement.

Financial Covenants

Companies that have credit agreements with financial maintenance covenants should closely monitor their financial covenant levels to ensure continued access to loans under their facilities and to avoid a default. Companies may consider preemptively seeking an amendment to avoid an anticipated default or create borrowing capacity.

— Historical Nature of Calculation. Companies should bear in mind that financial covenants are often measured on a trailing twelve month basis, meaning that any negative impact on the financial covenant would be felt long after life has "returned to normal."

— Covenant Lite / Springing Facilities. Some revolving credit agreements have financial covenants that "spring" only if the revolving credit facility is utilized above an agreed threshold. Companies with those credit agreements should be mindful of the relevant levels and how they are calculated (including whether cash may be netted when calculating the leverage ratio) and ensure that if they exceed those levels they will be able to comply with the covenant once triggered.

— Ongoing Maintenance Covenants. For companies that have revolving credit agreements that include financial covenants that are tested regularly (without regard to revolver utilization), it is even more important to consider the impact borrowing under the revolver will have on leverage during the relevant test period and covenant levels, taking into account any anticipated step-downs in covenant levels.

— Asset-Based Facilities. Asset-based credit agreements ("ABLs") typically include the concept of a "borrowing base" (assuring a certain level of collateral coverage) which could be adversely impacted if the value of a company's inventory or receivables declines. Under ABLs, availability would potentially shrink along with the borrowing base. Additionally, ABLs often include additional "springing" financial covenants, reporting obligations and potentially onerous cash management-related obligations as availability declines. Many ABLs also give lenders broad discretion to alter eligibility criteria for inventory and receivables included in the borrowing base, as well as impose reserves to protect against new risks. Accordingly, as the outbreak continues, a company's ability to borrow under its ABL may contract and the company may find itself with increasing obligations thereunder.

EBITDA Adjustments

Companies should review the definition of EBITDA in their credit agreements to identify potential addbacks that may be utilized to limit the covenant impact resulting from reductions to net income or EBITDA as

a result of the outbreak, including addbacks related to the following:

— unusual, non-recurring or exceptional expenses, losses, costs or charges;

— charges, losses, lost profits, expenses or write-offs that are indemnified or insured by a third-party;

— proceeds of business interruption insurance; and

— addbacks for lost revenue generally, or (less frequently) related specifically to disasters and others acts of god.

The ability to utilize addbacks to EBITDA will help mitigate the impact not only on financial maintenance covenants, but also ratio-based incurrence tests for, among other things, debt and liens, and certain pricing and mandatory prepayment sweep step-downs.

Financial Reporting

Under most credit agreements, companies are required to report periodically to lenders on the operations and financial performance of the company. Borrowers should begin to prepare to report on the impact of the outbreak on its business beginning in the next reporting period. Reporting requirements typically include:

— MD&A;

— projections / budget;

— financial statements with compliance certificate and unqualified audit opinion at year end;

— notices of default, material litigation and material events expected to have a MAC; and

— “other information” lenders may request under relevant catch-all provisions.

Given the anticipated economic impact of the outbreak, lenders will scrutinize COVID-19 disclosure in the upcoming reporting period, so companies should begin to develop a strategy regarding disclosure, particularly if the disclosure will indicate a material decline in financial performance, a potential covenant default in future periods or any other “red flags” for lenders.

Fund Finance

Investment funds face issues similar to those described above under their revolving credit agreements. In addition, fund facilities often include a borrowing base that is adversely impacted by negative developments relating to the fund’s investors, with the effect of excluding those investors from the borrowing base, thereby potentially reducing availability under the facility. Examples of so-called “exclusion events” include (i) bankruptcy-related events at the investor; (ii) a material judgment being rendered against an investor; (iii) failure by an investor to make capital contributions when due; and (iv) a decrease in the credit quality of certain rated investors. In addition to triggering a possible decrease in the borrowing base, failure by investors to make capital contributions may also trigger notice requirements and, depending on size and/or number of investor defaults, potentially result in a default under the agreement. Later in the life of a fund, the fund’s credit agreement may include a condition to borrowing or financial maintenance covenant related to the net asset value of the fund’s portfolio investments. Funds should review their credit agreements with these issues in mind to ensure that they will have access to their facilities when needed and to provide them the opportunity to seek amendments in advance, if desired.

Conclusion

The COVID-19 outbreak will have a wide-ranging impact on companies and funds that are borrowers under credit facilities. While some issues arising under credit agreements may be obvious, other will be more nuanced. Companies and funds should not hesitate to reach out to the members of our Debt Finance Group listed above or your regular contacts at the firm to discuss the issues addressed above, or other concerns they have about credit agreement compliance.