Joint Report from the Chairs

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Please email either of us if you have any ideas for either of the Committees or wish to participate in any project, subcommittee or leadership role. The Committees have a number of projects underway. Our subcommittees and task forces are very active and always welcome input. Please do not hesitate to volunteer!

We hope you enjoy this issue, and invite you to get involved in your committee(s).

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FEATURED ARTICLES

PERFECTION AND PRIORITIES: LESSONS LEARNED FROM PHILADELPHIA ENERGY SOLUTIONS  
By Ira L. Herman and Mark I. Rabinowitz

The pressure to “get the deal closed” and give up on important deal points in the course of intercreditor negotiations is often hard to resist. But resistance is not futile. Important priority rights in and to collateral, including insurance, must be preserved by standing firm on substance and making sure the deal is properly documented. This is particularly true when a transaction involves lenders with different priorities in a borrower’s property, and whether the transaction is a standard 1L/2L deal, a unitranche deal, or a split lien deal. The message was recently driven home once again by a decision addressing

COVID-19: MODIFICATION OF LOAN AGREEMENT PROVISIONS  
by Stephanie Bakes, Maria Barclay and Tim Fanning, Practical Law Finance

USEFUL LINKS AND WEBSITES

VIEW CURRENT REPORTS AND DEVELOPMENTS OF THE FOLLOWING COMMITTEES AND TASK FORCES:

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• Subcommittee on Loan Documentation
• Subcommittee on Loan Workouts
• Subcommittee on Maritime Financing
• Subcommittee on Past Chairs Advisory
• Subcommittee on Programs, Meetings and Communications
• Subcommittee on Real Estate Financing

Featured Articles
perfection and lien priority issues in a split lien deal, in the Philadelphia Energy Solutions (“PES”) chapter 11 cases.

On June 21, 2019, an explosion and fire destroyed the Girard Point refining facility owned by PES in South Philadelphia. Shortly thereafter, several PES entities (PES debtors) filed voluntary petitions for relief under chapter 11. At all times relevant, the PES debtors had $1.25 billion in insurance coverage for property damage (“PD”) and business interruption (“BI”) losses.

Prior to the commencement of their chapter 11 cases, the PES debtors financed their operations with two facilities, a specialized working capital facility with ICBC Standard Bank PLC (“ICBCS”), as lender, and a term loan facility with several lenders and Cortland Capital Market Services LCC, as administrative agent (“Cortland”).

By the time the PES debtors filed for chapter 11 relief, their physical assets and the revenue stream generated by the operation of those assets had been destroyed, leaving the PES Debtors, their Creditors' Committee (“UCC”), ICBCS, and Cortland to duke it out over their respective rights and priorities in and to proceeds of certain PD and BI insurance.

The reason both PD and BI insurance policies were at issue regarding PES is the physical destruction of the PES refinery that resulted in the loss of PES's ability to operate. As is true with regard to BI policies in general, the coverage available to PES was limited to situations where the “actual loss sustained by the Insured resulting from the necessary interruption of business [is] caused by direct physical loss or damage by a peril insured against, to property insured herein ... ” (emphasis added). By way of contrast, BI insurance with similar policy language most likely will not cover losses suffered by businesses shut down due to the current COVID-19 pandemic, due to the absence of physical damage. However, each policy is different, and lenders would be well advised to review any applicable policy language and factual circumstances before making any determination about the extent of the BI coverage available to a borrower.

The Term Loan Facility

The PES debtors were the borrowers under an approximately $698.6 million term loan facility provided by the term loan lenders, with Cortland as administrative agent.

The term loan facility financed the debtors’ exit from chapter 11 in their prior cases and was approved by Judge Gross pursuant to the Court’s prior confirmation order. That confirmation order provided that on the effective date of the prior chapter 11 plan, “the liens granted and contemplated by the New First Lien Term Loan Documents shall be valid, binding, perfected, and enforceable liens on the collateral specified in the New First Lien Term Loan Documents for the benefit of the secured parties under the New First Lien Term Loan Documents.” Among the covenants in the term loan facility documents was the debtors’ affirmative covenant to name Cortland “as insured party or loss payee with respect to applicable insurance policies.”

The documents also included a mandatory prepayment provision that would be triggered upon certain “Asset Sales” or “Recovery Events” (both as defined in the term loan facility documents). The mandatory prepayment provision states, “[F]or the avoidance of doubt, any cash proceeds received from business interruption insurance shall not be required to be used by the Loan Parties to prepay the Loans under this Section 2.06(b).” Additionally, the agreement made clear that the defined term recovery event “shall not include proceeds received from business interruption insurance.”

In connection with the term loan facility, certain PES entities executed a term loan security agreement with Cortland on Aug. 7, 2019. That agreement was governed by New York law and granted Cortland a collateral security interest in certain assets of each grantor.

On Nov. 1, 2018, Cortland was issued an evidence of property insurance certificate, and on July 3, 2019, Cortland and the PES debtors executed a term loan facility forbearance agreement stating:
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“The Loan Parties hereby acknowledge and agree that, subject to the Intercreditor Agreement, (i) all property insurance proceeds that any Loan Party is or may be entitled to (including, without limitation, casualty and business interruption insurance proceeds ... ) as a result of or in any manner related to the fire that occurred in the refinery operated by the Borrower and its Subsidiaries located in Philadelphia, Pennsylvania on or around June 21, 2019 (... and such proceeds, the 'Specified Insurance Proceeds') constitute Collateral securing the Obligations and (ii) the Secured Parties hold valid and perfected liens over any and all such Specified Insurance proceeds.”

