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Deloitte Legal – *Lawyers* cvba | 2 April 2020

Deloitte Legal Newsflash
Banking and Finance

Assessing the COVID-19 impact on existing financing agreements in Belgium

The COVID-19 outbreak and its disruptive effect on the global economy raises many concerns about how parties need to deal with the execution of current contractual arrangements.

This is of greater relevance for financing agreements. Next to their payment obligations, borrowers are usually bound by several engagements, the breach of which could have severe consequences.

What follows is an indicative list of typical clauses of financing agreements that could be impacted by the current context, the potential impact for borrowers after a breach thereof, and the possible remedies.

Summary

Borrowers should start by **carefully reviewing the list of repeating representations and warranties** (also verifying when these are deemed to be repeated), **undertakings, financial covenants** (and their relating testing dates) and **events of defaults**, as well as their scope (only applicable to borrowers or to other members of the group as well).

The presence of **Material Adverse Change and cross default** clauses should also be verified.

Once a clear mapping of provisions likely to be impacted is made, borrowers should evaluate whether remediation periods apply, and whether **mitigators** could be relied upon (such as a material adverse change concept, materiality thresholds or baskets).

One should also verify the presence of **force majeure** and **hardship** clauses that could, under certain circumstances, allow to negotiate the fulfilment of certain obligations.

Based on such analysis, borrowers fearing that some of their obligations could be breached should (i) envisage **remediation measures** (equity cures, intragroup loans, etc.) and verify whether these would be authorised under the financing agreement, and (ii) contact their lender to start negotiating the necessary **waiver or amendment**.

The loan facilities agreements as a radar

Properly drafted facilities agreements should enable lenders to rely on clauses allowing them to monitor the borrowers' business and financial situation closely.

Representations and warranties

Facilities agreements usually contain a list of representations and warranties that are not only made on signing/closing, but which are also deemed to be repeated throughout the duration of the agreement. Such representations and warranties can be required to be made on each proposed utilisation date and/or on the first day of each interest period, for example. Please bear in mind that repeating representations and warranties are usually made with respect to the circumstances that exist at the time when they are made.

Two examples of representations and warranties usually contained in loan agreements, which could be impacted by the current situation are (i) the absence of insolvency or restructuring proceedings (usually drafted in a broad sense) or (ii) the absence of material adverse effect (for more details please see *Infra*) in the assets, business or financial condition.

Please bear in mind that representations and warranties can not only be required from the borrower, but also from the parent company or other members of the group. Their scope therefore should be carefully reviewed.

Undertakings

Facilities Agreements also generally include undertakings, which are (positive or negative) obligations to be met by the borrower or other members of the group during the agreement's entire duration.

Certain agreements may, for example, include an asset disposal undertaking (e.g. to reduce borrower indebtedness), the implementation of which within a specified timeframe is likely endangered by global market uncertainty.

Companies planning to implement specific measures with the purpose of enhancing their cash position, such as assets disposals or the conclusion of additional financing arrangements, should carefully review the list of undertakings contained in existing financing agreements. These usually

contain, for example, undertakings in the form of restrictions to additional financial indebtedness or assets disposals.

Financial covenants

Financial covenants are expressed as undertakings from borrowers to ensure that it meets specified ratio tests at specified times and during specified periods. There is no general rule as to which covenants are taken up as part of a given facilities agreement.

An obvious example of covenants at risk in the current situation are those based on the cash flow level. This would be the case e.g. for the Cash flow Cover Test, seeking to measure borrower ability to generate sufficient cash flow in order to service their debts. Leverage covenants, calculated as a ratio of debt to EBITDA should also be carefully reviewed.

Other agreements may require specific cash covers, expressed as a minimum predetermined amount of cash (including, where relevant, available commitments under existing facilities) that should be available to the borrower at a given time.

Importantly, financial covenants should be formally tested at specified times and with respect to specified periods, and should usually be reported upon when delivering annual (or quarterly or other) financial statements.

General information undertaking

Information undertakings contained in financing agreements can include, next to the delivery of periodic financial statements, a requirement for borrowers to promptly provide such additional information regarding its (or its group's) financial condition, assets and operations (including any requested amplification or explanation of any item in the financial statements) the lender may request.

Borrowers should be ready to provide such information as may be requested by lenders, and update them on the practical effects of the COVID-19 outbreak on their (or their group's) business and financial condition.

