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# COVID-19 and its potential impact on financing arrangements

March 2020

The COVID 19 (the novel Coronavirus) situation continues to develop rapidly and is being followed with keen interest and obvious concern. We already know that this global pandemic will have a severe social and economic impact on every sector also in Austria.

Many companies are concerned that the current lack of ability to fully conduct certain businesses may adversely impact on their ability to service forthcoming loan payments under financing arrangements.

The purpose of this article is to address the specific issues that can potentially arise in financing agreements that lenders and borrowers alike will need to consider in the light of the pandemic, and to highlight the need to consider and take advice on loan agreements.

To facilitate a better understanding of these issues, we have selected below some of the relevant sample clauses contained in LMA style loan agreements, although the exact wording of these clauses may differ in individual loan agreements.

## COVID-19 containment measures may trigger events of default or termination events

It goes without saying that many entrepreneurs are concerned by the current situation. In addition to concerns of a personal nature, the concerns for their business can also be critical.

Especially in larger scale financing agreements, there are a variety of contractual clauses that may be relevant in connection with the current COVID-19 crisis. Most obvious, non-payment of principal repayment instalments or interest amounts is the key issue when businesses cannot operate as normal. However, many of the specific issues discussed below go beyond the simple non-payment of due amounts. If not remedied, the breach of contractual provisions of a loan agreement may lead to an event of default (“EoD”) or a termination event under a loan agreement. If an EoD occurs, the lender is usually entitled to accelerate all outstanding amounts, demand immediate payment and / or enforce security interests. Apart from the fact that any enforcement action would substantially threaten the business operations, ultimately an EoD may result in insolvency.

## How to avoid an event of default / termination event

An immediate EoD can be avoided if the lender agrees to a temporary standstill period or to grant a temporary waiver of termination rights or specific contractual covenants.

A potential request for waivers or amendments to covenants that are at risk of being breached might – as a first step – focus on the specific effects of the coronavirus pandemic over a limited period. This will avoid giving the borrowers “carte blanche” and hence protect lenders’ interests, while providing temporary relief to borrowers.

In the medium and long term, however, a wider restructuring needs to be considered. Such restructuring could involve, for example, a prolongation of the payment terms with a view to easing the financial burden by stretching the tenure of the financing over a longer period. Also, interest payment terms could be adjusted.

Whether such restructuring is a viable option will depend on the long-term prospects of one’s business. A going concern analysis will need to be conducted to assess whether a business is expected to bounce back following the COVID-19 crisis.

If such long-term prospect can be evidenced, the lenders are usually expected to be open to such discussions in order to avoid capital-intensive write offs.

## Immediate next steps

As a first step, borrowers and lenders alike are advised to examine their loan documentation closely with a view to establishing, among others, financial covenants, grace periods for all events of default and potential penalties for breaches of representations and warranties, covenants and notice requirements.

Borrowers are advised to assess their ability to continue to draw on existing facilities. The current crisis may not only have an impact on the existing and fully utilized credit lines, but also on any open credit lines and future drawings thereunder which are at risk of being cancelled by the lenders.

If a borrower is faced with not only one creditor but a pool of creditors, the borrowers are well advised to set up a structured process to discuss the current COVID-19 situation with all their creditors at the table.

In particular, the more complex larger scale facility agreements that follow international standards increase the risk of a borrower triggering a chain reaction when entering into discussions with creditors on a bilateral basis only.

In addition, borrowers need to consider delaying any non-essential investments and/or selling assets as a way of raising cash to address short-term liquidity requirements.

### Current legislative efforts

Some countries – like Hungary – have already implemented statutory stays of loan receivables. In Austria, there is currently no such legislation in place. We will keep a close eye on such developments.