Additionally, two of the debtors executed separate exit mortgages (effective Aug. 7, 2018) and certain other incremental mortgages (effective April 5, 2019). Under the mortgages, Cortland received a lien on and security interest in “all proceeds of any” insurance policy relating to “Real Estate or Equipment,” “including the right to collect and receive such proceeds.”

On Aug. 8, 2018, Cortland filed UCC-1 financing statements with the Delaware Department of State covering all of the debtors' assets and disclosing its security interests in “[a]ll assets of the Debtor of every kind and nature, whether now owned or hereafter acquired and wherever located, and all proceeds and products thereof.”

The Working Capital Facility

On June 18, 2019, the several PES entities and ICBCS executed an intermediation facility agreement, as part of the exit facility PES obtained when exiting a prior chapter 11 case. Pursuant to the intermediation facility agreement, among other things, the relevant PES entities agreed to “[k]eep [their] property insured at all times” and “name ICBCS as mortgagee, additional insured and loss payee” on the debtors’ insurance policies. The Court correctly characterized the intermediation facility as a “working capital arrangement that helps the [] [debtors] run their business. Another way to look at the intermediation facility is that it a specialized type of ABL hybrid with some elements that look like somewhat like a consignment or floor plan financing.

The confirmation order in the prior chapter 11, provides, in relevant part, for the perfection of the security agreement and states that on the plan’s effective date, “the liens granted and contemplated by the New Intermediation Facility shall be valid, binding, perfected, and enforceable liens on the collateral specified in the New Intermediation Facility for the benefit of the secured parties under the New Intermediation Facility.”

A property insurance certificate stating that ICBCS was an “Additional Insured” and “Loss Payee/Mortgagee” under the policy was issued and provided to ICBCS.

Intercreditor Agreement

On Aug. 7, 2018, certain PES entities, Cortland, ICBCS and Merrill Lynch Commodities Inc. entered into an intercreditor agreement that governs the parties’ respective priorities with respect to various categories of collateral.

Discussion of Split Collateral Loan Transactions

In many respects the PES capital structure is a good example of a “split collateral” loan transaction. In a “split collateral” loan transaction, a working capital loan (maybe an ABL) is coupled with a term loan (often referred to as a cash flow loan), where two lenders or sets of lenders (typically, an ABL lender or lenders and a term loan lender or lenders) share liens on a single collateral pool, each with priority over a different set of assets in the pool.

Generally, the ABL lender, will have priority liens on the in its borrowing base (most commonly current assets such as receivables and inventory) often referred to as the ABL priority collateral, and junior liens over the remaining asset base (generally fixed assets). The term loan lender, conversely, will have priority liens over the fixed assets and junior liens over the borrowing base assets. To better understand the split collateral loan structure dynamic, it is important to be aware that a common feature of “split collateral” intercreditor agreements is symmetry – the priority rights of the ABL lender with respect to the ABL priority collateral will for the most part mirror the priority rights of the term lender with respect to the term loan priority collateral. This type of intercreditor relationship
exists in sharp contrast to the more familiar “all assets” intercreditor arrangement between a first-lien and second-lien lender, where the lenders are willing to take shared collateral, but one lender is willing to exchange more risk for better economics.

In contrast, a “split collateral” intercreditor typically involves an ABL lender that is by definition focused on the most liquid collateral of the borrower, and a term lender that may be either collateral-focused (if there are significant fixed assets) or looking almost entirely to cash flows to support the credit. The documentation will include provisions establishing the respective lien priorities, enforcement standstill periods, turnover and application-of-proceeds clauses, a set of bankruptcy right waivers, limits on amending one side’s credit documents without the other side’s consent, and a bailout right (which is sometimes drafted bilaterally in accordance with the general principle of symmetry in “split collateral” arrangements, but is also often drafted solely in favor of the term loan lender, especially when the ABL facility is relatively small and there is little prospect of the ABL lender desiring to pay out the term loan lender in order to step into its shoes).

In split collateral intercreditor agreements, ABL priority collateral typically is defined by reference to asset classes, while term priority collateral (or the equivalent) is defined as all shared collateral that is not ABL priority collateral (usually inventory, receivables and cash). The lines drawn in the intercreditor agreement have an impact on the underlying credit agreements as well – for example in stating the term loan agreement’s mandatory prepayment requirements with respect to dispositions of collateral. The intercreditor agreement also usually specifies how to allocate proceeds of mixed priority collateral – i.e. how much of the proceeds to attribute to the ABL priority collateral and how much to the term priority collateral (for example, by allocating book value to the ABL priority collateral and the remainder of the proceeds to the term priority collateral).

In addition to the core borrowing base assets, such as inventory and accounts receivable, the ABL lender will want the ABL priority collateral to include references to UCC asset classes such as chattel paper, deposit accounts, documents, instruments, supporting obligations and general intangibles, to the extent related to any of the other ABL priority asset categories; products and proceeds of the foregoing should be covered. On the other hand the term loan lender will seek to carve back from the ABL priority collateral any assets that constitute proceeds of the term priority collateral – such as any receivables and payment intangibles owed on account of a disposition of fixed assets, or deposit accounts containing proceeds of fixed assets or other term priority collateral. An excellent example – a carve out of equity interests in subsidiaries.

The Decision of the Bankruptcy Court Concerning the Perfection Issues

After litigation was initiated, U.S. Bankruptcy Judge Kevin Gross of the District of Delaware issued a decision Feb. 28 concerning the relative rights of the parties to proceeds of the PD and BI insurance.

