

FINANCE AGREEMENTS IN COVID-19 CRISIS SITUATION

INFLUENCE OF COVID-19 PANDEMIC AND
SPECIFICS IN GERMANY (LEX “CORONA”) ON
FINANCING ARRANGEMENTS

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orrick

Relevant Topics in International Financings Due To COVID-19 – Overview

For existing financing arrangements:

- Material Adverse Effect/Force Majeure
 - New utilization requests
 - Cancellation of existing commitments
 - (Event of) Default
- Compliance with Financial Covenants
- (Proactive) Update of the Base Case Models
- Information requests by the Lenders due to potential (Event of) Default
- Increased costs due to decrease in rating

For new financing arrangements:

- Proof that there is no Material Adverse Effect
- Amending of pre-agreed Financial Covenants and update of the Base Case Model to avoid immediate (Event of) Default
- Increase of costs (interest, fees) due to increased risk
- Usage of new public financings programs
- Usage of electronic signatures to avoid signings *in persona*



Existing Financings – Material Adverse Effect (1)

As COVID-19 measures may have a material adverse effect on the ability of a Borrower to satisfy its respective obligations, this may be qualified by Lenders as a Material Adverse Effect (“**MAE**”) or Material Adverse Change (“**MAC**”). Whether or not this is the case depends on the MAE definition included in the respective financing arrangements. Topics connected herewith could be the following:

- **New utilization requests/Cancelation of existing commitments:**
 - New utilization requests may not be satisfied by the Lenders/Agents arguing there is a MAE.
 - It shall be double checked by the Borrowers making the utilization request that repeating representation and warranties are still satisfied.
 - Most likely agency desks will check the utilization requests very diligently in the current situation. Thus, full compliance with formal requirements may be of essence to receive required liquidity.
 - Though the Lenders may not accelerate already utilized facilities, there is some risk that they may cancel available commitments/“freeze” the revolving facilities due to occurrence of MAE.



Existing Financings – Material Adverse Effect (2)

- **(Event of) Default/Acceleration:**

- Generally pursuant to standard financing documentation, the occurrence of a MAE entitles the Lender(s) to accelerate the respective facilities granted. On the other hand, due to the generally broad definition of MAE and thus, the uncertainty of whether COVID-19 really lead to a MAE, the liability connected to undue acceleration as well as existing reputational risks, the probability that Lenders may accelerate the granted facilities extensively is rather low.
- However, Lenders may use the situation and request from the Borrower to obtain respective waivers as a matter of precaution for which document and waiver fees may become due and payable.
- Cross-Default Risk: Though under certain financing arrangements, COVID-19 may not lead to MAE/MAC, a MAE/MAC may occur under other financing arrangements and/or agreements of which a relevance for a “Cross Default”- (Event of) Default (e.g., in project financings respective concession, EPC, power purchase and O&M agreements may be terminated and lead to a(n) (Event of) Default).



Existing Financings – Force Majeure

- Explicit Force Majeure clauses are rather not included in German law governed financing documentation and normally covered by MAE/MAC (cf. above). However, they can be of essence in agreements which are relevant for Cross-Default provisions.
- Whether the developments connected with COVID-19 can be Force Majeure depends on the respective definition in the documentation, the factual background and the case at hand and must be analyzed in detail.
- If Force Majeure is applicable, it may release the Borrower from fulfilment of certain obligations at least for a certain period of time or provide him with a claim that the financing documentation is amended, respectively. On the other hand, an acceleration by the Lenders may also be possible if an amicable solution cannot be found.
- In addition or in absence of Force Majeure provisions, the principles of the “frustration of the purpose” (*Wegfall der Geschäftsgrundlage*) may apply.



Existing Financings – Financial Covenants/Business Day

- **Financial Covenants:**

- Due to the sudden decrease of incoming cash flows because of the COVID-19, there is a high risk that EBITDA/cash flow-related Financial Covenants (e.g., Leverage, DSCR, ICR, etc.) may be breached in the near future as has been calculated without the “Corona-Effect”. This may lead to (Events of) Default and finally, acceleration of the facilities granted.
- Usage of (normally limited) cure rights in the current situation is possible, however, it may lead to the consequence that such cure rights may not be available in the future. Due to the fact that MAE/MAC issues may be discussed with the Lenders in any case, rather, potentially, a waiver shall be obtained instead of using cure rights.
- If waivers are discussed with the Lenders, future influence of the “Corona-Effect” on the Base Case Model shall be taken into account and respective Financial Covenants (Covenants Reset).

- **Definition of Business Day:** As Business Day definition normally refers to a day on which financial institutions are open of business, based on quarantine measures it shall be monitored whether this is actually the case.



