Precautionary revolver draws – financial cure for COVID-19?

Restructuring Alert

COVID-19 Alert

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Coronavirus disease 2019 (COVID-19) isn't just dangerous for people, it's dangerous for business. As government-mandated lockdowns and shutdowns proliferate, businesses are seeing their revenue dry up or stop entirely. Meanwhile, most major cash obligations, such as rent and debt service, remain due and payable on their regular schedules.

While some expenses can be reduced, such measures may be painful: furloughing employees, for instance, often results in another hit to cash, due to the need to pay out vacation pay and severance. As a result, many companies with access to revolving credit facilities find themselves considering whether to make a pre-emptive draw now to ensure they have enough liquidity for the future.

So why *wouldn't* a borrower facing the uncertainty of the new COVID-19 economy make a precautionary revolver draw? Well, it turns out there are a number of reasons.

First, borrowers need to understand their loan documents and the conditions therein for revolver draws. Most loan documents require, as a condition to any revolver draw, that the borrower "bring down," (*ie*, verify) that all the representations and warranties (R&W) the borrower makes in the loan documents will be true and correct as of the date of the draw. Thus, borrowers hoping to draw down on their revolvers in this environment must consider whether the R&W they gave at the loan's inception, or at the last draw, are still valid: Is the borrower still solvent? Has a material adverse change, or material adverse effect , occurred? Is there an event of default resulting from a reduction in the scale of operations, or a material contract or customer account? Before making any precautionary draw, borrowers and their counsel are encouraged to carefully review loan documents for the relevant R&W and "default" definitions to determine whether they can truthfully sign a draw request attesting that no defaults have occurred. Borrowers should keep in mind that individuals who knowingly make false written representations to lenders can be held personally liable for any resulting damages.

Second, savvy borrowers are encouraged to consider what's next after the draw request is made: Will the lender be able to argue that the COVID-19 pandemic is a force majeure that excuses it from honoring an otherwise valid draw request? And if the lender does honor the request, is a default inevitable? While the timing of the COVID-19 pandemic was such that it may not cause affected borrowers to default when their financial covenants are tested at the end of Q1, most will not be so lucky at the end of Q2; then what? In addition, many facilities include springing financial covenants that arise when revolver utilization increases; will the borrower be able to satisfy the new, higher covenants? Regardless of financial covenants, borrowers are also encouraged to consider their audit delivery requirements: with most accounting firms having withdrawn their staff from positions onsite at clients, will the borrower still be able to deliver its quarterly financials with the typical 90-120 days required by most loan documents?

Third, there may be a middle road between (a) making a draw that could cause a future default and (b) taking the risk that a default occurs before a draw is made, leaving the borrower without sufficient liquidity to carry it through the COVID-19 pandemic. As discussed above, precautionary revolver draws present issues and problems for both borrowers and lenders. Borrowers and lenders are encouraged to sit down and have a frank discussion about the current state of the business and what is needed to ride out the COVID-19 pandemic. Borrowers don't want to be in default, and lenders don't want non-performing assets on their books.

If you have any questions about this article please reach out to Eric Goldberg or Matt Schwartz.

If you have any questions regarding these new requirements and their implications, please contact the authors, any member of DLA Piper's Restructuring group or your DLA Piper relationship attorney.

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