The Court found that Cortland, as term loan agent, had a perfected security interest in the BI policy and BI proceeds at all relevant times, because (i) New York law provides that creditors perfect security interests in insurance policies by being named loss payees and, according to the court’s analysis, Cortland is a loss payee, and (ii) the prior confirmation order perfected Cortland’s security interest in the policy proceeds.

Similarly, the Court found that ICBCS “has a clear perfected security interest in the BI Policy and Proceeds.” To reach this conclusion, the court relies on the blanket lien on the debtors’ assets provided in favor of ICBCS, pursuant to the ICBCS security agreement, the BI policy’s endorsement naming ICBCS as a loss payee/mortgagee and the fact that the BI policy also names ICBCS as an additional insured.

In reaching this conclusion, the Court rejected the UCC’s attempt to invalidate the liens on BI proceeds as “after-acquired property” under section 552(a) of the Bankruptcy Code. As the opinion explains, section 552(b) “provides that a security interest cannot be avoided if the after-acquired property is proceeds of collateral subject to a security interest which the secured creditor held prior to the bankruptcy and extends to the underlying collateral and its proceeds.” Therefore, since both Cortland and ICBCS held a security interest in the BI policy and BI proceeds “as loss payee/mortgagee” before the petition date (as discussed above), the Court found that the liens in the BI proceeds could not be avoided.

Most interestingly, the Court also bases its holding concerning the entitlement of the lenders to insurance proceeds on a completely separate and important legal theory:

It is also the case [states the Court] that the BI Proceeds are not property of Debtors’ estates. Insurance proceeds which a debtor assigns “cannot be reclaimed by the debtor.” In re McLean, 132 B.R. 271 at 284 (Bankr. S.D.N.Y. 1991); In re Moskowitz, 14 B.R. 677 at 677, 680-81 (Bankr. S.D.N.Y. 1981) (reasoning that insurance proceeds a debtor assigns are not property of the estate and payment of the proceeds is not a voidable preference); In re Suter, 181 B.R. 116, 119 (Bankr. N.D. Ala. 1994) (reasoning that a loss payee means insurance proceeds are not property of the estate).

The same logic obviously would apply to the assignment of insurance proceeds by the PES Debtors to Cortland, as well as to other situations where a company has similarly assigned insurance proceeds.
Priority of Lender Interests in the BI Policy Proceeds

Having found that both Cortland and ICBCS had perfected security interests in the BI policy, the Court then decided that “by virtue of the Intermediation Facility, ICBCS Security Agreement, and the Intercreditor Agreement, ICBCS’s liens have priority over the liens belonging to the Term Loan Agent.” According to the Court, the intercreditor agreement “clarifies the priority question, and the result favors ICBCS.” The opinion cites two law review articles that, according to Judge Gross, confirm that ICBCS has the priority interest in the BI policy and BI proceeds.

In reaching its conclusion, the court reasons that ICBCS’ “non-exclusive priority collateral … comprises all of the Debtors’ business assets,” whereas Cortland’s priority collateral is “primarily real estate, fixtures and equipment based on the Intercreditor Agreement” and “[s]uch collateral does not create a priority security interest in the proceeds from business interruption insurance.” Judge Gross cites to a 1992 Western District of Missouri case - MNC Com. Corp. v. Rouse, 1992 WL 674733 (W.D. Mo. Dec. 15, 1992) - as “instructive and supportive of the Court’s rationale.” After considering the various agreements in play and their relevant definitions, the court concludes that “[b]ecause ICBCS has a first-priority interest in Debtors’ Accounts, Inventory, and General Intangibles and Money as it relates to Accounts and Inventory, ICBCS has a perfected security interest that takes priority over the Term Loan Agent’s perfected security interest.”

However, all is not lost for the term loan lenders, as the Court expressly recognized that “ICBCS is very likely not entitled to all of the proceeds from the BI Proceeds, and ICBCS must not prejudice the rights of the Term Loan Agent to recover the remainder or even the bulk of the BI Proceeds for which the Term Loan Agent also has a perfected security interest.” The Court also notes, that “[i]t is unlikely, perhaps inconceivable is more appropriate, that the insurers will negotiate with the Term Loan Agent and/or ICBCS without assurance of a full and final release.” The Court, perhaps with an air of resignation, therefore acknowledged that the dispute will almost certainly land back in Court for the determination of “how best to apportion the BI Proceeds based on the facts and the size of recovery of insurance proceeds.”

Priority of Lender Interests in the PD Policy Proceeds

With respect to the PD proceeds, the Court concluded that ICBCS has priority on proceeds “related to SOA Separate Assets and Collateral and SOA Priority Collateral, which includes Inventory,” and Cortland has priority on the PD proceeds “related to all other Common Collateral, which includes all Fixtures, Equipment, and pursuant to the Mortgages, Real Estate.” Finally, the court held that Cortland has priority over ICBCS in the PD proceeds for the Girard point plant, while ICBCS had priority in such proceeds with respect to the hydrocarbons and refined products that had been lost.

On March 13, the UCC appealed Judge Gross’s decision and order which is now pending with the Third U.S. Circuit Court of Appeals.

Lessons Learned

PES is a textbook case and a road map of how a bankruptcy court reviews and scrutinizes a loan transaction. It is also one of many cases that instruct never to cut corners regarding documentation of liens and assignments. Even though it is obvious, it is worth restating here: when disaster strikes, a good set of loan documents can be the difference between a potential recovery and a possible total loss.