Existing Financings – Information Obligations

- **(Proactive) Update of the Base Case Model:**

- The borrowers may be obliged to proactively update the Base Case Models provided to the Lenders, which is dependent on the concrete financing documentation. This may consume additional resources (e.g., work force may be needed at the other end, potential costs for an auditor, who has to verify the data) and further decrease available liquidity.
- On the other hand, an update of the Base Case Model may also provide a change to openly discuss with the Lenders the situation and achieve waivers/Covenants Reset. Additionally, an updated Base Case Model (if the respective figures do not show MAE/MAC) can be used as mitigation element to avoid acceleration of the facilities granted based on MAE/MAC.

- **Information obligations/requests by the Lenders due to potential (Event of) Default:**

- Normally financing documentation includes information obligations of the Borrower to inform the Lenders regarding any (Events of) Default or even events which are likely to result in such events. Some agreements may even go further and request provision of information with regard to any impairment of the financial situation.
- Apart from that, Lenders are generally allowed to request information from the Borrowers if there is suspicion of some distressed situation. Respective requests may also be connected with the costs for the Borrowers as respective experts requesting and reviewing provided information of the Lenders are normally to be paid by the Borrowers.





Existing Financings – Increased Costs/Additional Security/Deferrals

- **Increased Costs/Additional Security:**

- Financing documentation may include clauses that the economic conditions may be changed if the rating of the Borrower decrease, which then will be connected with increased interest payments over the remaining life time of the financing and may potentially stress DSCR and ICR covenants.
- Potentially, in the event that the Lenders have a suspicion that the rating of the Borrower may decrease, they may also request to confirm the rating by a rating agency. This may cause additional costs.
- In addition, it is not uncommon in financing documentation to enable the Lenders to call for additional security in case of rating decreases.

- **Deferrals:**

- Deferrals are a common method in case of acute liquidity problems. The question is whether such can be considered as a "defaulted exposure" pursuant to the Capital Requirements Regulation if the deferral is lasting for a long time period. This may lead to a significant increase of the regulatory capital requirements.
- Pursuant to the German regulator's FAQ published recently, respective deferred claims do not qualify as defaulted if interest on the deferred amounts must be paid as agreed in the respective financing arrangement. If the deferral is applicable pursuant to mandatory law, also in such case a default shall not occur. It can be assumed that also in other jurisdictions the regulators will take similar approach how to deal with the respective question.



New Financings – MAE/MAC and Financial Covenants

The below points are applicable for fully new financings as well as for financings with ongoing negotiations (e.g. where a term sheet was already concluded and the final documentation is in the drafting phase). By reading the below the parties shall consider the fact where the negotiations stand and apply the said respectively.

- **Representation that there is no MAE/MAC:**

- Once executing the financing documentation as well as making a utilization requests, the Borrower normally has to make a representation that there is no MAE/MAC and nor (Event of) Default.
- To this extent respective documentation may deem COVID-19 consequences not to be MAE/MAC/ (Event of) Default.

- **Agreeing on reasonable Financial Covenants/amending of pre-agreed Financial Covenants and update of the Base Case Model to avoid immediate (Event of) Default:**

- It can be advisable that before concluding the final financing documentation to update the Base Case Model and also to double check the possibility to fulfill the Financial Covenants as agreed potentially already pre-agreed in the term sheet or pre-discussed with the Lenders/Arrangers.
- Potential solution can also be to agree with the Lenders that potential effects of COVID-19 shall not be considered in the future calculating the Financial Covenants being an one-time effect.

New Financings – Costs Increase, Usage of Public Programs and Signing of the Documentation

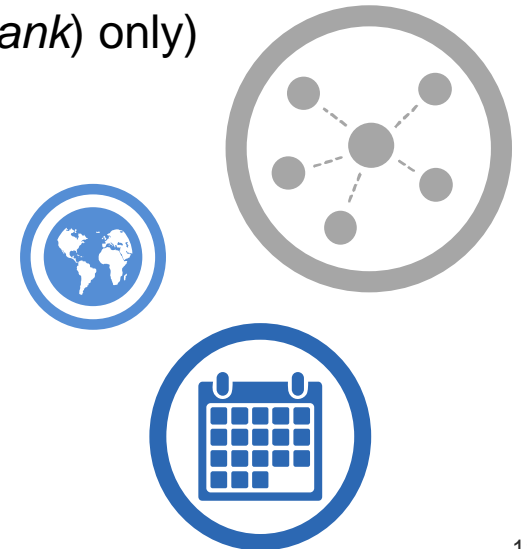
- **Increase of costs (interest, fees) due to increased risk:** It shall be discussed with the Lenders/Arranger whether a potential increase of interest or additional fees are to be expected pursuant to COVID-19 consequences on the economy.
- **Usage of new public financings programs:**
 - As Borrowers may be interested to use new public financing programs that are offered by different governments respective curve-outs in the permitted transactions, permitted indebtedness, permitted security, etc., may be included in the financing documentation.
 - In addition it may be discussed with the Lenders whether they are willing to accept, for example, state-provided guarantees as security to reduce the yield on the financing. In addition, a form of the respective financing may also be changed from a classic loan to a bond, for example, to allow a refinancing by the European Central Bank (“**ECB**”) under the Pandemic Emergency Purchase Programme.
- **Usage of signing software/electronic signatures to avoid signing rounds *in persona*:**
 - It can be advisable in the current situation to waive the requirement of signing rounds *in persona*.
 - Instead, in the most jurisdictions, the execution of the documents is possible by pdf-signing. In addition, signing web-based applications like DocuSign, AdobeSign, etc., (very common tools in the VC scene) can and shall also be used to execute financing documentation.



