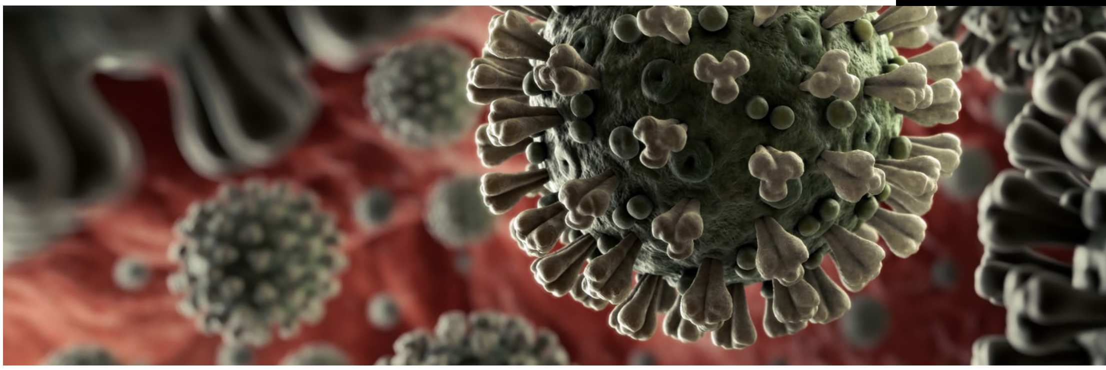

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NEWS

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.

First of all, 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. 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 early maturity of any outstanding obligations, which would have an even more serious effect on the economic and financial situations of companies.

Steps are being taken to combat the economic consequences the COVID-19 pandemic and a state of emergency has been declared. Following this, the Council of Ministers issued Decree 12/2020 of 2 April ("Decree") to introduce a set of exceptional urgent measures. These measures are necessary, appropriate and proportionate to the situation, and their goal is to prevent the spread of the COVID-19 pandemic, to safeguard human life and public health, and to ensure that services continue to function.

Other measures may be adopted and Central Bank of Mozambique will continue to exercise its regulatory power. However, the Decree does not expressly provide for any moratorium for financing agreements as other states have done. The legislature opted to include another benefit of considerable importance to ongoing credit operations. The Decree suspends all default notices, default situations and enforcement actions resulting from a delay in paying principal and interest that cannot be paid due to the measures adopted by the Government in Decree 12/2020 of 2 April.

> **"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, it is necessary to establish a cause-effect relationship between the measures introduced in the Decree (or their consequences) and the breach of the contractual obligations, that is, non-payment of instalments of principal and interest. If this is established, the finance providers cannot issue default notices, declare early maturity or execute any guarantees provided, all by virtue of a delay in fulfilling obligations and termination of the contract.

The scope of application of the above measure is limited because it is necessary to prove the existence of the causal link. Furthermore, it is temporary. Consequently, businesses and financial institutions must analyse the wording of the agreements in question to be able to plan the actions to be taken in respect of them.

Accordingly:

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 impending situations of breach of contract and, in particular, breach of pecuniary obligations. Although not expressly provided for in the agreement, it is recommended that debtors take a proactive stance in anticipating any potential breach in order to fulfil the ancillary duty of information that is imposed by good faith;

"Debtors must analyse the information obligations contained in the financing agreement."

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 situations of early maturity of obligations: financing agreements commonly list a wide range of situations in which obligations mature early for reasons not related to a breach of pecuniary obligations. Therefore, besides the situations involving a breach of financial covenants, provision is made for cases such as a stoppage of activity, a 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 suspension of the rule of law), submission of petitions for the insolvency of the debtor, or the beginning of enforcement actions against the debtor;

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 early maturity 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 equivalent agreements;

> **"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."**

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 waiver of the requirement to fulfil certain obligations due to the current situation;

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 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;

Requests for waiver: financial institutions should analyse and respond as quickly as possible to any requests for waiver in the fulfilment of the obligations. 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;

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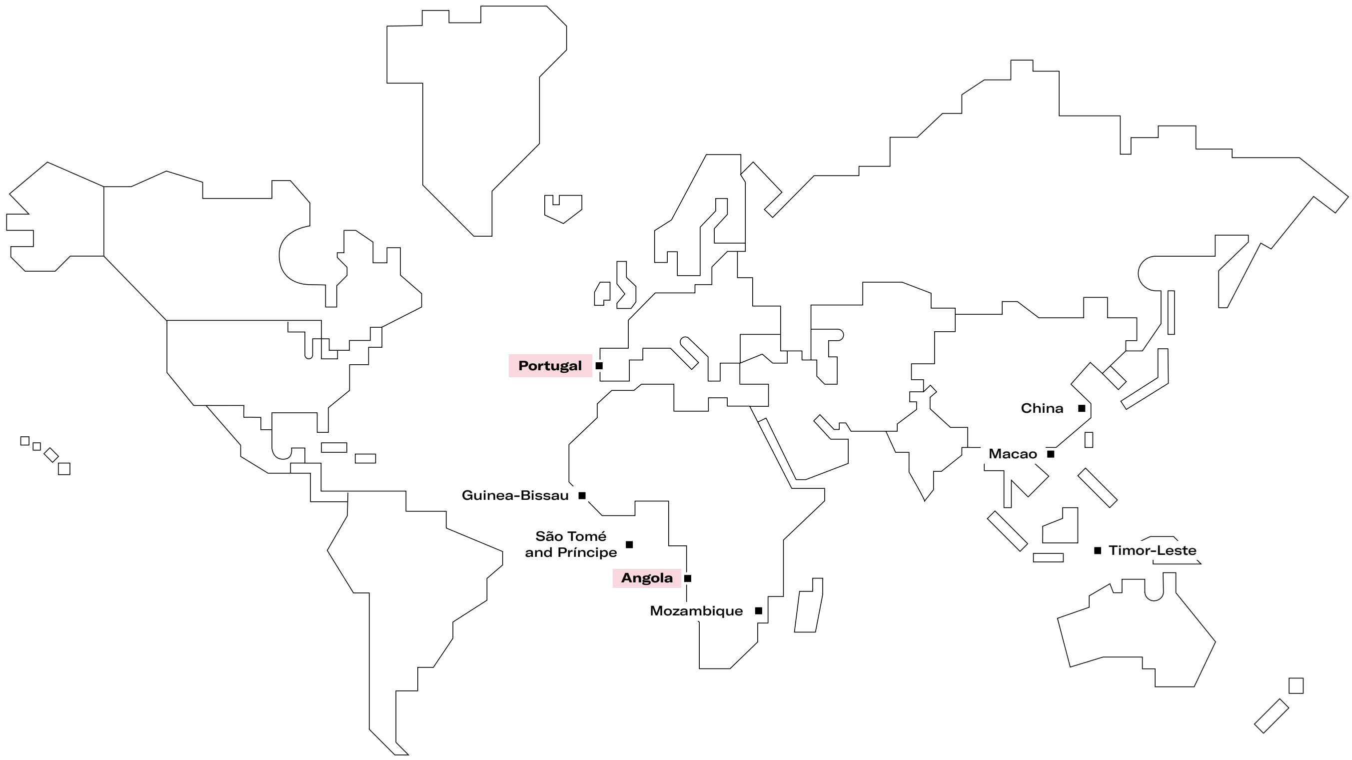
"Financial institutions should prepare for a wave of restructuring of financing agreements especially designed to deal with the liquidity problems faced by debtors. They could also involve adapting the agreements and their operations to the foreseeable impacts of COVID-19 on the activity of the debtors."

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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