A second lesson of PES, and one that is no less important, is that in the negotiation of any loan transaction involving multiple tranches of secured debt, whether the transaction is a unitranche, split lien or traditional 1L/2L deal, lenders and counsel must never lose sight of the business terms of the deal and take all steps necessary to ensure that the lender’s lien priorities are clearly delineated and preserved. Any lender relying on priority collateral will be well served by the use of clear and specific language in documentation to avoid disputes and litigation risk after a default.

Finally, the court’s finding that the insurance proceeds assigned to the lenders in PES were not “property of the estate” is important to lenders in many ways. First, properly assigned insurance proceeds cannot be accessed by a debtor seeking to use the proceeds as cash collateral in a bankruptcy case, since the debtor has no interest in such proceeds. And, second, payment of such proceeds to the lender should not be subject to avoidance, or claw back, since the proceeds are excluded from property of the debtor and its bankruptcy estate. Taking assignments, in addition to taking collateral and perfecting under the UCC, should not be overlooked as an important right that can be obtained by a lender when documenting a loan transaction.
COVID-19: MODIFICATION OF LOAN AGREEMENT PROVISIONS
by Stephanie Backes, Maria Barclay and Tim Fanning, Practical Law Finance

This Article presents a review of loan agreement provisions that have been modified as a result of COVID-19. This Article also provides examples of specific language that market participants have used in loan agreements as they navigate the pandemic.

With the ongoing uncertainty surrounding the economic effects of and government and corporate responses to the 2019 novel coronavirus disease (COVID-19) pandemic, borrowers and other loan market participants must consider multiple issues under their loan agreements. The most pressing issue for many borrowers in the short term is the preservation of liquidity and the ability to access additional liquidity in the face of falling revenues. During the coming weeks and months, many borrowers are likely to face additional covenant compliance issues as well.

As a result, borrowers and other loan market participants are increasingly focused on loan terms as they continue to navigate the effects of the pandemic on business operations. Practical Law Finance has analyzed recent credit agreements and credit agreement amendments to determine market practice for several provisions during the COVID-19 pandemic. This Article considers these provisions and focuses on the specific language and variations in drafting found in recent loan agreements and loan agreement amendments.

For more information on COVID-19 loan agreement issues, see Practice Note, COVID-19: Loan Agreement Considerations for Corporate Borrowers.

Material Adverse Effect

Material adverse effect (MAE) definitions are often highly negotiated with borrowers paying particular attention to two points in the MAE definition:

- Inclusion of prospects. Borrowers often resist the inclusion of prospects as being too speculative. They typically argue that lenders should not have the right to declare that an MAE has occurred because of events that have not yet had an impact on their business or financial condition.
- Exclusions. Borrowers may try to exclude from the MAE definition events or conditions that affect the borrower’s industry, the financial markets, or the US in general to avoid breaches of the loan agreement that are beyond their control. Lenders may take the position that these are matters of risk allocation and that the risk of an event occurring that has a material adverse effect should be borne by the borrower rather than the lender.

A key question in light of COVID-19 is whether the pandemic and its effects on a borrower’s business constitute a MAE under a standard definition or representation.

The bullets below provide examples of recent credit agreements and credit agreement amendments that have addressed COVID-19 in their MAE definitions and representations:

- A carve-out in the MAE definition that the impact of COVID-19 on a business does not constitute an MAE for a specified period of time:
  
  “… notwithstanding anything to the contrary set forth herein, solely for purposes of determinations that are made during the period from the Closing Date through and including December 31, 2020 of whether a Material Adverse Effect exists, the direct and indirect impacts of the COVID-19 Pandemic on the business, property, liabilities (actual and contingent), operations, condition (financial or otherwise), results of operations, or prospects of the Borrower and its Subsidiaries taken as a whole that were disclosed to the Lenders on or prior to the Closing Date shall not be deemed to constitute a Material Adverse Effect” (see Boston Scientific...
• “… during the period from the Closing Date to one (1) year after the Closing Date, a Material Adverse Effect shall not be deemed to exist solely as a result of the coronavirus disease known as COVID-19 to the extent that the impacts of COVID-19 on the business, property, operations or financial condition of the Borrower and its Restricted Subsidiaries, taken as a whole, do not disproportionately impact the Borrower and its Restricted Subsidiaries, taken as a whole, relative to other similarly situated companies in the same industry as the Borrower that are operating in the United States” (see Teradyne, Inc. credit agreement);

• “provided that for purposes of clause (a) of this definition, the Coronavirus Disease 2019 ("COVID-19"), the declaration on March 13, 2020, of the national emergency relating to COVID-19, and related legislative, regulatory and executive actions, and the direct or indirect impacts of the foregoing on the Borrower and its Restricted Subsidiaries occurring on or prior to the date which is three hundred sixty-four (364) days after the First Amendment Effective Date shall not constitute a material adverse effect on the business, assets, operations, properties or condition (financial or otherwise) or results of operations of the Borrower and its Restricted Subsidiaries, taken as a whole” (see Encompass Health Corporation first amendment); and

• “… means any material adverse change in the business, condition (financial or otherwise) or results of operations of the Company and its Subsidiaries taken as a whole; provided that the impacts of the COVID-19 pandemic on the business, condition (financial or otherwise) or results of operations of the Company and its Subsidiaries that were disclosed in the Disclosure Documents or in any S-4 filing in connection with the Neptune Transactions filed, or otherwise provided to the Lenders, prior to the Effective Date will be disregarded” (see International Flavors & Fragrances Inc. credit agreement).