Until July 2021, EU Member States shall implement the EU Restructuring and Insolvency Directive. This Directive will ease larger scale restructurings allowing *inter alia* for enforcement moratoriums, suspensions of the insolvency filing obligation in certain circumstances and majority votes with binding effects on holdouts. Hopefully, the EU Restructuring and Insolvency Directive will now be implemented swiftly as certain of the instruments could certainly be useful already prior to the end of the implementation period (July 2021).



**The entire CMS Banking & Finance team is at your disposal and happy to assist with assessing your existing loan documentation and discuss advised steps to be taken. You can always reach us via phone or e-mail. Please click [here](#) for contact details.**

# Specific issues

## A. Non-payment

Sample Clause	
<b>Non-payment</b>	
An Obligor does not pay on the due date any amount payable pursuant to a Finance Document at the place at and in the currency in which it is expressed to be payable unless:	
(a)	its failure to pay is caused by:
(i)	administrative or technical error; or
(ii)	a Disruption Event; and
(b)	[payment is made within:
(i)	(in the case of paragraph (a)(i) above), [ ] Business Days of its due date; or
(ii)	(in the case of paragraph (a)(ii) above), [ ] Business Days of its due date]/
<b>OR</b>	
[payment is made within [ ] Business Days of its due date.]	

### Potential implications

The event of default (EoD) for non-payment of debt is the key EoD in every financing agreement.

COVID-19 is already having a significant impact on the hospitality, leisure, trading and tourism industry. Further world-wide travel restrictions, interruptions and delays in the supply chain and office closures, are likely to affect businesses in almost every sector.

In such circumstances it is not unlikely that many businesses will face difficulties or even inability to meet scheduled payments of interest, principal and fees.

### What can be done at the moment?

If your business is adversely affected, or likely to be affected, by the COVID-19 containment measures, it is essential that you enter promptly into discussions with your lender(s).

- Lenders and borrowers alike should be, or become, aware of the relevant terms of their financing arrangements:
  - Especially in larger finance transactions, non-payment events of default sometimes contain specific grace periods allowing for a remedy for a payment default. In some industries, such grace periods may be the light at the end of tunnel, provided that COVID-19 measures will soon be lifted.
  - No payment default can sometimes occur if the non-payment is caused by a “Disruption Event”. However, unfortunately this exemption will often be of no help to struggling companies. Such events usually only cover “technical disruptions”, i.e. a collapse of the payment systems. “Disruption in business” is not covered by such exemption.

- Especially in larger groups, the borrowers need to consider the possibility of curing payment defaults by raising additional money from other group companies, e.g. the parent. While this can often result in a breach of other undertakings in the facility agreements (e.g. negative pledge undertaking, undertaking not to incur any additional financial indebtedness), lenders may be open to such financial indebtedness if such debt is used to facilitate continued business operations or repayment of the lender's claims. Common forms of such additional financial indebtedness could e.g. be to raise subordinated intra-group debt.
- If the borrower has a large volume of customer claims (e.g. claims against purchasers of its goods and services), borrowers could consider alternative forms of fund raising by e.g. factoring these receivables. In the current market environment though, the feasibility of such factoring will largely depend on the credit quality of the debtors. If the debtors themselves are adversely affected by COVID-19, it is doubtful that a third party (factor bank) would be willing to enter into such factoring or supplier finance relationships. In any event, negative pledge clauses and the like will need to be considered before disposing of a borrower's assets.

## B. Financial covenants

### Sample Clause

#### Financial covenants and other obligations

- a) Any requirement of Clause [ ]. (Financial covenants) is not satisfied [or an Obligor does not comply with the provisions of Clause [ ] (Information Undertakings)] [and/or Clause [ ] (General Undertakings)].
- b) An Obligor does not comply with any provision of any Transaction Security Document.

#### Potential implications

Especially in a larger finance transaction, financial testing of key financial indicators (e.g. the loan-to-value-ratio (LTV), the leverage ratio or the equity ratio) is quite common. Such financial covenants may indicate whether a business is underperforming, possibly due to loss of income and deterioration in asset values. They act as an early warning signal for lenders of borrower financial distress – in particular, “cashflow”, “interest cover” and similar covenants that focus on a borrower's ability to service interest on, or make scheduled repayments of, outstanding debt.

