TRENDING TOPIC

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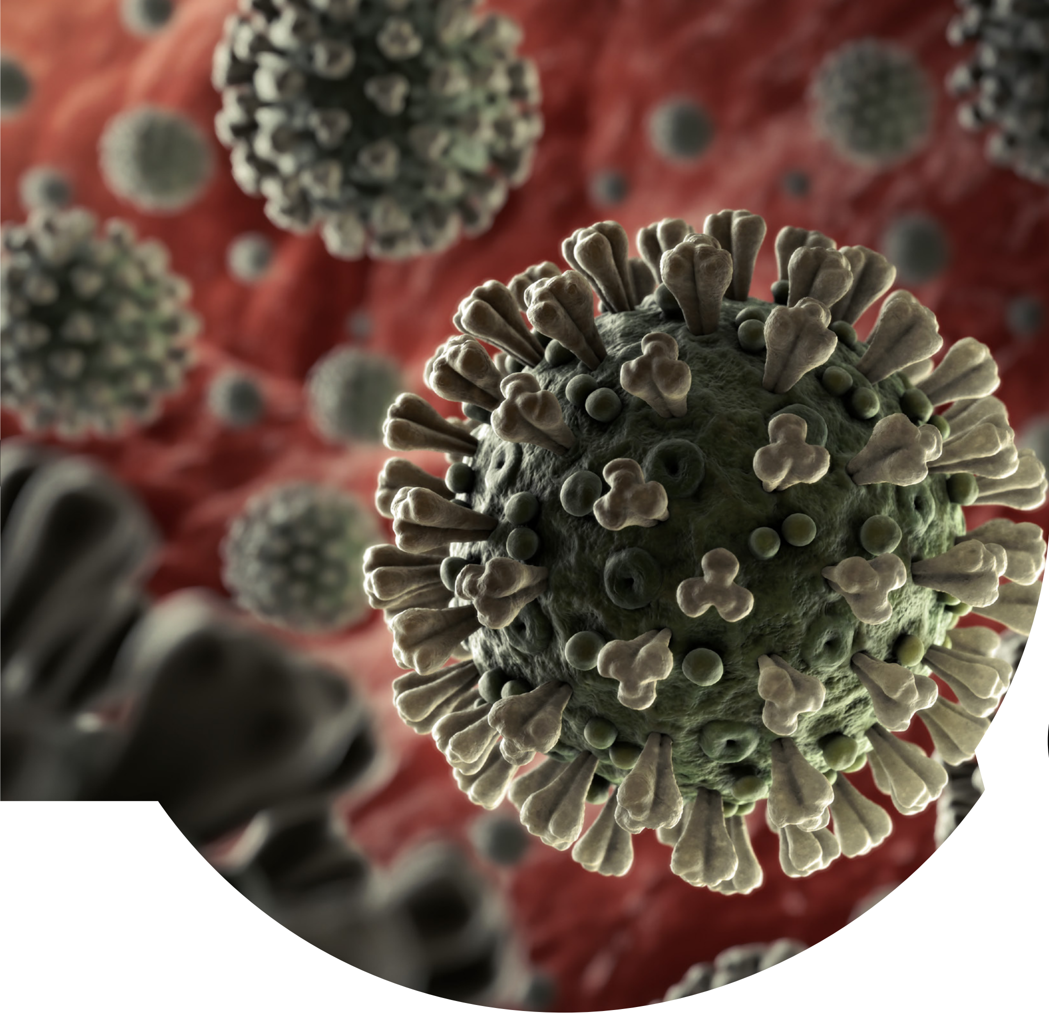

BANKING AND FINANCE

Coronavirus: Impact on financing agreements

The business financing sector is among those that could suffer the greatest impact due to the economic crisis that is expected to be the inevitable result of the global COVID-19 pandemic. In fact, the paralysis of economic activities will undoubtedly have a negative impact on the liquidity of companies that have to make regular payments under financing agreements.

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These liquidity problems will seriously harm the ability of companies to meet their obligations on time. This is likely to lead to breaches of contract that could be grounds for terminating the agreements and for the acceleration of any outstanding obligations, which would have an even more serious effect on the economic and financial situations of companies.

The current situation is an exceptional one that is not always adequately addressed in the financing agreements themselves. Therefore, companies and financial institutions should analyse the wording of their agreements so they are in a better position to plan the actions to deal with any issues that arise under them.

