The implications of the Coronavirus pandemic on loan agreements and other finance documents

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The devastating effect on the economy caused by the Coronavirus pandemic has adversely affected the business and financial condition of many companies. A company who has loan agreements or other financial arrangements in place and has encountered, or may potentially encounter, financial difficulties due to the current situation should carefully review its loan agreements and other finance documents to assess whether and to which extent the company is and is expected to be in compliance with the terms thereof. Whereas loan agreements do not typically include force majeure clauses, many loan agreements and other finance documents include material adverse effect/change clauses, which may potentially be triggered as a consequence of the effect the Coronavirus pandemic has had on the business and financial condition of a company. In addition to material adverse effect/change clauses, provisions in loan agreements that are likely to be relevant in this context are the representations, undertakings (financial, general and information), conditions for utilisation and events of default. To the extent the company determines that a non-compliance has occurred or is expected to occur, it should take appropriate actions to address such actual or potential non-compliance, which in many cases includes informing and discussing the situation with its lenders.

The purpose with his article is to briefly discuss the potential consequences the Coronavirus pandemic, or the effect it has had on the economy and the business and financial condition of borrowers, on loan and other financing arrangements, in particular what borrowers should take into account in relation hereto and what borrowers can do in case of a potential breach of the provisions in loan agreements and other finance documents. While it should be noted that there are many different types of loan agreements and other finance documents, and each type of financing arrangement has its own set of finance documents, many existing loan agreements are to some extent based on the recommended form of facility/facilities agreements developed by the Loan Market Association (LMA). For this reason, we will in this article focus mainly on loan agreements that are to some extent based on the recommended form of facility/facilities agreements developed by the LMA.

Which provisions in loan agreements may typically be affected?

It is clear that the turbulent financial markets caused by the Coronavirus pandemic has adversely affected and resulted in financial difficulties for many companies, but what implications does this have on a borrower's existing loan agreements and other finance documents and the borrower's compliance with the terms thereof? Given a typical loan agreement that follows the recommended form developed by the LMA, the provisions in loan agreements that are in particular relevant in this context include:

- **Conditions for utilisation:** Are there conditions for further utilisation of loans under the loan agreement that the borrower may potentially not be able to fulfil and hence that the borrower will not be able to utilise further financing under the existing loan agreement?
- **Representations:** Will the borrower be able to make the relevant representations? Which representations are repeating? Are there any exceptions, thresholds or carve-outs that are applicable in this case?
- **General undertakings:** Will the borrower be able to comply with its general obligations and, if not, are there any exceptions, thresholds or carve-outs that are applicable in this case?
- **Information undertakings:** Will the borrower be able to deliver all required information to the lender in a timely manner as required by the loan agreement? Is there a default under the loan agreement or other finance documents that the borrower should notify the lenders of?
- **Financial covenants:** Which financial covenants are included and how they are measured and calculated? Is the borrower in compliance with the financial covenants and will the borrower be able to comply with the financial covenants going forward if the situation does not improve?
- **Material Adverse Effect:** Does the loan agreement include the concept of Material Adverse Effect? Does the definition of Material Adverse Effect cover the current situation? In which provisions in the loan agreement is a Material Adverse Effect relevant and how does this affect the representations, undertakings, events of default and other provisions in the loan agreement?
- **Events of Default:** Are there any events of default that will be triggered by the current situation? Is there a cross default provision that could potentially be triggered due to defaults under the borrower's other financing arrangements? Does the suspension of payments under the borrower's other debt or the commencement of negotiations with the borrower's other creditors trigger an event of default under the current loan agreement?

The above list is only a non-exhaustive list of typical provisions that may be affected and therefore borrower should always carefully review the relevant loan agreement and other finance document in their entirety to ensure that the borrower has a full picture of all the provisions that may be affected by the current situation.

However, it is worth mentioning that it is very unusual that loan agreements or other finance documents include provisions which would relieve the borrower from its payment obligations due to any reasons other than reasons attributable to an administrative or technical error. It is also worth noting that few loan agreements include force majeure provisions that are relevant in this context, which could relieve the borrower from its payment obligations due to the current situation. Therefore, a borrower cannot normally avoid its payment obligations under the loan agreements or other finance documents due to reasons attributable to the Coronavirus pandemic and the effect it has on the borrower's business and financial condition.

Material Adverse Effect clauses in loan agreements

Material Adverse Effect clauses are commonly included in loan agreements that follow the recommended form developed by the LMA, and it is worth saying a few words about the Material Adverse Effect clauses in loan agreements in the context of the current market situation.

Firstly, the borrower needs to review the loan agreement and other finance documents to check whether the loan agreement or other finance documents include the concept of Material Adverse Effect, material adverse change or similar concept.