Since many credit facilities, when testing financial covenants for compliance purposes, measure EBITDA over the last four fiscal quarter period, the negative impact of the COVID-19 outbreak could last well into 2021.

#### What can be done at the moment?

Lenders and borrowers will need to assess the impact of COVID-19 on borrowers' ability to comply with their financial covenants.

If breaches of financial covenants are expected, borrowers need to take action. Such actions might include:

- Obtaining a temporary waiver of the covenant testing from lender(s).
- Curing the breach by an additional equity injection. This will, of course, require financially sound owners that are willing to support their companies in case of crisis (which in turn will depend on the long-term prospects that owners see for their business).

- Furthermore, if borrowers predict breaches, they may have contractual rights to cure by additional capital injections or raising subordinated group debt (see also above with respect to potential cures of payment defaults).

## C. Insolvency

### Sample Clause

**"Insolvency Event"** in relation to an entity means that the entity:

- (a) is dissolved (other than pursuant to a consolidation, amalgamation or merger);
- (b) becomes insolvent or is unable to pay its debts or fails or admits in writing its inability generally to pay its debts as they become due;
- (c) makes a general assignment, arrangement or composition with or for the benefit of its creditors;
- (d) institutes or has instituted against it, by a regulator, supervisor or any similar official with primary insolvency, rehabilitative or regulatory jurisdiction over it in the jurisdiction of its incorporation or organisation or the jurisdiction of its head or home office, a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors' rights, or a petition is presented for its winding-up or liquidation by it or such regulator, supervisor or similar official;
- (e) has instituted against it a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors' rights, or a petition is presented for its winding-up or liquidation, and, in the case of any such proceeding or petition instituted or presented against it, such proceeding or petition is instituted or presented by a person or entity not described in paragraph (d) above and:
  - (i) results in a judgment of insolvency or bankruptcy or the entry of an order for relief or the making of an order for its winding-up or liquidation; or
  - (ii) is not dismissed, discharged, stayed or restrained in each case within 30 days of the institution or presentation thereof;
- (f) [     ]
- (g) has a resolution passed for its winding-up, official management or liquidation (other than pursuant to a consolidation, amalgamation or merger);
- (h) seeks or becomes subject to the appointment of an administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official for it or for all or substantially all its assets (other than, for so long as it is required by law or regulation not to be publicly disclosed, any such appointment which is to be made, or is made, by a person or entity described in paragraph (d) above);
- (i) has a secured party take possession of all or substantially all its assets or has a distress, execution, attachment, sequestration or other legal process levied, enforced or sued on or against all or

substantially all its assets and such secured party maintains possession, or any such process is not dismissed, discharged, stayed or restrained, in each case within 30 days thereafter;

- (j) causes or is subject to any event with respect to it which, under the applicable laws of any jurisdiction, has an analogous effect to any of the events specified in paragraphs (a) to [(h)/(i)] above; or
- (k) takes any action in furtherance of, or indicating its consent to, approval of, or acquiescence in, any of the foregoing acts.

### Potential implications

Inability to pay creditors when debts become due would be a default trigger and could also give rise to more general insolvency concerns. Besides the non-payment, the insolvency event of default can be a key threat to certain borrowers these days. Such event not only covers the formal opening of insolvency proceedings but more specifically covers with material insolvency of borrowers: their inability to perform payments when due or their over indebtedness.

### What can be done at the moment?

If there is risk of the insolvency EoD being triggered, both borrowers and lenders need to act swiftly.

The rather broad nature of such clauses often leads to a significant uncertainty of borrowers in situations of turmoil. As usually also “the commencement of negotiations” with creditors are covered by such clause, even the above discussed measures to seek waivers or standstills may lead – by way of a cross default (see below) - to a chain reaction for a borrower under its various credit facilities.

