

Considerations for a Possible Debt Ceiling Standoff

February 2, 2023

On January 19, 2023, the U.S. Treasury announced that it had reached the so-called “debt ceiling.” While a divided Congress negotiates an increase in the debt ceiling with the White House, the United States risks a default as soon as June 2023. In the interim, the U.S. Treasury is taking extraordinary measures to avoid what would be, at best, a disruptive and, at worst, a catastrophic economic event. Senior management, boards of directors and private equity sponsors would be well-advised to evaluate the potential consequences of any such default on their companies and portfolio companies, and plan for actions that could be taken at the appropriate time. In this brief note, we highlight potential action items for consideration.

- **Board Preparation and Discussion.** Hold a risk management-focused discussion at a near-term board meeting led by senior management to prepare the board of directors for the impact of a possible U.S. default on the company and to identify actions the business could take to prepare for how to respond.
- **Investment Committee Preparation and Discussion.** Similarly, private equity sponsors should hold a portfolio-wide review of the potential impact of a possible U.S. default on each of its portfolio companies and identify specific actions each portfolio company can take to respond based on its particular industry and exposure to a potential U.S. default.
- **Financing and Liquidity.** Consider available sources of company liquidity, including whether and when to draw down on any established lines of credit. Revolving lines of credit typically require certain conditions to be satisfied prior to a draw, including bringing down a no material adverse effect representation, so companies should consider their current and future ability to comply with those conditions when considering whether they should draw. Private equity sponsors could evaluate fund-level financing sources, whether existing or newly established, including NAV facilities in addition to traditional subscription lines and re-evaluate reserves for follow-on investments.

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- **Capital Markets Access.** In the event that the impasse leads to a government shutdown, agencies like the U.S. Securities and Exchange Commission may not be open for business, which may prevent registration statements from being declared effective or EDGAR from being available for filings to be made. Companies without an available shelf registration statement (or those with a shelf registration statement expiring in the near term) should consider filing a new shelf in order to eliminate a potential hurdle to accessing the capital markets.
 - **Disclosure.** As companies prepare to release their Annual Reports on Form 10-K, they should consider whether updated risk factor disclosure is necessary or appropriate to highlight the risk of a U.S. government default on the company. Similar disclosure could also be made in the first quarter Form 10-Q, if a default is still a possibility at that time. Augmented MD&A disclosure may also be appropriate, particularly as it relates to known trends or uncertainties that may impact the business as a result of any U.S. government default or shutdown, including any liquidity and capital resources concerns. Private equity sponsors should consider whether updates are needed to fund marketing materials, including case studies, pitch books and private placement memorandums.
 - **Investor Relations.** Investor relations and communication teams at companies and private equity firms could begin preparing questions and answers relating to the impact of a U.S. government default or shutdown on the business of the company or portfolio. As always, Regulation FD obligations should be kept front of mind as the company engages with investors.
 - **Government Relations.** Companies and sponsors consider whether their government relations teams or other lobbying efforts could have influence on where U.S. government spending may be reduced or other aspects of a potential compromise to the current stalemate. In addition, companies and private equity sponsors should consider any impact arising from the potential inability to interact with government agencies in the ordinary course or in the context of a transaction due to their closure.
 - **Constituent Communications.** Communications, human resources, supply chain management and other internal teams could contemplate and draft the communications that may be necessary to address concerns of their respective constituents, including employees, customers, suppliers and vendors.
 - **Contractual Obligations.** As companies consider entering into material agreements that include so-called material adverse effect or material adverse change provisions, consider whether a U.S. government default or shutdown should be carved out of that provision to avoid the impact thereof on a business resulting in a right to

terminate the relevant contract. Similarly, companies could consider whether agreements that include *force majeure* clauses should relieve the parties from performing their contractual obligations in the event of a U.S. government default or shutdown. In addition, companies could undertake a review of their existing material agreements containing these types of provisions to determine their and their counterparties' respective rights in these circumstances.

While the White House and U.S. Congress seem to be making some progress in discussions on raising the debt ceiling, the sharply partisan nature of political discourse in the United States today raises the possibility that this time may be different and a compromise may not be reached before the U.S. Treasury exhausts its extraordinary measures. In that unfortunate situation, having spent time now thinking about the various potential impacts of such an event on the company's business and how the company may react could pay dividends. We are available to discuss any of the foregoing or other considerations at your convenience.



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