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COVID-19 NEWS OF INTEREST

The COVID-19 Pandemic: What Happens if a Lender Fails to Fund Its Commitment?

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OVERVIEW

As more borrowers draw down on their revolving credit facilities to meet liquidity and working capital needs amid the ever-changing landscape of the COVID-19 pandemic, a question that has surfaced is, "What are the consequences of a lender who is unable or refuses to fund its share of a borrowing request?" Although we have not seen any indication of lender failures in the current crisis, now is a good time to review the lessons of the last crisis and the protections that have been built into most modern credit agreements as a result.

Defaulting lender provisions made their way into financing agreements after the financial crisis of 2008 and subsequent bank failures, in response to market concerns about lender defaults under loan commitments. These provisions have become standard language in multi-lender financing agreements, particularly those with revolving components. Many defaulting lender provisions in financing agreements today are substantially similar to the sample defaulting lender provisions set forth in the Model Credit Agreement Provisions published by the Loan Syndications and Trading Association, more commonly known as the LSTA.

Given the day-to-day uncertainty in the financial markets created by COVID-19, we expect more borrowers to attempt to shore up their liquidity by drawing on their revolving credit facilities, increasing pressure on lenders. As of today, lenders have continued to meet their commitments and fund revolving loans (and other committed financing on demand); however, if this crisis continues for an extended period, and more borrowers draw on their lines of credit, borrowers will be well-served to take a closer look at their rights and remedies in the event a lender fails to fund a requested draw.

WHAT IS A DEFAULTING LENDER?

Financing agreements describe defaulting lenders in various ways, but commonly a defaulting lender is, among other things, a lender that:

(a) has failed to fund (i) all or any portion of its loans within X number of days of the date such loans were required to be funded, unless the lender has notified the borrower, agent, letter-of-credit issuer or any other lender in writing that its failure to fund is due to its belief that the conditions that the borrower must meet to be funded have not been satisfied, or (ii) any amount owed to the agent or any other lender;

(b) has given notice to the borrower, agent, letter-of-credit issuer or any other lender in writing that it does not intend to comply with its funding obligations, or has made a public statement to that effect, unless such writing or public statement relates to such lender's obligation to fund a loan hereunder and states that such position is based on such lender's determination that a condition precedent to funding cannot be satisfied; or

(c) has failed to confirm in writing to the agent and the borrower that it will comply with its prospective funding obligations within X number days of the date of any request by the agent or borrower for such confirmation.

Whether a lender meets the requirements of being a defaulting lender is typically determined by the agent, and the agent's determination is conclusive and binding absent manifest error, upon written notice from the agent to such lender.

PROTECTIONS FOR BORROWERS IN RELATION TO DEFAULTING LENDERS

The obligations of lenders to fund their share of commitments in financing agreements are several. Each lender's obligation to fund is its own obligation. One lender cannot refuse to fund because another lender failed to fund, and no lender is required to fund any portion of a loan that was to be funded by another lender.

In the event that a borrower has met all of its obligations to draw on its line of credit and a lender fails to provide its portion of the funding, the borrower can sue the defaulting lender for breach of contract; however, litigation can be expensive and time-consuming, financing agreements may contain certain waivers that could limit the damages available to the borrower in litigation and litigation doesn't solve the borrower's immediate need for liquidity.

Borrowers can also look to immediate remedies under the terms of their financing agreement. Protections available to borrowers against defaulting lenders may include provisions that permit the following:

(a) *Replacement of Defaulting Lenders.* Borrowers can invoke "yank-a-bank" provisions to replace a defaulting lender with a lender selected by the borrowers at the cost and expense of the borrowers. However, replacing

defaulting lenders requires borrowers to repay their outstanding loans at par, in which case, borrowers may not find a cost-effective replacement if the loans are trading at a significant discount on the secondary market; plus the costs and expenses of replacing a defaulting lender are additional costs borne by borrowers.

(b) *Termination of the Commitments of Defaulting Lenders*. Borrowers can terminate the unused commitments of a defaulting lender on a non-pro rata basis, notwithstanding that commitment reductions typically require such reductions to be pro rata among all of the lenders. However, similar to the issue faced with replacing lenders, borrowers are required to repay the outstanding loans at par in connection with a commitment reduction. Additionally, borrowers lose borrowing capacity that cannot be reinstated.

(c) *Withholding of Fees Payable to Defaulting Lenders*. Borrowers can retain fees that would be payable to a defaulting lender on the undrawn portion of its commitment. Some financing agreements require borrowers to continue paying such fees, but they are distributed by the agent to the non-defaulting lenders.

(d) *Limitation of Voting Rights of Defaulting Lenders*. Defaulting lenders are typically excluded from the definition of “Required Lenders” and are not entitled to vote on matters, including matters requiring the vote of 100% of the lenders, unless such matters affect certain fundamental rights, such as the increase of a defaulting lender’s commitment, reduction of payments, and extension or postponement of payments.

CONCLUSION

The aforementioned protections offer options to borrowers in dealing with defaulting lenders; however, these protections do not make up for the immediate shortfall of the liquidity and working capital needs of borrowers to finance operations, and in some cases, as mentioned above, the protections actually place additional costs and responsibilities on borrowers.

In order to ensure that borrowers have access to their liquidity and to mitigate risks associated with defaulting lenders, borrowers anticipating drawing on lines of credit should be proactive in communicating with their agents and lenders to discuss any funding concerns and options in the event that a lender defaults in its funding obligations beyond what is set forth in the financing agreement.

We at Willkie remain committed to providing legal advice and services to all of our clients. We are available should you wish to discuss any of your options in relation to defaulting lenders as well as any other legal concerns or issues you may face in light of this unprecedented public health crisis. Please feel free to reach out to any of us with any questions you may have.

Willkie has multidisciplinary teams working with clients to address coronavirus-related matters, including, for example, contractual analysis, litigation, restructuring, financing, employee benefits, SEC and other corporate-related matters. Please click here to access our publications addressing issues raised by the coronavirus. For advice regarding the coronavirus, please do not hesitate to reach out to your primary Willkie contacts.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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