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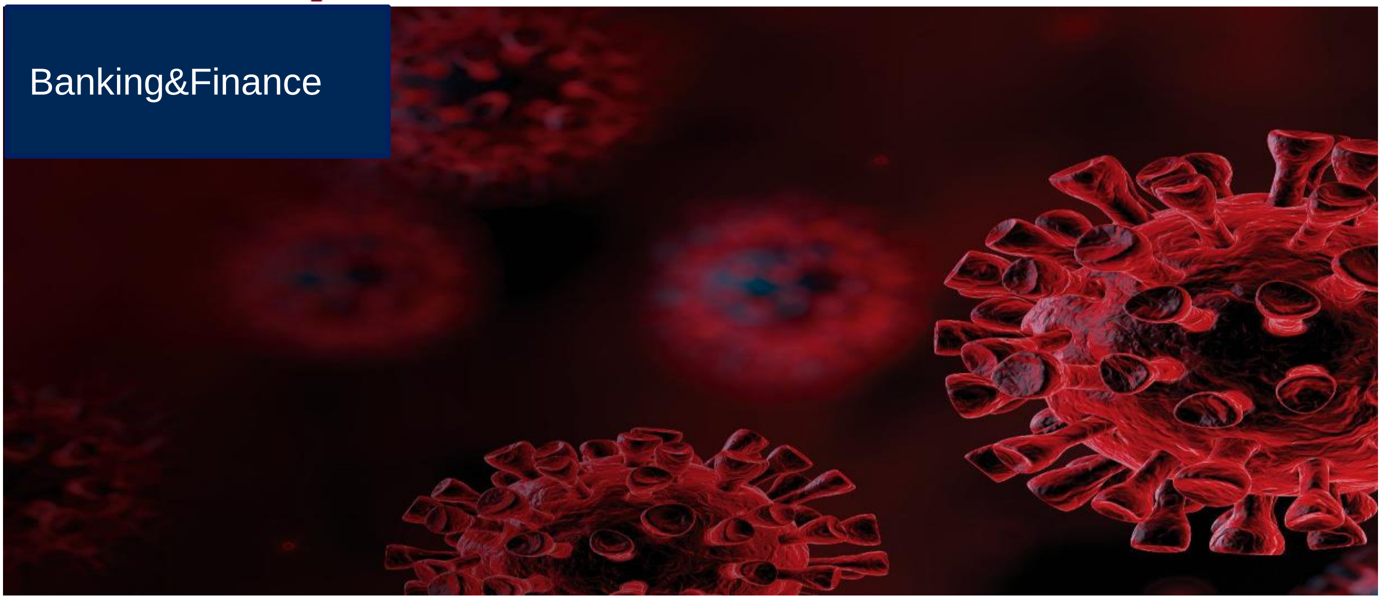

COVID-19: Pandemic Warrants Another Look at Your Finance Documents

The COVID-19 outbreak has had a snowball effect, disrupting the operation of global and local macroeconomic system. Considering this rapidly changing situation, companies, sponsors, banks and other financial institutions need to be aware of the potential financial, regulatory and legal consequences for their business.

In this article, we elaborate the key issues arising from the COVID-19 outbreak that apply to existing and new finance structures, which we believe warrants a closer look.

1. Financial Covenants

<u>Traditional Loans</u>: A traditional loan is a lender-friendly type of loan facility, generally with protective covenants incorporated into the loan agreement for the safety of the lender, including financial maintenance tests that assess the debt-service capabilities of the borrower. Maintenance financial covenants generally require a borrower to maintain certain ratios (e.g. loan to value ratio, debt to equity ratio, leverage ratio, interest coverage ratio) and any breach of a maintenance covenant may trigger an event of default under the relevant loan agreement. The effect of this clause is that the lender becomes allowed to intervene if the borrower does not meet certain performance criteria tested at regular intervals due to the deterioration of its financial condition. Since COVID-19 may have an adverse impact on a borrower's financial status and this may result in a breach of the maintenance covenants, the lenders will need to carefully analyze the borrower's financial statements, the terms of the covenant itself and the rights granted to the lenders in case of a breach.

<u>Covenant-Lite Loans</u>: Covenant-lite loans offer a more flexible approach, with fewer restrictions on the borrowers and fewer protections for the lender. The core feature of covenant-lite loans is the absence of financial maintenance tests. Instead, these loans typically have a covenant package with components similar to high-yield bonds. Under covenant-lite finance structures, all maintenance financial covenants are replaced with incurrence financial covenants that are only tested when the borrower takes certain specified steps such as incur debt, issue a prohibited dividend, or make an unpermitted acquisition. In this respect, despite the borrower's financial distress, no financial covenant event of default would be triggered solely on the basis of the financial deterioration of the credit.