Events of default

Events of default clauses should be carefully reviewed. Some of them, specifically those relating to insolvency and insolvency proceedings can have a wide scope that covers, for example:

- the commencement of negotiations with one or more creditors, with a view to reschedule any indebtedness;
- the inability to pay debts when they are due, or suspending the payment of any debts;
- the conclusion of an arrangement with a creditor; and
- the declaration of a moratorium.

The occurrence of a seizure or attachment (unless being discharged within a specific timeframe) on the borrower's assets is also likely to be listed as an event of default.

Events of default may cover those limited to the borrower only, or can extend to events occurring regarding other members of the group.

Cross default and MAC clauses

In addition to the above, there are two other clauses typically contained in financing agreements, which should be taken into serious consideration.

Under cross default clauses, any default under another financing agreement of the borrower (or another member of the group) may lead to a default under a given financing agreement. The scope of these cross default clauses can also extend to a delay in payment, or to the suspension or cancellation of commitments. As the financial distress is global, these clauses are likely to lead to a domino effect if not closely monitored.

MAC (Material Adverse Change) clauses are also a rising concern. Under these clauses, any event or circumstance that the lender reasonably believes as having or being reasonably likely to have a Material Adverse Effect would lead to an event of default.

The existence of a material adverse effect or a material adverse change is a factual concept, which is usually left to the lender's appreciation. Generally speaking, it means that an unforeseen event has occurred, significantly and negatively affecting the borrower's (or its group's) business or the repayment capacity.

A Material Adverse Effect is usually defined as a material adverse effect or material adverse change on a borrower's (or its group's) business, operations, property, condition (financial or otherwise), prospects, its (or the group's) ability to perform its obligations or the validity or enforceability of finance documents (including any security documents).

Given the way in which most MAC clauses are drafted in financing agreements, these certainly raise concern in the current environment.

In our view however, material adverse change and effect should be read as an event specifically impacting the borrower or its group of companies, rather than a general event impacting the market as a whole. In other words and in our view, the COVID-19 outbreak would not *per se* constitute a material adverse change. What should be conclusive to this analysis is an evaluation of the manner in which such crisis affects, *in concreto*, the business of the borrower and its repayment capacity. This should of course be evaluated on a case-by-case basis, but we believe it is unlikely that lenders will rely on such clause for seeking to accelerate the loan.

Breach and potential remedies

Breach and notification

The breach of a representation and warranty when it is deemed to be made will generally lead to an event of default. The same will go for the breach of an undertaking. Non-satisfaction of a financial covenant will also likely trigger the occurrence of an event of default.

Financing agreements also generally contain a general information undertaking, whereby the borrower (or other members of the group) is required to notify the lender of any

default (and the steps, if any, being taken to remedy it) promptly upon becoming aware of its occurrence.

It is also worthwhile noting that, if a compliance certificate should be delivered simultaneously with the financial statements to the lender, the form of such compliance certificate will also generally contain a statement whereby the borrower confirms no default has occurred and is continuing.

Contractual remedies

Provided that the breach can be remedied, most financing agreements provide that the borrower may rely on a remediation period of a few Business Days, which will usually start upon the Borrower becoming aware of such breach. However, such remediation periods are fairly short (generally around 10 to 30 Business Days). Hence, in most cases, these will most probably not help the borrower in the situation at hand, given that the COVID-19 impact on businesses is likely to extend beyond such period.

It is important to note that the remediation period (if any) applicable to the breach of a payment obligation under the financing agreement will usually be much shorter, in the range of 3 to 5 Business Days. This underlines the necessity for any borrower to promptly evaluate and closely monitor its repayment capabilities.

It is worthwhile mentioning that certain representations and warranties, undertakings or events of default may contain a mitigator. The concept of material adverse effect, which we have detailed *Supra*, could apply. In that case, the obligation to comply with a certain undertaking, or the occurrence of an event, would only lead to a default after a failure to do so, or if such event is likely to have a material adverse effect. Another important limitation is the inclusion of baskets or (quantitative) materiality thresholds.

Force majeure and hardship

Force majeure is a clause to exonerate the debtor's liability, and which stems from an unforeseeable and unpreventable external event that renders the performance of a debtor's obligation impossible, while remaining within the limits of the diligence that may be expected of it.

