CARES Act Loans and SPE Borrowers

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SPE borrowers should carefully review their existing loan documents when considering loans under the CARES Act to relieve liquidity pressures. Existing loans may contain SPE covenants or other provisions that limit additional indebtedness, trigger recourse liability or create defaults if additional indebtedness is incurred or statements are made that a party is unable to pay its debts as they become due. A PPP Loan or an Economic Disaster Injury Loan may violate such SPE covenants and/or potentially trigger unexpected partial or full recourse liability on the part of unwary guarantors.

Most SPE covenants limit additional indebtedness to trade debt not exceeding 3% or so of the original loan amount, prohibit such debt from being evidenced by a note and require that it be paid off within 60 to 90 days. An SPE borrower’s organizational documents usually contain similar restrictions and SPE covenants typically require strict compliance with organizational documents. In addition, nonrecourse carve-outs often make guarantors personally liable for SPE covenant violations and, in the case of subordinate financing, the full amount of the senior debt.

Many loan agreements treat written statements that a borrower is unable to pay its debts as they become due as a default and/or recourse trigger. Recourse guarantees often treat such statements as a full recourse event that makes the guarantor personally liable for the full amount of the loan. A written request for a loan modification or forbearance stating that such relief is needed because revenues are not sufficient to pay existing principal or interest could constitute such an admission. A recent NY case suggests that such a statement could become a source of guarantor liability.

In D.B. Zwirn Special Opportunities Fund, L.P. v. SCC Acquistions, Inc., 74 A.D 3d 530, 902 N.Y.S. 2d 93 (N.Y. - 1st Dept. 2010) a lender claimed that financial reports showing that a borrower’s liabilities far exceeded its assets effectively constituted a written admission that the borrower was unable to pay its debts as they became due and triggered personal recourse liability for the guarantor. The borrower delivered the financial information to the lender in conjunction with a request to restructure the loan. The Court concluded that merely sending financial information to a lender showing financial difficulty, without an express statement of the borrower’s inability to pay its debts, was not an admission that satisfied the springing recourse provision. However, if the borrower had made such a statement in an accompanying letter, the court basically said that this would have triggered the springing full recourse provisions and resulted in personal liability for the guarantor.

Most courts strictly construe nonrecourse carve-outs. In the case of additional indebtedness, recourse guarantors have been held personally liable for the full amount of the senior debt even where junior debt was paid off and the associated lien removed before senior lender even learned about it. (See CSFB 2001-CP-4 Princeton Park Corporate Center, LLC v. SB Rental 1, LLC, 980 A. 2d 1 (N.J. Super. Ct. App. Div. 2009)).

When considering a loan under the CARES Act borrowers subject to SPE requirements and nonrecourse carve-outs need to review not only the applicable SPE covenants but any related nonrecourse carve-outs as well. Definitions of “Permitted Indebtedness” should also be reviewed. We can assist you in the review of your current loan documents.
Ideally, any senior lender consent to a CARES Act loan would state that such indebtedness, and any request or documentation submitted in connection therewith, will not be deemed to be a default or violation of any SPE covenant or organizational document of the borrower, or trigger, by itself, any personal recourse liability on the part of a guarantor.

For more information on the matters discussed in this Locke Lord QuickStudy, please contact the author.

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