Buchalter

COVID-19 Alert

# *Commercial Finance & Leasing*

While there is still much uncertainty about COVID-19 and its long-term effects, there is no doubt that the virus has had a real impact on the commercial finance market. Many borrowers dependent on working capital lines and leveraged loans are showing signs of financial strain amid the spread of the virus. This is especially true for borrowers whose cash _ow and supply chains are dependent, either directly or indirectly, on customers and manufacturers under quarantine overseas.

As this sort of disruption continues to unfold with the spread of COVID-19, lenders should start to assess their rights and remedies under their existing commercial loan documents. And borrowers in the process of negotiating new commercial loans should carefully consider the risk and consequences of further business deterioration resulting from the virus. Below is a summary of issues and provisions that should be taken into consideration.

**Defaults, Forbearances & Workouts**

COVID-19 and its potential future effects on many businesses and industries will likely trigger a surge in defaults, forbearances and workouts. Thus, lenders should promptly undertake a review of their commercial loan documents, with counsel, for any deficiencies or so-called "soft-spots." This is especially the case if the loan was documented several years ago utilizing agreements that have since been updated with regulatory or legal changes, was heavily negotiated at closing, or has undergone a series of material amendments after closing.

Lenders and their counsel should pay particular attention to the grant and perfection of liens, the negative covenants, the MAC clause, how the financial covenants are calculated (especially EBITDA addbacks), and the lender's rights and remedies upon default. If the loan is syndicated, then agents and participant banks will also need to pay attention to voting rights, the amendment provision, and the so-called "yank-the-bank" provision.

**The MAC Clause**

In most commercial loan agreements, the lender may exercise remedies, refuse to lend, or terminate its commitment if a material adverse change (MAC) in the borrower's business, operations, prospects or financial condition has occurred. However, determining whether a MAC has occurred involves a detailed factual inquiry with an uncertain outcome. If wrong, the lender may be exposed to possible significant liability. For this reason, the MAC clause is notoriously difficult to invoke. It may be tougher to call a MAC for COVID-19 since the actual economic impact of the virus outside China thus far seems less severe than the financial markets' reaction. At the very least, the lender will need to show a sustained decline in the borrower's business or financial condition due to the outbreak or an unavoidable loss of material business that is reasonably expected to result from the spread of the virus. Lenders considering a MAC for any COVID-19 related issues should consult with in-house or outside counsel.