<u>Revolving Loans</u>: As revolving credit facility ("**RCF**") lenders were uncomfortable extending loans without any financial covenant protection, the market practice evolved to include at least one maintenance financial covenant in RCF agreements, which the lender will test only if the RCF exceeding a minimum threshold is drawn on the relevant test date (this feature is known as a "springing covenant"). A financially healthy borrower is typically able to manage cash flows so that this testing threshold is not exceeded on the relevant test date. However, COVID-19 may have an adverse impact on activity levels and supply chains that may result in greater working capital needs and the un-forecasted testing of springing covenants. Whether this will result in a breach of the springing covenant will require careful analysis of the borrower's financial statements and the terms of the relevant springing covenant itself. In the light of the foregoing, the lenders will need to assess the borrower's financial health by following the fluctuation of the aggregate amount of drawdown requests before the testing date.

Adjustment Provisions: Lenders should assess whether any additional cure rights (such as equity cure) are granted to the borrower in respect of financial covenant breaches.

2. MAC/MAE Clauses

The terms "material adverse effect" and "material adverse change" are drafted broadly and with some variety for top-tier sponsors and corporates. As such, it is necessary to analyze the specific clause wording on a case-by-case basis to consider whether the COVID-19 outbreak is relevant. Lenders may consider whether an express carve-out from the MAE definition for COVID-19 is appropriate. However, as we have seen when facing other macro-economic headwinds (most notably the global financial crisis, and more recently the US/China trade tensions and Brexit), lenders have traditionally looked for more demonstrable matters of fact, such as non-payment, before taking steps to accelerate or enforce a capital structure. Nevertheless, the material adverse change event of default might afford revolving facility creditors the opportunity to refuse to fund new (non-rollover) utilizations of the revolving facility, which may have significant consequences for liquidity constrained borrowers.

To the extent that the finance documents include a material adverse change event of default or representation, lenders should assess whether the current impact of COVID-19 would meet the definition of a material adverse change. If it does not, they should consider whether this situation might arise over time as the COVID-19 outbreak continues and consider the consequences of a material adverse change under the relevant finance documents.

MAE Drawstop: RCF lenders should consider whether the material adverse change event of default defined under the finance documents allow the lender to refuse to fund new utilizations of the RCF, which may have serious consequences for borrowers facing financial distress.

3. Funding Conditionality

Uncommitted Facilities: Under the uncommitted facility structure, in which the lender is not obligated to fund the borrower upon a drawdown request, the lender will not be exposed to any adverse effect of financial fluctuations created by the COVID-19 outbreak since the lender can freely reject a drawdown request at its sole discretion.

Committed Loans: The obligation of the lenders to fund under a signed but undrawn committed loan agreement is subject to (i) the satisfaction of numerous evidential and documentary conditions precedent; (ii) the making of several undertakings regarding the transaction by the borrower (and any guarantors) to the lenders; and (iii) certain representations continuing to be accurate (including "no default/no MAE/no MAC" representations). Failure to comply with these conditions gives rise to a “financing out”, entitling the lenders to walk away from their financing commitment. Accordingly, the lenders should consider whether the borrower’s ability to satisfy these conditions precedent is impacted by the COVID-19 outbreak.

4. Organizational Pitfalls

The COVID-19 outbreak has forced businesses around the world to adopt remote-working solutions and implement a technological infrastructure that allows the organization of online meetings and calls. Considering its remote-working policies and international travel restrictions, financial institutions should create alternatives to face-to-face meetings and signing organizations, especially for multi-jurisdictional transactions.

In this respect, we recommend banks to use electronic signatures instead of handwritten (wet) signatures to avoid falling into operational pitfalls. Under Turkish law, the main legal framework for electronic signatures is under the Electronic Signature Law No. 5070 (“**E-Signature Law**”).

Pursuant to the E-Signature Law, only secure signatures are accepted to have the same powers as handwritten (wet) signatures. Article 4 of the E-Signature Law defines a “secure e-signature” as an electronic signature that meets the following requirements: (a) it is exclusively linked to the signatory; (b) it is capable of identifying the signatory based on a “qualified electronic certificate”; (c) it is created using a secure electronic signature creation device, which is under the sole control and at the disposition of the signatory; and (d) it is linked to the data to which it relates in such a manner that any subsequent change of the data is detectable.

Conclusion

The COVID-19 outbreak raises numerous significant issues of sanitary, social and economic natures. While the COVID-19 recession sends the global economy into hibernation, financial institutions will need to carefully analyze the long-term implications of COVID-19 to minimize financial losses.

Please stay up to date with further developments at the Esin Attorney Partnership Coronavirus Helpdesk.