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Corporate Liquidity and the COVID-19 Pandemic

Borrowers across the credit spectrum and in a wide range of industries are working to develop and implement strategies to ensure they have sufficient liquidity to withstand the uncertain and expanding effects of COVID-19 (including tightening of commercial paper markets, widening of risk spreads, prolonged quarantines and store closures, contraction of consumer demand, shocks to the global supply chain and potential credit rating downgrades). And topping their list of key questions: whether, when and how much to draw on existing lines of credit.

Unlike in 2008, when the lack of bank liquidity was at the root of the financial crisis, so far bank liquidity (buttressed by multiple recent monetary policy moves) has been a source of strength. But companies must still weigh a number of critical considerations in making treasury management decisions in the coming days, weeks and months, including the following:

- **Assess Funding Conditions.** Understand the conditions to borrowing in the company's lines of credit, and evaluate the company's ability to satisfy them—not just today, but also in a forward-looking downside case. Borrowing conditions in revolving credit facilities typically include absence of defaults (including compliance with all affirmative and negative covenants, some of which could cause minor foot-faults, and financial maintenance tests) and the accuracy of representations and warranties (including, often, as to no "material adverse effect" and solvency). Borrowers that are uncertain they will be able to satisfy these conditions tomorrow should consider drawing today.

- **Message to the Market.** Coordinate internally and with appropriate advisors on whether and how to publicly announce any new borrowings, giving due consideration to whether investors and trade creditors are more likely to see the borrowing as a sign of impending liquidity issues, or rather as a responsible step to ensure safety. For public companies that conclude their borrowing is "material," disclosure on an 8-K will be required.

- **Base Rate vs. LIBOR Loans.** Weigh the cost of funds versus the speed of funding. In the current market environment, companies may be inclined to borrow based on the "LIBOR rate." But those in particularly challenged positions should consider requesting initial borrowings at the more expensive "alternate base rate," which borrowings are typically available on substantially shorter notice (same-day or next-day, versus 3-business days for LIBOR borrowings), and subsequently "converting" into LIBOR loans. This approach expedites the borrower's access to capital, and the later conversion typically does not require the borrower to bring down its representations (though borrowers should confirm this in advance).

- **Consider the Counterparties.** Understand who the lenders are. While traditional money center banks may be reluctant to assert a failure of funding conditions or call a default in ambiguous situations, other types of financial investors may be more aggressive. For instance, distressed borrowers with partially funded revolving credit facilities may find that their banks have—perhaps unbeknownst to the borrower—"participated" their commitments to funds which may be more aggressive in considering whether or not to fund.

- **Limitations on Liability.** Analyze the lenders' incentives with respect to funding requests. Nearly every credit agreement includes a consequential damages waiver; this provision reduces lenders' potential downside in rejecting a borrowing request. Also potentially problematic: the (somewhat common) failure to exclude from the borrower's indemnity obligations damages arising from the lenders' own material breach of their obligations (as opposed to just their "willful misconduct" and "gross negligence").

- **Critical Communication.** Maintain a constructive and ongoing dialogue with key sources of financing. Fostering these relationships is critical in challenging times.

As ever, clear-headed analysis and thorough preparation are key to weathering choppy financial markets. Companies should remain pro-active, and, in circumstances of doubt, should err on the side of maximizing liquidity.

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