• A carve-out in the MAE representation related to COVID-19 (time period not specified):

• “Since December 31, 2019, there has been no event or development which has had a Material Adverse Effect (excluding any event or circumstance resulting from the COVID-19 pandemic to the extent such event or circumstance has been publicly disclosed by the Borrower in its securities filings and the scope of such adverse effect is no greater than that which has been disclosed); provided that this condition shall not be required to be satisfied after the earlier to occur of the Security Release Date and the Limitation Date” (see Hyatt Hotels Corporation second amendment);

• “Since December 31, 2019, except for reasonably foreseeable and expected consequences of the COVID-19 pandemic as of the Effective Date, there has been no material adverse change in the business, assets, operations or financial condition of the Borrower and its Subsidiaries, taken as a whole” (see Penumbra, Inc. credit agreement); and

• “Since the date of the Audited Financial Statements, there has been no event or circumstance not otherwise disclosed prior to the Effective Date pursuant to any public filing with the SEC, either individually or in the aggregate, that has had or could reasonably be expected to have a Material Adverse Effect, provided that the impacts of COVID 19 on the operations, business, assets, liabilities or condition of the Company or any of its Subsidiaries as described in the Lender Presentation dated April 9, 2020 will be disregarded for purposes of this Section 3.05(c)” (see Watts Water Technologies, Inc. credit agreement).

• A qualified carve-out in the MAE representation related to COVID-19 (limited time period):

• “… provided that, for purposes of this Section 6.4, only from the Third Amendment Effective Date until the earlier of (x) September 30, 2020 and (y) the lifting of social distancing restrictions by Governmental Authorities in jurisdictions where substantially all of the Credit Parties’ revenue is generated, the impacts of the existing coronavirus pandemic on the business, operations, properties, assets, liabilities or condition (financial or otherwise) of the Borrower and its Subsidiaries taken as a whole that have already occurred and were disclosed in writing to Lenders in the Bank Presentation Materials distributed on March 16, 2020 (which included the Borrower’s Consolidated Leverage Ratio Covenant projections, a Covenant Forecast and Working Forecast Model) shall be disregarded for purposes of determining whether a Material Adverse Effect has occurred” (see Ruth’s Hospitality Group, Inc. third amendment).
Covenants

Many loan agreements contain financial covenants, but these vary widely in terms of their nature and scope. Financial covenants generally fall into one of two categories: maintenance covenants and incurrence covenants.

Maintenance Covenants

Maintenance financial covenants require the borrower to maintain a specified financial metric on an ongoing basis, such as a leverage ratio or an interest coverage ratio. As the COVID-19 pandemic evolves and protective measures continue to affect businesses and the wider economy, borrowers and lenders should pay close attention to their loan agreement covenants and plan to address issues as they arise. As loan default rates are rising, it becomes even more important for individual borrowers to address issues proactively, to avoid a loan agreement default in the future.

The bullet below provides an example of a recent credit agreement amendment where the parties addressed in the short term the impact of COVID-19 with regard to their maintenance covenant:

- Suspension of Compliance with Financial Covenants:
  - “Section 7.1 of the Credit Agreement is amended by waiving the requirement to comply with the financial covenants set forth in clauses (a), (b) and (d) of Section 7.1 solely for the fiscal quarter ending June 30, 2020” (see Unique Fabricating NA Inc. seventh amendment).

Incurrence Covenants

Incurrence covenants, which are a hallmark of covenant-lite loans, require the borrower to meet a specified financial metric whenever some particular corporate action occurs (for example, the borrower incurs debt or makes an investment). The borrower must only satisfy the required financial test if it wishes to take some action; it does not need to comply with the financial covenant at all times. The impact of the COVID-19 pandemic on the borrower’s business could leave it unable to take certain actions because falling revenues mean it is unable to meet an incurrence test.

The bullets below provide examples of recent credit agreements and credit agreement amendments where the parties have addressed the impact of COVID-19 by specifically permitting certain debt or lien incurrences that might otherwise have been prevented by the borrower’s ability to comply with the loan agreement’s incurrence covenants:

- COVID-19-related debt as an exception to the debt negative covenant:
  - “… (x) any loan or other financial assistance received by any Borrower or any of its Subsidiaries from any federal, state, local or foreign government program enacted in response to the COVID-19 outbreak in an aggregate principal amount not to exceed, together with any amounts incurred pursuant to Section 7.02(r), in the aggregate $275,000,000; and (y) any refinancings, refundings, renewals or extensions of Indebtedness permitted pursuant to Sections 7.02(s)(x); provided that the amount of such Indebtedness is not increased at the time of such refinancing, refunding, renewal or extension except by an amount equal to a reasonable premium or other reasonable amount paid, and fees and expenses reasonably incurred, in connection with such refinancing and by an amount equal to any existing commitments unutilized thereunder” (see Callaway Golf Company first amendment); and
  - “With respect to the Borrower or any of its Subsidiaries, Indebtedness entered into pursuant to the laws, rules, or regulations of the United States (including, for the avoidance of doubt, any agency or instrumentality of the United States, including the Federal Reserve and other federal bank regulatory agencies) promulgated under the Coronavirus Aid, Relief and Economic Security Act or any other legislation, regulation, act, or similar law in response to, or related to the effect of, COVID-19, in each case, as amended from time to time, provided the terms of and security for, such Indebtedness has been approved of, in writing, by the Required Lenders in their reasonable discretion” (see Astronics Corporation first amendment).
Liens securing COVID-19-related debt as an exception to the liens negative covenant:

“Liens in favor of any governmental authority junior to the Liens incurred under the Collateral Documents in connection with the receipt of any governmental assistance in respect of the coronavirus pandemic” (see American Airlines credit and guaranty agreement).

