

MANAGING DEBT COVENANTS IN HARD TIMES

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To say that current economic conditions are challenging for broadcasters is akin to noting that the Ice Age was chilly.

Like many industries, consolidation and growth were fueled by the easy availability of capital, and now broadcasters struggling under the weight of reduced advertising sales and large debt payments must also struggle to meet their loan covenants.

For those of us involved in both the regulatory and transactional sides of the industry, 2009 threatens to be the year that bankruptcies, loan workouts and alternative financing arrangements exceed all other major transactions.

In working with both broadcasters and their creditors seeking to navigate these dark waters, we have crafted some basic “rules of the road” that make it easier to both assess and preserve your options going forward.

At the outset, the most obvious piece of advice—and advice that is too often ignored—is that in today’s difficult financial environment, broadcasters need to continually focus on their relationships with their lenders.

Rather than avoiding such conversations as the risk of violating a loan covenant grows, broadcasters should actively engage their lenders, even if they find such discussions uncomfortable.

These discussions will help to build the lender’s comfort level that there are no surprises lurking around the corner and that the broadcaster is cognizant of its obligations to the lender and is working diligently to meet them.

A lender is far more likely to work with such a borrower to achieve a mutually beneficial result than when it learns from others that the borrower is struggling but has said nothing, or learns of problems only after the borrower has missed a payment or violated a loan covenant.

Also remember that in most circumstances, neither the broadcaster nor the lender wants a foreclosure. Foreclosures are typically a lose/lose proposition for both parties (although obviously worse for the broadcaster).

This is the context in which negotiations to restructure a loan occur. The lender wants to construct a path that leads predictably to the recovery of its investment, while the borrower is typically focused on delaying the lender’s enforcement of its legal remedies.

Buying this additional time can be costly, however, and a borrower and its legal counsel must weigh carefully the effects on a borrower of giving up certain rights and protections while trying to reach agreement to restructure a troubled loan.

This can be challenging, as a borrower with a loan in or near default often considers itself in a desperate situation. In such circumstances, the borrower is anxious to avoid the onset of an “event of default” or, if a default has already occurred, to keep the lender at bay while it tries to right its economic ship.

In this regard, the interests of the broadcaster and its lender may not be that different. Lenders generally prefer receiving loan payments (even if those payments need to be restructured) to the time and expense associated with foreclosing on collateral.

This is particularly true for borrowers holding FCC licenses, which the law does not permit to be subjected to traditional security interests. Most lenders do not want to be in the business of running broadcast stations and complying with the FCC’s myriad ownership and other rules.

Having said that, lenders are certainly going to seek concessions for loan modifications and delaying their pursuit of legal remedies. These concessions are usually aimed at ensuring that the lender’s security interests in the collateral are not adversely affected and streamlining enforcement of the lender’s remedies if the proposed restructuring ultimately fails.

Concessions demanded may include:

- Acknowledgment of the amount of the indebtedness and of the default.
- Waiver of defenses and claims or counterclaims against the lender.
- Waiver of notice and grace periods and immediate acceleration of the indebtedness upon a default under the restructured loan.
- Execution and delivery in escrow to the lender of title (e.g., a bill of sale, deed, etc.) to the collateral in lieu of foreclosure (to be invoked upon a future event of default).
- Consent to entry of a foreclosure judgment (upon commencement of a foreclosure action by the lender upon a future event of default).
- Securing obligations with additional collateral.
- Prior consent to lifting the automatic stay against foreclosure in the event of the borrower’s bankruptcy.

While a borrower may believe it has no choice but to accept these terms from the lender, the effect of losing these rights must be weighed carefully and defenses to the lender’s actions considered.

If the alleged default is a payment default, there may be a dispute about the lender’s calculation of the interest rate or of the amounts due. Also, while claims for lender liability are often unsuccessful, the lender’s behavior in a specific situation could have been sufficiently culpable as to make it more flexible in negotiations rather than risk having to later defend its actions.

Finally, a borrower must make a realistic assessment of whether it can comply with even restructured loan terms.

Hard questions include:

- Is the default the result of a temporary situation or a long-term problem?
- Is there sufficient cash flow to meet the restructured payment terms?
- Is a refinancing or a quick sale of one or more stations or non-core assets a realistic alternative if the restructuring fails?

A default under a restructured loan will generally leave the borrower in a much weaker position than the initial default. Depending on the terms of the forbearance agreement and the enforceability of some of the lender’s remedies, (i) the lender will usually have faster and easier means to take the property (other than the FCC licenses), (ii) the borrower (and guarantor) may now have liabilities secured by collateral that previously were unsecured liabilities and (iii) the borrower’s earlier defenses and claims against the lender may be lost or diminished with some of the borrower’s rights in bankruptcy compromised as well.

While loan restructurings and workouts can help buy critical time, a broadcaster and its legal counsel should consider carefully whether the price is worth paying. Such an analysis must necessarily take into account what alternatives may be available, and whether the proposed restructuring will allow the broadcaster to extract itself from a financial predicament or merely dig itself a deeper economic hole.