Hence, if a borrower is faced with more than one creditor, it is highly advised to set up an organized restructuring process. It is key to get all creditors at the table and agree with all of them on a standstill in order to avoid that any cross-default provision is triggered. The standstill period can serve to implement a larger scale refinancing that can avoid the need to file immediately for insolvency proceedings.

## D. Cessation of business

### Sample Clause

#### Cessation of business

Any member of the Group suspends or ceases to carry on (or threatens to suspend or cease to carry on) all or a material part of its business [except as a result of a Permitted Disposal or a Permitted Transaction].

### Potential implications

A mere threatened or temporary suspension of a material part of a business is enough to trigger cessation of business EoDs. Restaurants and hotels closed until further notice, grounded aircraft, ships remaining in port, developments halted by lack of workers all have the potential to force a temporary suspension of business.

It is so far unclear whether such events would be covered by typical cessation of business clauses. However, it cannot be excluded that such EoDs are triggered by the current COVID-19 measures – at least as concerns such key businesses affected by governmental closures.

### What can be done at the moment?

Parties should carefully review, and monitor on an ongoing basis, the loan documentation in the light of the specific situation of the debtor to assess whether COVID-19 could lead to triggering this EoD.

If this is the case, an immediate action by the borrower is required. As a short-term measure, a waiver by the lender is required. In case of COVID-19 related temporary shutdowns, lenders are expected to grant such waivers.

In addition, once the borrower's business is affected by any shutdowns due to COVID-19, they need to assess their entire financing arrangement in order to assess the overall impact on the existing funding.

## E. Expropriation

### Sample Clause

#### Expropriation

The authority or ability of any member of the Group to conduct its business is limited or wholly or substantially curtailed by any seizure, expropriation, nationalisation, intervention, restriction or other action by or on behalf of any governmental, regulatory or other authority or other person in relation to any member of the Group or any of its assets.

### Potential implications

Some financing agreements contain clauses whereby the closing down of the business premises resulting from any restriction or other action by a governmental, regulatory or other authority constitute an event of default.

Whereas such clauses are not typically aimed at pandemics or natural disasters (but rather seem to focus on events like seizures, nationalization or governmental interference), it cannot be excluded that an EoD may be triggered by the current COVID-19 measures by the Austrian government.

### What can be done at the moment?

Like in case of the cessation of business EoD, the parties should monitor the situation on an ongoing basis and maintain an open dialogue with their funding providers.

## F. Material adverse change (MAC)

### Sample Clause

**"Material Adverse Effect"** means [in the reasonable opinion of the Majority Lenders] a material adverse effect on:

- (a) [the business, operations, property, condition (financial or otherwise) or prospects of the Group taken as a whole; or
- (b) [the ability of an Obligor to perform [its obligations under the Finance Documents]/[its payment obligations under the Finance Documents and/or its obligations under Clause [ ] (Financial condition)]]/[the ability of the Obligors (taken as a whole) to perform [their obligations under the

Finance Documents)/[their payment obligations under the Finance Documents and/or their obligations under Clause [ ] (Financial condition)]; or

- (c) the validity or enforceability of, or the effectiveness or ranking of any Security granted or purporting to be granted pursuant to any of, the Finance Documents or the rights or remedies of any Finance Party under any of the Finance Documents.]

### Potential implications

The main purpose of a material adverse change (MAC) clause tends to be bringing a borrower to the table with lenders to address any possible concerns around the borrower's ability to weather the adverse economic consequences of a certain event.

Given the global nature of the COVID-19 pandemic, it could be difficult for lenders to maintain without challenge that this event of default has occurred, unless they argue it occurred in respect of all other comparable financings to which they are party.

However, MAC clauses tend to be heavily negotiated in loan agreements and the precise wording will, therefore, need to be carefully analysed to establish whether a MAC could be called.