For more information on maintenance and incurrence covenants, see Practice Note, Loan Agreement: Financial Covenants.

Addbacks to Measures of Financial Performance

Financial covenant ratios commonly measure a specified financial metric against EBITDA or consolidated net income. If the borrower’s financial performance declines as a result of the pandemic, it may fail to maintain a required ratio, resulting in an event of default. Similarly, many of these loan agreements calculate leverage on a “net debt basis,” so to the extent liquidity is constrained and there is less cash on the balance sheet, leverage will increase for any given amount of debt.

During the COVID-19 pandemic, borrowers and lenders are likely to pay particular attention to financial performance addbacks as these may be used to lessen the impact of the pandemic on the borrower’s financial results. In a given loan agreement, it may be unclear whether one-time, extraordinary expenses related to COVID-19 are within the scope of the loan agreement’s add-backs.

EBITDA

The bullets below provide examples of recent credit agreements and credit agreement amendments that have clarified the impact of COVID-19 in their EBITDA definitions:

• Not including any EBITDA add-backs relating to COVID-19:
  
  • “For purposes of [the financial covenant] definition, for the avoidance of doubt, Consolidated EBITDA as used in this definition will be calculated without giving effect to any revenue-related addbacks relating to the COVID-19 virus outbreak” (see Bright Horizons Family Solutions, LLC fourth amendment); and
  
  • “… means, with reference to any Test Period, EBITDA for such Test Period, plus, without duplication… (f) all unusual and/or non-recurring costs, expenses, charges, losses and similar items (excluding, in each case, costs, expenses, charges, losses and similar items resulting from or attributable to the Covid-19 pandemic) not to exceed 10% of Adjusted EBITDA …” (see Willdan Group, Inc. third amendment).

• Including add-backs specifically relating to COVID-19:
  
  • “… nonrecurring factory charges related to cancelling approximately $350,000,000 in inventory purchases due to lower expected sales related to COVID-19, in an aggregate amount not to exceed (i) $20,000,000 for the four fiscal quarters of 2020 and (ii) $20,000,000 for the four fiscal quarters of 2021, but with no unutilized portions of such limits carried forward to any future period…” (see Wolverine World Wide, Inc. second amendment); and
  
  • “… means, on a consolidated basis for any fiscal period, net income of the Company and its Subsidiaries (exclusive of equity earnings in non-consolidated affiliates except to the extent such earnings have actually been distributed in cash to the Company or any Subsidiary during such period) plus… (vii) to the extent elected by the Company, (A) other unusual, non-recurring or one-time cash expenses, losses and charges and (B) costs, expenses, losses and charges directly or indirectly related to or resulting from the COVID-19 pandemic, in an aggregate amount not to exceed $75,000,000 in any four fiscal quarter period (but not more than $300,000,000 until the termination in full of the Aggregate Commitments)…” (see ConAgra Brands, Inc. credit agreement).

Consolidated Net Income

The bullets below provide examples of recent credit agreement amendments that have addressed COVID-19 in their consolidated net income definition:
Amendments to the definition of Consolidated Net Income:

• “The definition of “Consolidated Net Income” set forth in Section 1.1 of the Term Loan Agreement is hereby amended by inserting the following sentence at the end thereof: “For the avoidance of doubt, the impact of COVID-19 on the Borrower and its Restricted Subsidiaries shall not be considered an extraordinary loss for purposes of sub-clause (ii)(g) [catch-all provision for extraordinary losses or gains] of this definition” (see REV Group, Inc. fifth amendment); and

• “… means, for any period, for the Borrower and its Subsidiaries on a consolidated basis, the net income of the Borrower and its Subsidiaries for that period (excluding cash or non-cash gains or losses for that period that are unusual, one-time or non-regularly recurring or not from operations, and that are not attributable to the COVID-19 pandemic)” (see Texas Roadhouse, Inc. first amendment).

Information Delivery

Loan agreements require borrowers to provide their lenders with information, notices, reports, and compliance certificates on an ongoing basis during the life of the loan.

Market participants anticipate delays with the delivery of information during the COVID-19 pandemic. Many borrowers may request an extension as they struggle to update their statements on time. Borrowers may also have difficulty delivering timely audits. Audit firms are uncertain whether they will be able to complete site visits and comply with the required social distancing guidelines.

The bullets below provide examples of recent credit agreements and credit agreement amendments that have addressed COVID-19 information and delivery provisions:

• Updated forecasts to address COVID-19:

  • “Section 5.01(e) of the Credit Agreement shall be amended to insert “(provided that, with respect to such plan and forecast delivered for the Fiscal Year ending January 2, 2021, the Company will furnish to the Administrative Agent, for distribution to each Lender, such plan and forecast as updated to address the impact of the COVID-19 coronavirus pandemic by no later than April 30, 2020) (in each case, in form and substance reasonably satisfactory to the Administrative Agent)” at the end thereof” (see Fossil Group, Inc. second amendment).

