

You're in Breach... Now What?

A Practical Guide to Waivers and Consents for Private Equity Companies and Portfolio Companies

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The best-structured loan covenants in credit facilities are flexible enough to allow a borrower to grow, while reducing the lender's risk of loss. However, many models and projections underlying those covenants are at risk of becoming obsolete as the global economy shifts to a new, and still emerging, landscape. The majority of CEOs surveyed now [expect](#) an economic recession in the next 12 to 18 months. As supply chains continue to be delayed and fractured with no end in [sight](#), and financial markets experience record volatility, businesses across the economy are being stymied by unprecedented uncertainty. Over the past few months, we have seen a number of portfolio companies of private equity firms need waivers or consents from covenants in their credit facilities at a rate we haven't seen since the beginning of the COVID-19 pandemic.

Factors to Consider

Private equity companies and their portfolio companies should weigh the legal, business, and practical factors when requesting waivers and consents. While these terms are often used interchangeably, waivers and consents are fundamentally different.

A consent should be requested when a portfolio company is seeking approval for a one-time action prohibited under the loan agreement (or is looking for permission to avoid taking a required action) — typically, a forward-looking request. Failure by a borrower to obtain any consent required under the terms of its loan agreement is usually an event of default, giving the lender the right to exercise certain remedies. In contrast, a waiver should be sought for a breach of a covenant after the fact.

The business and practical considerations in connection with waivers and consents include:

- **Equityholder Reporting.** Private equity sponsors and their portfolio companies may not want to deliver a waiver to their ultimate equityholders and co-investors because waivers involve companies admitting to, and taking responsibility for, a default. In this situation, a portfolio company may want to ask its lender if, instead of drafting the document in the form of a waiver for a breach, a “retrospective” consent can be given.
- **Negotiating Power.** Portfolio companies have more bargaining power prior to the occurrence of a default, especially if the default could trigger consequences, such as cross-defaults to material agreements. A portfolio company may want to push for a consent if it knows that trouble lies ahead.

- **Frequency of Requests.** A waiver or consent is intended for a one-time action. If a portfolio company prefers a permanent change, it should ask for an amendment to the loan agreement instead of a waiver or consent.
- **Types of Requests.** Common request triggers include:
 - **Add-on Acquisitions:** If not already permitted, add-on acquisitions generally require a consent prior to signing a purchase agreement to avoid a breach, and in some cases, a consent may be needed before execution of a commitment letter.
 - **Financial Covenants:** Missing a financial covenant typically requires a waiver after the fact. Lenders are reluctant to prospectively consent to financial covenant breaches.
 - **Deliverables:** Failure to provide a deliverable, such as an audited financial statement, could require either a waiver or consent depending on the situation. If the auditors have signaled that they will not be able to complete their audit in the required time window, then it is common to request a consent to a late delivery.
 - **Dispositions:** If a portfolio company is planning any significant asset sale, it should review its credit documents and obtain any necessary consent before such disposition to avoid a breach.
 - **Other Common Triggers:** Incurring debt, granting liens, entering into joint ventures, and making distributions or dividends, in each case not expressly permitted under the loan agreement.
- **Timing.** Portfolio companies should confirm with their counsel how the following considerations may delay the timing of the proposed action:
 - If the consent will involve additional credit underwriting, credit committee, or other internal lender approvals.
 - If the consent requires all lender or super-majority lender approval (see below).
 - If the consent has specialized or cross-border elements or conditions that require additional diligence, local counsel, or documentation.
 - If the lenders are imposing special conditions to the effectiveness of the consent, such as collateral security steps, especially those involving third parties like insurance brokers, landlords, and depository banks.

Required Lenders

In a syndicated or multilender facility, it may be necessary to obtain the consent of all lenders to make certain consents and waivers effective. A syndicated facility may have a “required lender” concept wherein a subset of the lenders is needed to waive or consent certain actions. This amount may be from 51% to 75% of the outstanding principal and commitments of the lenders. In contrast, other actions require 100% lender approval, such as altering any of the economic fundamentals of the loan agreement (including the payment schedule,

interest rate, and maturity date). For required lender actions, it may be a good idea to obtain signoff by minority lenders to avoid any discontent, even if their consent is not technically required.

Other Breaches/Other Amendments

Portfolio companies should confirm that all potential breaches in connection with any action are discussed with their counsel. For instance, if a portfolio company is incurring debt in connection with an acquisition for which it is seeking a consent, the portfolio company should get consent to the incurrence of the acquisition debt. It could also request an amendment to the financial covenants in the loan agreement to account for the acquisition debt. The portfolio company and their counsel also should confirm that no covenants in the other loan documents, such as the security documents or any subordinated debt, need to be waived.

Additionally, if the loan agreement is being amended, the portfolio company may want to take the opportunity to review, in light of financial results and operating projections, whether any other changes to the loan agreement should be made that are not related to the proposed action. In this way, the portfolio company can avoid having to later incur the costs of a standalone amendment.

Finally, when seeking a waiver for an event of default, it is important that the portfolio company review all the related notice requirements. The portfolio company should ensure that it has given notice of the proposed action to all required parties within the time frames required by the loan agreement. A portfolio company's negotiating position will be weaker if a default is mishandled in a way that creates more defaults and the appearance of withholding information.

Conditions

Lenders can require conditions in exchange for entering into a waiver or consent. Lenders may require a fee that could be a percentage of the commitment amount or a flat fee, as well as legal expenses. Lenders may require additional diligence, such as pro forma financial statements, after giving effect to the proposed action. If debt or equity is issued in connection with the proposed action, lenders may require that the loans be prepaid with the proceeds. Regarding legal documentation, lenders may require corporate authorizations, acknowledgments, and consents by all loan parties, as well as reaffirmations of the representations and warranties in the loan documents, including that there are no defaults both before and after giving effect to the proposed action.

Conclusion

As financial conditions continue to be volatile across industries, most lenders are sympathetic to changing circumstances that could lead to a waiver or consent, but it is paramount to keep the lines of communication open between lender, portfolio company, sponsor, and legal counsel to ensure there are no surprises.

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