With respect to negotiating new deals, it remains to be seen whether strong borrowers will attempt to specifically carve the direct effects of COVID-19 out of the MAC clause.

We would expect lenders to engage with the customers with a view to supporting their businesses, but this will be balanced by the need to preserve the lender's risk profile.

### What can be done at the moment?

If a loan agreement contains a MAC clause, the short-term breaches could potentially be remedied by an agreed waiver (while reserving lender's rights). While such waiver is lasting, increased reporting could be agreed between the parties so that the lender remains fully in the loop as regards the progress of the business operations.

## G. Audit qualification

### Sample Clause

#### Audit qualification

The [Parent's] Auditors qualify the audited annual consolidated financial statements of the [Parent]/[the Group].

### Potential implications

As the COVID-19 pandemic is hitting businesses at the time when most of them are in the stages of preparing their annual financial statements, also potential qualifications in the auditor's report may be triggered by current developments.

### What can be done at the moment?

The companies and their auditors need to assess whether the current measures taken against COVID-19 are likely to impact on the auditor's report.

This may in particular be relevant where a company already in past accounting periods had financial trouble (over indebtedness) but on basis of a positive going concern prognosis was able to avoid

insolvency proceedings. Such positive going concern prognosis may now be impacted by the COVID-19 crisis.

## H. Cross-default

### Sample Clause

#### Cross default

- (a) Any Financial Indebtedness of any member of the Group is not paid when due nor within any originally applicable grace period.
- (b) Any Financial Indebtedness of any member of the Group is declared to be or otherwise becomes due and payable prior to its specified maturity as a result of an event of default (however described).
- (c) Any commitment for any Financial Indebtedness of any member of the Group is cancelled or suspended by a creditor of any member of the Group as a result of an event of default (however described).
- (d) Any creditor of any member of the Group becomes entitled to declare any Financial Indebtedness of any member of the Group due and payable prior to its specified maturity as a result of an event of default (however described).
- (e) No Event of Default will occur under this Clause 29.5 if the aggregate amount of Financial Indebtedness or commitment for Financial Indebtedness falling within paragraphs (a) to (d) above is less than [ ](or its equivalent in any other currency or currencies).

#### Potential implications

Most finance transactions will include cross default provisions whereby the borrower is automatically deemed to be in default under the current transaction if they defaulted under another transaction. Cross-default provisions therefore have a domino effect.

A cross default may also be triggered by a breach of finance agreements not related to non-payment, or in case of the financial covenants breaches (see above).

#### What can be done at the moment?

Like in case of Non-payment, borrowers and lenders should consider the relevant terms and thresholds across their loan documents and such borrower's other debt instruments.

Hence, if a borrower is faced with more than one creditor, it is highly advised to set up an organized restructuring process. It is key to get all creditors at the table and agree with all of them on a standstill in order to avoid that any cross-default provision is triggered.

## I. Information undertakings

#### Potential implications

Reporting and notification obligations to lenders vary between loan agreements, but typically include:

- financial information and auditors reports

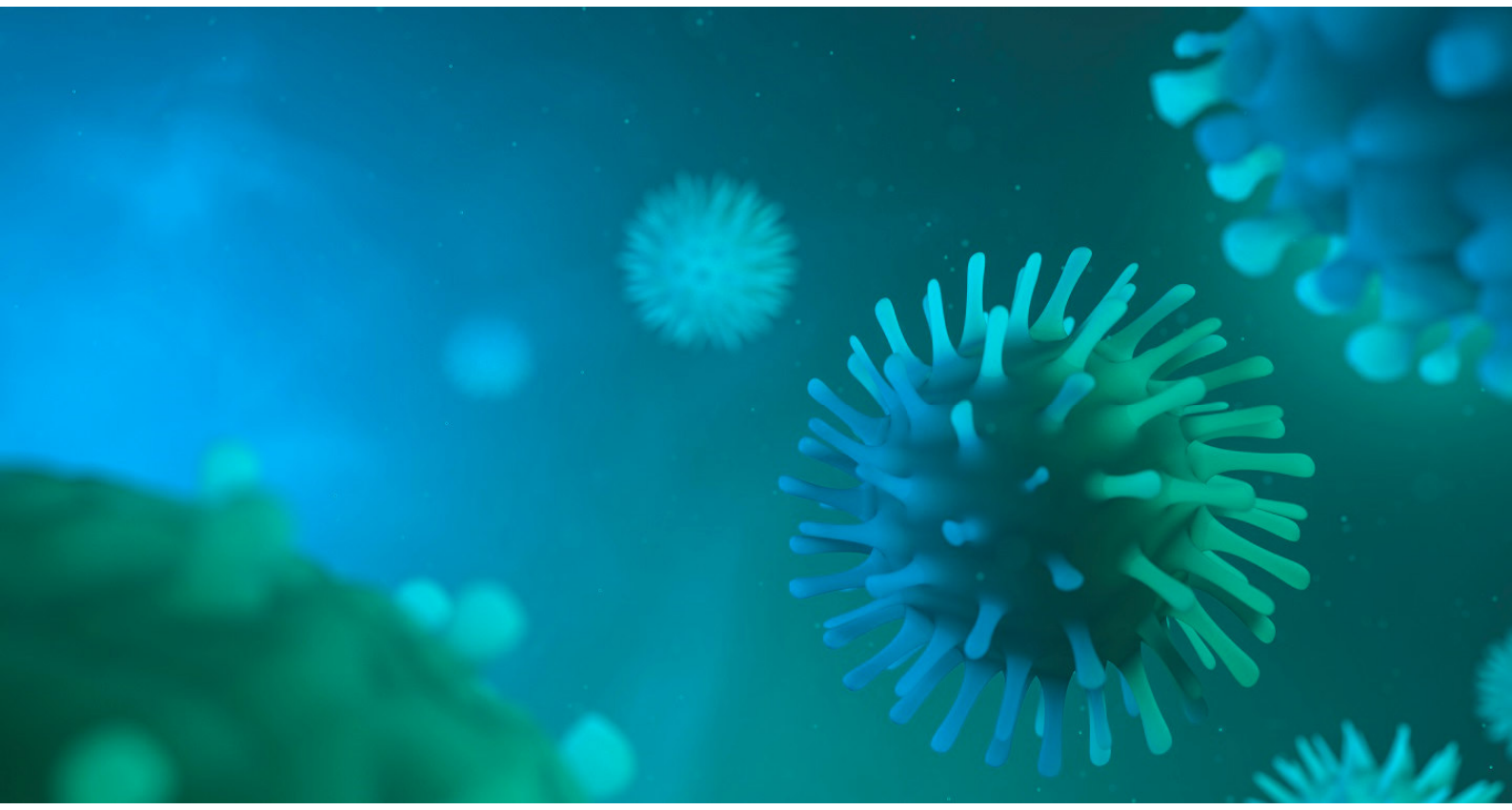
- compliance certificates
- defaults
- changes in credit rating
- litigation and material contracts and/or developments expected to have a material adverse effect
- and a catch-all provision for any additional information requested by the lenders.

Loss of trade, supply shortages, office closures, etc. are likely to trigger breaches or termination rights in material contracts. The borrowers need to monitor and disclose such developments to lenders.

### **What can be done at the moment?**

Borrowers should review their obligations to provide notices to the lenders under the loan documentation.

If borrowers do not comply with their obligation to inform lenders of a breach, lenders may find themselves in a difficult position. On the one hand they do need to reassess credit risk and consider how best to their position, but on the other hand they need to consider any restructuring options to offer to the borrower to hopefully avoid a formal insolvency process, as keeping the borrower trading usually brings a better result for both parties. This provision therefore can also enable the lenders to request the information they need to evaluate the risk, if the parties are not already engaged in discussions.



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