• Change in delivery method as a result of limited site visits/social distancing:

  • “In light of current recommendations for social distancing and increased remote working measures in place during the COVID-19 pandemic, and the resulting limited ability of the parties to send and receive approvals, confirmations, consents, demands, determinations, notices, requests or other communications required or permitted under any Loan Document via non-electronic methods as described in this Section 10.2, from and after the First Amendment Effective Date until the end of the Modification Period (the “Email Notice Expiration Date”), the Borrower and the Administrative Agent shall deliver all formal approvals, confirmations, consents, demands, determinations, notices, requests or other communications required or permitted under this Agreement or any Loan Document and as permitted by applicable law in writing via email, return receipt requested…” (see Chatham Lodging, L.P. first amendment).

• Postponement of inspections as a result of COVID-19:

  • “… In the event that inventory and Collateral inspections are prohibited by any Governmental Authority in response to COVID-19, all inventory and Collateral inspections shall be postponed until such time as the Administrative Agent or other third parties are permitted by Governmental Authorities to resume conducting such inspections” (see LDRV Holdings Corp. fourth amendment).

• Extension of due date if borrower is unable to meet deadline as a result of COVID-19:

  • “Each Loan Party shall, upon the reasonable request of the Administrative Agent, use commercially reasonable efforts to obtain, within 90 days after the Effective Date (or within 90 days after the date on which the
applicable Collateral becomes located at a leased property, as the case may be) (or, in each case, such later date as the Administrative Agent may agree in its Permitted Discretion; provided that to the extent such delay has arisen as a result of circumstances relating to the COVID-19 pandemic, the Administrative Agent shall agree to appropriate extensions in light of such circumstances), a Collateral Access Agreement, in form and substance reasonably acceptable to the Administrative Agent, from the landlord of such leased property” (see Arconic Corporation credit agreement).

Event of Default

A misrepresentation under a loan agreement results in an event of default, which allows the lender to take action against the borrower. The actions may be as severe as terminating their lending commitments and accelerating and demanding repayment of the outstanding loans.

Loan agreements with ongoing lending commitments, such as revolving loans and delayed draw term loans require the borrower to bring down its representations at each borrowing. If the borrower cannot make particular representations because of the effect of the pandemic, the borrower cannot access additional credit under the loan unless the problematic representation is either modified or waived. Borrowing in breach of a representation constitutes an event of default. Similarly, if the borrower breaches a covenant in its loan agreement due to the effects of the pandemic on its business and this remains unrectified after the expiration of any grace period, this also constitutes an event of default.

Borrowers should review their loan agreement obligations and consider the effects of the COVID-19 pandemic on their requirements.

The bullets below provide examples of recent credit agreement and credit agreement amendments that have addressed COVID-19 in the loan agreement’s event of default provisions:

- Excluding COVID-19 shutdown measures from events of default:
  
  “Any Loan Party or any of its Subsidiaries (excluding the Excluded Entities) is enjoined, restrained, or in any way prevented by the order of any court or any Governmental Authority (other than in connection with any COVID-19 “non-essential business” or similar shutdowns issued by any Governmental Authority) from conducting all or any material part of its business for more than 15 days, (ii) any other cessation of a substantial part of the business of Global Parent or any of its Subsidiaries (excluding the Excluded Entities) for a period which materially and adversely affects Global Parent or any of its Subsidiaries (excluding the Excluded Entities), or (iii) any material damage to, or loss, theft, or destruction of, any Collateral, whether or not insured, or any strike, lockout, labor dispute, embargo, condemnation, act of God or public enemy, or other casualty which causes, for more than 15 consecutive days, the cessation or substantial curtailment of revenue producing activities at a Real Property that, in any case described in clause (i), (ii) or (iii), results in or could reasonably be expected to have a Material Adverse Effect during the term hereof” (see Franchise Group Inc. second amendment); and

- “the Loan Parties shall cease to do business as a hotel at each of the Borrowing Base Properties or terminates such business for any reason whatsoever (other than temporary cessation in connection with any continuous and diligent renovation or restoration of any individual Borrowing Base Property following a Casualty or Condemnation or a temporary closure of a hotel required pursuant to any executive order or other Requirement of Law in connection with the COVID-19 pandemic)” (see Chatham Lodging L.P. first amendment).

- Exclusion of rent payments as a payment default during the COVID-19 pandemic:
  
  “The Borrower or any Material Subsidiary shall admit in writing its inability or fail generally to pay its debts as they become due (other than any rent payments not paid in connection with the COVID-19 pandemic)” (see Chipotle Mexican Grill, Inc. credit agreement).

Prepayments

During the pandemic, some borrowers that are experiencing declining revenues may look to shore up their cash positions by other means, such as by selling assets, raising additional equity, or incurring other debt. Borrowers considering these actions should review their loan agreement’s mandatory prepayment provisions to ensure they do not undermine the borrower’s objectives. Mandatory prepayment provisions require the borrower to prepay a portion of the debt with the proceeds from certain actions. In leveraged loan
agreements it is typical for lenders to require prepayments of loans and, in some cases, reductions of revolving commitments with proceeds of asset dispositions, equity issuances, debt incurrence, excess cash flow, and extraordinary receipts (such as insurance proceeds).