Secondly, to the extent the borrower's loan agreement or other finance documents in fact includes the concept of Material Adverse Effect, the borrower should review the relevant definition of the term and assess whether the definition actually covers the current situation. Although the recommended form of facility/facilities agreements developed by the LMA contains a suggested definition of Material Adverse Effect, such definitions are often specifically negotiated and the wording and scope can vary to some extent on a case by case basis. Most typical definitions of Material Adverse Effect are drafted in a such a way that they are not (and on their own) triggered solely by the Coronavirus or the pandemic caused thereby. However, the negative consequences to the borrower's business and financial condition caused directly or indirectly by the Coronavirus may be significant enough to trigger a Material Adverse Effect, and hence the borrower should carefully review the definitions of Material Adverse Effect in its loan agreements. That being said, in case a Material Adverse Effect clause would be triggered due to financial difficulties having occurred, it is very likely that certain other provisions in the finance documents have also been triggered which may be more relevant in this context, such as a non-compliance with financial covenants or other undertakings or standalone events of default (payment default, cross default etc.).

Thirdly, to the extent the borrower establishes that the definition of the Material Adverse Effect may potentially cover the current situation, the borrower should review the loan agreement and assess which provisions in the loan agreement are affected by Material Adverse Effect. Typically, under loan agreements based on the recommended form developed by the LMA, the definition of Material Adverse Effect may be relevant in the context of at least the following provisions in loan agreements:

- the conditions for utilisation (directly or indirectly with reference to no default or event of default having occurred or is continuing);
- the representations and undertakings (which representations and undertakings are qualified with reference to Material Adverse Effect?); and
- the events of default (as a standalone event of default).

It should be noted that to the extent a company has entered into a commitment letter or mandate letter regarding commitments from lenders to provide financing, it is recommended that the company carefully reviews the relevant commitment documents, as certain commitment documents include material adverse change provisions that are more extensive than the typical Material Adverse Effect definitions in loan agreements, according to which the obligations of the lenders under the commitment documents may be subject to, for instance, any events or circumstances which has adversely affected or could adversely affect the international or any relevant domestic loan, debt, bank, capital or equity markets. Such provisions may in certain cases be triggered by the current market situation and consequently such provisions could potentially relieve the potential lenders from the obligation to provide the financing pursuant to the commitment documents.

Which actions should a borrower take?

To the extent the borrower has existing loan agreements or other financing arrangements in place and the current market situation has had an adverse impact on the borrower's business and financial condition, it is recommended that the borrower considers the following actions:

- review the borrower's existing loan agreements and other finance documents carefully, preferably with the help of the borrower's legal advisor, to assess the potential consequences the current situation has on the loan agreement and other finance documents and to assess which (if any) further actions are required;
- when reviewing the loan agreements and other finance documents, the borrower should pay specific attention to:

  - <u>Representations:</u> which representations and general undertakings are included in the loan agreements and other finance documents, and will the borrower be able make the representations and comply with the undertakings in the loan agreements and other finance documents;

  - <u>Information Undertakings:</u> which information undertakings are included in the loan agreements and other finance documents, whether the borrower will be able to comply with the information undertakings and in particular whether there is an obligation to notify the lender of the situation;

  - <u>Financial Covenants:</u> how are the financial covenants measured and calculated and is the borrower in compliance with the financial covenants, and will the borrower be able to comply with the financial covenants going forward if the situation does not improve;

  - <u>Material Adverse Effect:</u> please see above under section "Material Adverse Effect clauses in loan agreements";

  - <u>Events of Default:</u> which events of default are included in the loan agreements and other finance documents and will any event of default will be triggered by the current situation (directly or indirectly); and

  - <u>Other Finance Documents:</u> except the actual loan agreements, are there any other finance documents that may contain provisions which may be relevant in this context; and
- if, following review of the borrower's existing loan agreements and other finance documents, the borrower determines that there is a non-compliance, or the borrower expects that a non-compliance may potentially occur, take appropriate measures as a result thereof. Which measures the borrower should take obviously depends on a number of different factors, and a discussion of these measures is beyond the scope of this article, but in most cases it is recommended that the borrower keeps the lenders duly informed of the situation and the actual or potential non-compliance with the loan agreements or other finance documents, and keeps an open dialogue with the lenders. Transparency is often of significant importance in situations like these.

As a separate point, to the extent the borrower intends to enter into negotiations with its lenders with a view to amending the terms of the loan agreement or rescheduling any of its indebtedness due to financial difficulties, the borrower should be careful not to trigger any events of default under the borrower's other loan agreements, as certain loan agreements may contain events of default clauses that may potentially be triggered by the borrower rescheduling any of its indebtedness due to financial difficulties or suspending payments of its debt.

How can Delphi assist?

Delphi's banking and finance department advises Swedish and international banks and financial institutions, funds, companies and other lenders and borrowers in connection with Swedish and cross-border financing transactions and offers services within a wide range of banking and finance related matters, such as debt capital markets transactions, financial markets regulation, consumer credits, project financings, financial restructurings and insolvency law. If you have questions regarding the effects of the Coronavirus pandemic and the current market situation on your company's loan agreements and other financing arrangements or the other topics discussed above, you are welcome to contact Berndt Pettersson, who is a partner and head of Delphi's banking and finance department in Stockholm.

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