Issues to be considered by debtors

Information obligations:

Debtors must analyse the information obligations contained in the financing agreements, in particular, the ones that oblige them to inform the financial institutions of imminent contractual breaches and, in particular, in what related to breaches of pecuniary obligations. Although not expressly provided for in the agreement, it is recommended that debtors take a proactive approach in anticipating any potential breach in order to comply the ancillary duty of information arising from good faith principles;

Breach of financial covenants:

The presumed liquidity problems and loss of turnover that will be felt by debtors may lead to a breach of the financial ratios set out in the financing agreements. As a result, companies should look at solutions that would make it easier to fulfil their obligations (for example, capital injections), in light of the cure periods provided for in the agreement and in order to demonstrate that the company has a plan to restore the levels of the financial ratios agreed in the short and medium term. On this point, it is also important not to neglect the potential impact of any disruption of the work of auditors and the operations of stock markets, which will make it more difficult to calculate these ratios;

The impact of other events of default:

Financing agreements commonly list a wide range of events of default, other than breach of pecuniary obligations, which could lead to the anticipation of obligations. Therefore, besides the situations involving a breach of financial covenants, provision is made for cases such as a cessation of activity, material adverse effect on the economic activity of the debtor, violation of laws or regulations (note the impact of legislative measures taken in the context of a state of emergency), submission of petitions for the insolvency of the debtor, or the commencement of enforcement actions against the debtor;

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Cross-default:

The early maturity of obligations under the financing agreement will not only have an impact on the financing agreement itself. It may also cause other financial institutions to declare the acceleration of their agreements. They will do so to ensure that they are in the same position to the other creditors and that they do not lose out because they have taken a more passive or understanding approach to the difficulties of debtors. This means the potential impact of default should not be considered in isolation, but rather in light of its potential impact on other agreements;

Requests for waiver / cure periods:

Debtors must also check whether there are any cure periods that apply in the event of default, without prejudice to the information duties mentioned above. If these periods are not sufficient to remedy the default and prevent the early maturity of the obligations, debtors should once again actively submit requests for waivers due to the current situation;

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Force majeure or impossibility to perform:

Debtors should also look at the extent to which they can benefit from clauses that provide for situations of force majeure. These are clauses which, when there are unforeseeable events outside the control of the parties, provide for the temporary suspension or even the termination of the obligations contained in the agreements in question, without this giving rise to a duty to pay compensation. If such a clause exists, the burden of proving the existence of the situation of force majeure falls on the party that wishes to take advantage of it. That party must demonstrate a causal relationship between the event of force majeure – the pandemic – and its failure to fulfil its obligation. Even if the agreement does not contain a force majeure clause, it is still possible for the defaulting party to take advantage of the rules set out above. To do so, that party will have to prove that it has become impossible for it to fulfil its obligations for reasons not attributable to it.

Issues to be considered by financial institutions

Termination of agreements:

In view of the exceptional nature of this situation, the question of whether to exercise the right to terminate the agreement should be examined with particular care. This is because debtors could, with a likelihood of success, claim partial objective impossibility to perform their obligations under the agreement, or a case of force majeure, under the general terms of the civil law. As a result, the termination of the agreement without a thorough and careful legal analysis and the proper grounds could be considered an abusive exercise of this right. This is particularly so if the termination is based on non-pecuniary obligations, and the consequence could be civil liability on the part of the financial institution;

Cure periods:

Before starting any action to terminate an agreement, the financial institution should check whether there are any cure periods that temporally restrict the possibility of exercising the right of termination. Otherwise, it will have to adequately justify the impossibility of remedying the breach during the cure period;

Requests for waiver:

Financial institutions should analyse and respond as quickly as possible to any requests for waiver from debtors. In doing so, they should take into account the specific situations alleged and the likelihood of the breach being remedied in the future. They should also check whether the agreement provides for any maximum periods to respond to such requests in order to avoid inadvertently providing tacit consent;

Due dates:

The current crisis may make it difficult to calculate deadlines using the concept of "business days" as this concept is often linked to the days when banks are open to the public or the days that certain financial markets are open for trading. Any doubts in calculating the date obligations are due can have a significant impact on relations with the debtors;

Restructuring of agreements:

Financial institutions should prepare for a wave of restructuring of financing agreements especially designed to deal with the liquidity problems faced by debtors. The restructuring could include, for example, grace periods for capital and/or interest. They could also involve adapting the agreements and their operations to the foreseeable impacts of COVID-19 on the activity of the debtors. In particular, changes could be made to the way of calculating financial covenants so they are immune to the impacts of COVID-19. The restructuring of agreements can also be designed to protect financial institutions from any disbursement obligations and to limit the risk of the operation. ■

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