The bullets below provide examples of recent credit agreement amendments that have addressed COVID-19 in debt and equity-related mandatory prepayments:

• Mandatory prepayments with net cash proceeds of equity issuances:

  • “in the event that the Borrower shall receive any Net Cash Proceeds from the issuance of Equity Interests of the Borrower at any time after the Amendment No. 3 Effective Date, the Borrower shall, no later than the third Business Day following the receipt of such Net Cash Proceeds, prepay the Loans in an amount equal to (x) if such Net Cash Proceeds are received at any time from the Amendment No. 3 Effective Date until the end of the Availability Period, the lesser of (a) 100% of such Net Cash Proceeds and (b) the amount required for the Covid Relief Borrowing Base Condition to be satisfied immediately after giving effect to such prepayment and (y) if such Net Cash Proceeds are received at any time after the Availability Period, the greater of (I) 50% of such Net Cash Proceeds and (II) the lesser of (a) 100% of such Net Cash Proceeds and (b) the amount required for the Covid Relief Borrowing Base Condition to be satisfied immediately after giving effect to such prepayment (and, solely in the case of this clause (y), the Commitments shall be permanently reduced by such amount)…” (see Monroe Capital Corporation third amendment).

• Mandatory prepayments with net cash proceeds of debt:

  • “In the event that any Obligor shall receive any Net Cash Proceeds from the issuance of Indebtedness at any time after the Amendment No. 3 Effective Date, such Obligor shall, no later than the third Business Day following the receipt of such Net Cash Proceeds, prepay the Loans in an amount equal to (x) if such Net Cash Proceeds are received at any time from the Amendment No. 3 Effective Date until the end of the Availability Period, the lesser of (a) 100% of such Net Cash Proceeds and (b) the amount required for the Covid Relief Borrowing Base Condition to be satisfied and (y) if such Net Cash Proceeds are received at any time after the Availability Period, 100% of such Net Cash Proceeds (and, solely in the case of this clause (y), the Commitments shall be permanently reduced by such amount)…” (see Monroe Capital Corporation third amendment).

Government Programs

In March 2020, the US Congress passed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). The CARES Act is intended to provide economic relief to individuals and businesses facing economic hardship due to the COVID-19 pandemic.

Under the CARES Act, the Small Business Administration (SBA) set up new loan programs for small businesses, including under the Paycheck Protection Program (PPP). PPP loans, which are forgivable loans on below market terms, can be used by eligible companies to help pay operational costs, including payroll, rent, health benefits, insurance premiums, and utilities. The US Federal Reserve (Fed), along with the Secretary of the Treasury, also established a Main Street Lending Program to mitigate the adverse economic effects of the pandemic. There are three loan facilities in the Main Street Lending Program and this program is expected to present similar issues to borrowers and lenders as the PPP, particularly in terms of permitting the additional debt to be added to the borrower’s capital structure and accommodating and requiring the borrower’s compliance with its terms.

For additional information on the CARES Act programs, see:

• Practice Note, Road Map to the Coronavirus Aid, Relief, and Economic Security Act (CARES Act).
• Practice Note, COVID-19: Federal Reserve Lending and Liquidity Facilities.
• Checklist, CARES Act: Small Business Administration Paycheck Protection Program: Lender Guidance.
• Checklist, CARES Act: Stimulus for Small Businesses Under the SBA.
• Checklist, Main Street Priority Loan Facility (MSPLF) Summary.
For examples of credit agreements and credit agreement amendments that have added provisions related to the government stimulus programs, see MiMedX Group Inc. first amendment, The Marcus Corporation first amendment, Cheesecake Factory Incorporated first amendment, Wireless Telecom Group first amendment, and AeroCentury Corp. loan and security agreement.

Looking Ahead

In the few months that COVID-19 has swept across the world and the US in particular, many companies’ businesses have been significantly affected, with some sectors of the economy suffering devastating declines. As a result, affected companies may need to seek modifications of their loan agreement terms to continue operating their businesses without breaching their loan agreement obligations. Given the level of uncertainty surrounding the pandemic and the trajectory of the US and global economy, the best course for borrowers and lenders is to be proactive and to keep open lines of communication so that they may anticipate problems under their loan agreements and take early action to solve them.

Although the discussion of loan term modifications in this Article is not intended to be an exhaustive survey, it provides examples of ways loan parties have dealt with COVID-19 in their loan agreements and Practical Law Finance will continue to monitor developments.
Useful Links and Websites

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Please find below a list of electronic links that our members may find useful:

1. www.lexology.com – In cooperation with the Association of Corporate Counsel, Lexology provides articles and practical tips relating to the practice of law.
2. The UCCLAW-L listerv is sponsored by West Group, publisher of the “UCC Reporting Service.” The listserve is an e-mail discussion group focusing on the Uniform Commercial Code. To subscribe to the UCCLAW-L listerv, go to http://lists.washlaw.edu/mailman/listinfo/ucclaw-l
5. Gonzaga University’s new Commercial Law Center has a variety of links to useful sites and can be accessed at https://www.law.gonzaga.edu/centers-programs/commercial-law/
6. The International Association of Commercial Administrators (IACA) maintains links to state model administrative rules (MARS) and contact information for state level UCC administrators. This information can be accessed at http://www.iaca.org
7. The Uniform Law Commissioners maintains information regarding legislative reports and information regarding upcoming meetings, including the Joint Review Committee for Uniform Commercial Code Article 9. You can access this information at http://www.uniformlaws.org/Committee.aspx?title=Commercial Code Article 9
10. The Secretariat of Legal Affairs (SLA) develops, promotes, and implements the Inter-American Program for the Development of International Law. For more information, go to http://www.oas.org/DIL/
11. The National Law Center for Inter-American Free Trade (NLCIFT) is dedicated to developing the legal infrastructure to build trade capacity and promote economic development in the Americas. For more information, go to http://www.natlaw.com

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