Available Governmental Financial Assistance Programs

Financial Assistance Programs available in Germany for the time being:

- ECB Pandemic Emergency Purchase Programme with amount of EUR 750bn which also includes a corporate sector purchase programme under which also corporate bonds are also eligible to be purchased (however, investment-grade rating of BBB- is a minimum requirement)
- KfW liquidity programs (available through principal bank (*Hausbank*) only)
- Measures of local governments (available through principal bank (*Hausbank*) only)
 - Facilities by state development banks of the federal states (*Förderbanken*)
 - Guarantees (*Bürgschaften*) by the guarantee banks (*Bürgschaftsbanken*)
 - Other quick (direct) liquidity measures for small corporates





Lex “Corona” in Germany – Short Overview

- Incorporation of an economic stability fund (*Wirtschaftsstabilisierungsfonds*) to support big companies (two of the following criteria must be fulfilled: >249 FTE, EUR 50m of revenues or EUR 43m of assets; however also open for start-ups with a valuation above EUR 50m or strategically important enterprises with the meaning of Section 55 AWW) by financial assistance:
 - EUR 400bn for guarantees
 - EUR 100bn for direct investments
 - EUR 100bn to cover investments through KfW
- Suspension of insolvency filing requirements (until 30 September 2020 with prolongation possibility until 31 March 2021) and easement of requirements for restructuring loans if granted between March and September 2020
- No claw back for loans and security provided in the current situation until September 2023 if granted between March and September 2020. Same is applicable to shareholder loans (but not security granted to the shareholder).
- Suspension of tax payments which may be used by the Borrowers to obtain additional liquidity (until 31 December 2021)
- Implementation of eased requirements of short-time working allowance (*Kurzarbeit*) which may be used to decrease operating expenses



How we can help?

- Assess liquidity needs and develop strategies for various scenarios
- Review finance and other contracts for defaults, remedies and breaches
- Negotiate forbearances, standstills and waivers to defaults on lending facilities or contracts caused by the virus's economic impact
- Working with our other finance business-unit partners, structure innovative lending solutions to carry through the virus's impact
- Working with our litigation partners to consider litigation risk and strategies
- Structure temporary alternative arrangements
- Prepare for bankruptcy alternatives
- Assess opportunistic distressed M&A for companies with exceptionally strong balance sheets to make acquisitions, and those who can't access financing and instead look for strategic alliances
- Address any regulatory enquiry which may arise (e.g., license requirements/disclosure obligations)
- Provide advise on the issuance of debt securities and other debt instruments on capital markets

Team Biographies



Timo Holzborn
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Timo has a special focus on Finance & Restructuring and has been advising clients on finance and restructuring law matters for more than 15 years.

He heads our Banking & Finance practice in Germany and inter alia served as member in certain creditors' committees (e.g., van Netten, Gerry Weber) and advises in the fields of capital markets, bank regulatory & asset management (incl. AIFs), corporate law and derivatives/carbon trading.

Timo helps his clients, among them, banks, corporates, listed companies and asset managers in capital markets and finance transactions, M&A, squeeze outs, IPOs/ICOs as well as with regard to compliance. He also has special market experience regarding (renewable) energy, banking (stock exchange), automotive insurance and fund structuring, as well as technology.

His experience includes having advised the main creditor Hemlock in the insolvency of Solarworld, major OEM on the restructuring proceedings of Takata and Eisenmann, including creditor coordination and safeguarding of supply chain, listed companies in crisis and restructuring and insolvency receivers in several court proceedings.



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Olexiy focuses on providing legal advice to financial institutions and corporate clients regarding banking and finance with a strong focus on restructuring and insolvency matters.

Key aspects of his work are financings and restructurings of any kind as well as advising clients on issuance/restructuring of bonds and further debt instruments on capital markets. Apart from that, Olexiy was involved in a substantial number of disputes, dealing with matters of banking supervision law, as well as finance and insolvency law. Furthermore, Olexiy has specific know-how and experience in transactions and legal proceedings connected to CIS-states, in particular the Ukraine and Russia.

Olexiy's clients, which he advised on restructuring and insolvency-related matters, are such well-know names like Goldman Sachs, DVB Bank, Kathrein SE, Merkur Offshore, CRCI, Somerston and many others.



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