In our view, the COVID-19 outbreak in itself will not be sufficient to invoke force majeure. Again, one should look at the specific circumstances of the case and evaluate them *in concreto*, by assessing the foreseeable or preventable nature of the event arising because of COVID-19, and the impact it would have on the borrower's business and repayment capacity.

Belgian law recognises the concept of force majeure, meaning it could be invoked even though not specifically provided for in the financing agreement, but is generally interpreted *stricto sensu*. In addition, its consequence on the borrower's obligations under the financing agreement should be correctly interpreted. It is generally recognised, under Belgian law, that a force majeure event would not free the debtor of its payment obligations. Instead, such debtor could seek to rely on the force majeure event to claim a temporary suspension of

payment obligations for the duration of the force majeure event.

Hardship is a principle of law whereby a party may ask the other party to renegotiate the contract if an event has occurred and has rendered its performance excessively onerous. Unlike force majeure, the execution of the obligation is possible, but has become onerous as a result of such event to the point that requiring such party to meet its obligation would be excessively disproportionate.

Even though such concept was highly debated before Belgian courts, hardship is not (yet) recognised under Belgian law. This means that parties to an agreement that does not contain specific clauses authorising a party to request the agreement's re-negotiation, upon the occurrence of certain events, may not rely on a general rule of law for seeking the suspension, renegotiation or termination of the contract

The financing agreement may include force majeure and/or hardship clauses, in which cases their scope (and where relevant, the list of events and circumstances they cover) should be carefully reviewed.

Consequences of a breach

When an event of default has occurred and is continuing, meaning it has not been remedied within a specified period, the lender will usually be entitled to accelerate the facility. In such a case, the lenders may cancel the commitments, seek full repayment of the loans made and enforce their security interests.

Another consequence of the occurrence of a default could be that no further drawdowns or utilisation may be made. The making of any utilisation will indeed usually be subject to the absence of default.

In addition, depending on the financing agreement, non-satisfaction of certain pre-determined financial ratios may lead to other consequences. There may be pre-determined ratios, which once met or breached instead of leading to an event of default, would lead to a partial prepayment requirement or a revision of the interest rate applicable to the loans.

Financing agreements entered in asset financing or asset based lending transactions may, for example, contain loan to value ratios. This covenant has the effect of limiting the amounts made available to the borrower to a percentage of the value of a certain pool of assets (generally serving as collateral). If the value drops, the borrower either needs to partially prepay an amount of the loan to meet the percentage, or pledge additional assets to increase the value of the pool of assets/securing portfolio. If loan to value requirements are included in a financing agreement, the potential impact of the COVID-19 outbreak on the value of these assets should be evaluated without delay.

Amendment and waiver

Where specific circumstances are likely to trigger the breach of a representation and warranty, an undertaking or a covenant, or are likely to lead to the occurrence of an event of default under the financing agreement, the borrower may wish to

seek a waiver from the lender or request the latter to consent to an amendment of the agreement.

If the borrower has identified potential remediation measures that could help preserve its solvency, and if these measures are not authorised by certain negative undertakings or events of default provisions, an amendment or waiver could be requested from the lender. The amendment of a specific financial covenant or waiving related specific provisions could also be an option for avoiding a breach under the financing agreement.

In a club deal scenario, the agreement will likely contain a specific majority to be obtained and a list of certain matters, the amendment of which would be subject to an "all lenders" consent.

In this context and provided any issue is brought to the lender's attention in a timely manner, we anticipate lenders to be receptive to their debtors' positions and to help them, to the extent possible, in seeking alternatives.

This is also evidenced by the announcement made by the Belgian National Bank during the last week-end of March 2020, that an agreement was reached with the Belgian banking sector on specific measures allowing a deferral of payment and the setup of guarantee scheme (Details), thereby showing its strong willingness to support the Belgian economy.

Note

The purpose of this document is to list some of the key features one would expect to observe in a financing agreement and that could be impacted by the current environment.

Of course, this document does not purport to list all relevant aspects of a financing agreement in an exhaustive manner. In addition, the information contained herein is general.

Each situation needs to be analysed in concreto and based on the financing agreement at hand and the specifics of the case.

Our banking and finance law experts are readily available to assist you in reviewing your financing agreement, answer any questions you may have in connection to the topic at hand, and assist you in (ongoing) negotiations with your lender(s).

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