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COVID-19: How it may affect your loan and finance agreements

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Many loan and finance agreements contain obligations on the borrower, which may be affected or challenged due to the COVID-19 situation. In this newsletter we have outlined the typical issues to check and be aware of as a borrower.

Depending on the type of financing your business has obtained, your business will as a borrower often be subject to several obligations, which a borrower will have to comply with during the term of relevant loan (or other financing arrangement). For regular loan and credit agreements these obligations are often referred to as undertakings or covenants, where those most likely affected by the COVID-19 situation are the so-called *information undertakings* and *financial covenants*. The lender will often also have certain remedies available for extraordinary situations. Below we have outlined some likely issues based on the standards provided by the Loan Market Association (LMA), but financing agreements not based on LMA standards will often entail similar provisions.

Information undertakings

The borrower is typically obliged to deliver certain information and reporting, such as financial statements, budgets, monthly/quarterly accounts and other financial information, to the lender on certain deadlines and based on certain pre-agreed reporting templates/models. If a borrower due to the COVID-19 situation changes the way of reporting or is unable to meet a reporting deadline, this could mean a breach of the borrower's obligations under the information undertakings.

A change in the reporting could be the case if the borrower chooses to postpone VAT and/tax payments as permitted by the Danish Authorities due to COVID-19. Another likely scenario could be that the borrower is not able to conduct the annual general meeting and therefore not able to have the annual account approved at the general meeting. In such case a borrower with an undertaking to provide the lender with the approved annual accounts within a certain deadline, could have difficulties meeting this deadline.

It will require analysis of the relevant agreement to determine whether and which information undertakings could potentially be breached, but the general recommendation is to contact the lender and agree on how to proceed with the reporting in a way which is possible for the borrower, but on the other hand meets the requirements from the lender's side. Specifically, with respect to general meetings, we note that the Danish Government have passed legislation which extends deadlines for filing annual reports and is expected to pass legislation which allows for virtual or electronic general meetings for all companies. This new and expected legislation could solve the issue that many Danish companies, particularly those listed on a stock exchange, are currently faced with, of approving the annual accounts in time, but does not solve the issues that multinational groups face as legislation is not uniform across borders.

Financial covenants

The financial covenants have the purpose of showing the lender on a regular basis the financial status of the borrower based on certain parameters, often referred to as *ratios*. The loan agreement will contain agreed thresholds and levels for the ratios, and if these are not met on the agreed test dates, so borrower will be in breach of the financial covenant. The most common financial covenants are:

- Cashflow coverage ratio:

Measures the ability of the borrower to generate sufficient cashflow to pay its obligations as they become due

- Interest coverage ratio:

Measures the ability of the borrower to generate operating profits to cover its interest costs

- Leverage ratio:

Measures the debt level of the borrower compared to its operating profits on a certain date

It seems very likely that many borrowers due to the COVID-19 situation will be challenged with respect to these ratios. Many loan agreements will also contain so-called *cure periods* allowing the borrower to cure the breach of a ratio within a certain timeframe. However, for many borrowers the cure-period will not be sufficient, and it could be relevant to seek to negotiate adjusted temporary ratios. Especially, if it is likely that the borrower will be able to get back on track after COVID-19.

Other relevant provisions

Force Majeure

Many borrowers will consider whether the COVID-19 situation is a force majeure situation, and whether this will affect the borrower's obligations under loan and finance agreements. In relation to loan agreements governed by Danish law, we refer to our newsletter on the Danish force majeure concept, and we note that negative effects on the financial situation of a borrower due to the COVID-19 situation at its current stage will, in respect of most finance arrangements, likely not constitute a force majeure situation (as the force majeure concept is generally interpreted under Danish law).

The LMA standards are drafted to be governed by English law, and many Danish borrowers are parties to such English law loan agreements. The concept of force majeure under English law is a purely contractual concept and therefore requires that the loan agreement contains a force majeure provision. It should be determined whether 1) the COVID-19 situation is covered by the wording of the force majeure provision, 2) the performance of obligations have been prevented, hindered or delayed due to the COVID-19 situation, 3) the non-performance was due to circumstances outside the control of the non-performing party, and 4) it was not possible to avoid or mitigate the the event.

The LMA standards do not operate with a general force majeure provision (other than in respect of certain specific provisions, such as liability on the part of the agent/lender), but English law also has available the doctrine of *frustration,* which can be relevant if the frustrating event (in this case the COVID-19 outbreak) is 1) unexpected, 2) beyond the control of the parties, and 3) makes performance impossible or radically different from that which the parties contemplated at the time of entering into the contract. The threshold is quite high, and whilst it will in each case be a specific assessment, it is likely that a borrower will not be able to establish that a standard loan agreement has been frustrated solely due to COVID-19.

Material Adverse Effect

The LMA standards and many other finance agreements operate with the concept of *Material Adverse Effect*, which typically allows the lender to take certain measures or remedies, including acceleration/termination, if a situation occurs which is likely to have a Material Adverse Effect on either the business of the borrower or certain other contractual arrangements or assets of the borrower (such as real estate). It is likely that lenders could argue that the COVID-19 situation will have such a Material Adverse Effect on the business or assets of certain borrowers.

Other undertakings

It is likely that the COVID-19 situation could result in borrowers not being able to meet other undertakings in their loan or finance agreements. This is especially relevant for real estate financing where the loan agreement will typically contain undertaking relating specifically to the properties, such as maintenance, tenancy occupation ratio and similar. Such borrower should generally try to mitigate the negative effects on the properties by keeping up maintenance level and similar as much as possible and focus on these specific undertakings.

Disruption Event

If the COVID-19 situation results in payments systems and other financial market systems being affected or unavailable, this could constitute a so-called *Disruption Event* under the LMA standard, which typically entails that the non-payment by a borrower caused by the Disruption Event will not be a breach of the loan agreement. This will not mean that the continuing non-payment can be justified by reference to COVID-19, but for as long as the borrower is for example unable to make wire transfers due to the payment system bot being available, the non-payment will often be excused.

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