

COVID-19: Preparing for Counterparty Distress or Insolvency



The full ramifications of the COVID-19 pandemic are uncertain, but we should expect that significant economic dislocation will be felt not only by industries already suffering from financial distress and seeking bankruptcy relief (retail, healthcare, small biotech, pharma companies, and energy) but many other industries, including manufacturers, carriers, shippers, and companies in the hospitality and entertainment industries.

We highlight below certain measures that companies should consider taking in connection with the economic impact of COVID-19 and the likely uptick in bankruptcy filings by counterparties laboring under a liquidity crisis caused by the economic slowdown.

1

Material Contracts

Important contracts should be reviewed with attention paid to provisions that may be triggered by the inability to perform. These include force majeure clauses, termination rights, insurance procurement clauses, and minimum requirements provisions. Know your counterparty. Maintain open communications to obtain whatever insight you can into their current financial situation and business plans. Determine whether there are viable alternatives for sourcing needed supplies or services and whether termination of your existing contract is an option. Remember that in the event of a bankruptcy filing by a counterparty, the automatic stay will prevent you from terminating your contract. If termination of a contract is otherwise a desired and available option, the termination right should be exercised prior to your counterparty's bankruptcy filing. Alternatively, there may be an opportunity to renegotiate your contracts on more favorable terms prior to the commencement of a bankruptcy case.

2

Intellectual Property Licenses

Review your software and other IP licenses and related escrow agreements and manufacturing agreements to determine the scope of your IP rights, including springing license rights, escrow release triggers, and other provisions that may be exercised prior to bankruptcy based on financial or other conditions.

3

Financing Arrangements

Review loan documents and other financial arrangements to ensure compliance with operational and financial covenants. Determine whether MAC clauses or other defaults have been triggered or negatively impact your ability to draw down under your credit facilities. Keep an open line of communications with your lenders but review whether alternative financing options exist.

Transactions

An increase in bankruptcy filings may provide an opportunity to acquire distressed assets in a manner that provides you with significant protections from successor liability and fraudulent transfer liability. The opportunities will be available to strategic buyers as well as financial buyers such as private equity or other funds with sufficient capital and the ability to make decisions and act quickly to participate in a bankruptcy auction process. Similarly, as borrowers experience financial distress opportunities may also arise for distressed debt investments, the implementation of loan-to-own strategies, the making of debtor-in-possession loans, or similar debt transactions.

Covington has significant experience guiding clients through the myriad of issues that arise from the insolvency of business partners and counterparties. Our restructuring team is seasoned in guiding management teams, lenders, creditors, counterparties, and other constituencies through challenging periods of economic turbulence. If you have any questions regarding the impact of bankruptcy on contractual rights or preparation for insolvency risks, please contact any of the following members of our Bankruptcy and Restructuring Practice.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Restructuring and Bankruptcy practice:

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