MARIMÓN
ABOGADOS

The impact of COVID-19 crisis on commercial loans and credit facilities

Commercial loans and credit facilities | COVID-19 crisis

I. Introduction

In the extremely dynamic development of measures to combat the coronavirus COVID-19, the Spanish Government declared a State of Alarm on Saturday March 14, 2020.

Along with this State of Alarm the Spanish Government has passed a number of legal regulations, including protective measures for debtors.

II. Scope of the new regulations

Most part of the new regulations passed by the Spanish Government in light of the COVID-19 crisis aims at protecting individuals, and only the most vulnerable.

In the case of financial agreements, Royal Decree-Law 8/2020, of 17 March 2020, on urgent and extraordinary measures to face the economic and social impact of COVID-19 introduced a protection for debtors (and personal guarantors) **but only** for those under financing agreements for the purchase of dwellings and subject to certain additional restrictions. However, Royal Decree- Law 1/20202, dated 31 March 2020 on complementary urgent and extraordinary measures to face the economic and social impact of COVID-19 has extended this protection to individuals that conduct professional or commercial activities in accordance with Act 37/1992, of 28 December on Value Added Tax that have suffered a substantial loss of income/turnover of at least a 40% and in relation to the mortgage loans obtained for the acquisition of the real estate properties linked to their professional or commercial activity. The protection for these debtors consists in the right to obtain a "moratorium", i.e. basically a suspension of (i) scheduled repayments; (ii) accrual of ordinary and default interest; and (iii) -obviously- the ability by the lender to accelerate the loan during the agreed duration.

In accordance with the new regulation the debtors shall have the right to expressly request the moratorium from the lenders within certain deadlines. The duration of the moratorium will be subject to the negotiation with the lender.

Similar measures have also been taken for credits granted to individuals in situation of vulnerability (and personal guarantors) not secured by a mortgage.

Therefore, the new regulations **do not affect** commercial loans and credit facilities granted to companies/legal entities.

III. Legal framework applicable to commercial loans and credit facilities

Unfortunately, no legal certainty exists as to how to treat the impact of COVID-19 on commercial financial agreements. At least in Spain, there has been no such a serious situation in the recent history of the country, from which one can anticipate what the approach of the Courts will be.

At first sight it could be considered that the fact that the new Spanish regulations only include protective measures for such vulnerable individuals in their financing of the purchase of dwellings, implies an understanding by the legislator that “other debtors” shall continue to be bound by the financial agreements in their own terms, COVID-19 having by will of the legislator no other impact on those contracts that what the parties thereto may have specifically agreed therein. However, this conclusion is premature. A case by case analysis will be absolutely necessary.

It is undoubtful that the impact of COVID-19, which is yet unknown to all of us, may well be huge and, while it will be important on most economic sectors, it will hit very hard some of them in particular. For instance, hotel and retail activities which operations have directly been banned by Law during the lock-down period declared by the Spanish Government, have quickly gone into a critical situation of 0 revenues and still many expenses to bear. Even when the confinement measures are lifted, the return to normality will probably be very slow.

This will for sure be the case of the tourism sector in general, which is key in Spain. As opposed, other sectors have been able to continue to (at least partially) operate and will probably do it better after the State of Alarm ends.

As far as real estate financing is concerned, it is already massively starting to happen that the operators of the affected businesses, who are usually tenants, are requesting a renegotiation of the lease agreements. The cash-flows of the landlords will be severely affected and this will have, in turn, an impact on (i) the cash availability for the landlords/borrowers to comply with their payment obligations vis-à-vis the lenders; (ii) the financial ratios and (iii) the valuation of the properties.

How to treat these situations in commercial financing agreements subject to Spanish law?

In accordance with Spanish law the starting point is always the principle of “*pacta sunt servanda*”. This means, that the general rule is that the financing agreement shall be complied with in its own terms. Let us however analyze two exceptional tools envisaged in Spanish law in order to deal with exceptional circumstances: a) "*force majeure*"; and b) “*rebus sic stantibus*”.

Force majeure is a tool expressly contemplated in our Civil Code and exempts the need to comply with a specific obligation or allows its suspension until the cause disappears, if caused by the existence of an extraordinary, unforeseeable or unavoidable situation that prevents the performance of the obligation. In general terms it seems that COVID-19 obviously fulfils these first three requirements. However, it will be key to analyze the specific provisions in the commercial financial agreements and the circumstances at hand affecting each borrower, which may be very different depending on the situation.

The aim is to determine whether the compliance with the obligation has in fact been prevented or has simply been made more difficult or less interesting than it was before the new situation arose. It shall be borne in mind that force majeure is rather a legal tool which exempts from complying with obligations to “deliver” or “to do” something that is impossible to deliver (for instance an industry cannot deliver a product if the production was stopped due to a force majeure) or impossible “to do” (for instance an airline cannot perform a flight if flying is impossible due to force majeure). On the contrary, a payment obligation is never “impossible” unless it has to do with a legal prohibition or a technical problem that makes the payment impossible.

The *rebus sic stantibus* doctrine is somewhat different. It does not exempt from the compliance with an obligation, but rather allows that in those agreements in which the COVID-19 generates a serious imbalance of performance between the parties, the party most affected has grounds to demand the renegotiation of the contract and, perhaps, to be partially discharged from the excessive burden that it entails.

Unlike *force majeure*, which operates directly, the *rebus sic stantibus* doctrine allows to force the renegotiation of the contract in order to adapt to the new situation. And that renegotiation will have many nuances, because each case will be different. The application of this doctrine requires proof of a direct effect that leads to a situation close to "sale at a loss" (using terms applied in some of the case law). In this sense, it should be remembered that the Supreme Court's ruling in which the rebus sic stantibus doctrine was applied based on the general impact of the 2008 crisis on the hotel business did not continue in subsequent ones and was the object of general criticism by the doctrine.

It is important not to mix up the above assumptions with the "difficulties, even extreme ones" that all companies are suffering as a result of the COVID-19 and which are generating cash flow tensions. It must also be taken into account, that in order to face the extreme financial difficulties caused by COVID-19 to many companies, the Spanish Government has provided some financial aids (in the form of state guarantees). Therefore, the Spanish Government is assuming part of the risk relating to COVID-19 so to avoid a “chain-reaction” of the different operators in the market (tenant-borrowers-banks) so the intention of the Spanish Government is not to cause a direct transfer of the risks of COVID-19 to the lender. In this context a diligent borrower shall be cooperative and do anything reasonably possible in order to mitigate the damages, which may include -depending on the circumstances and the consistency of this measure with the finance documents- the requesting of available state-guaranteed liquidity lines in order to continue -as far as practicable- with the agreed payments to the lender.

Each case is different, and it will be critical to (a) analyze the terms and conditions set forth in the particular finance documents and (b) understand the specific impact of COVID-19 on the borrower (and the lender).

In accordance with our case law, the rule is that the party who is affected by the exceptional circumstances which make it very difficult or even impossible to comply with a contract (in this case the finance documents), shall have the duty of diligently and transparently communicate its situation to the other party (the lender) as soon as possible, explaining transparently and in "good faith" the willingness to minimize the impact of the exceptional circumstances and requesting the corresponding "waivers". In the absence of such a communication, the lender will have the right to assume that the contract can be fulfilled in its own terms.

IV. Specific provisions in the financing agreements

Scheduled payments: Repayment of principal and interest: In our opinion the clear rule as a starting point is that payments shall timely be made by the borrower. Given that a payment obligation is never "an impossible" obligation to comply with, the borrower will not be able to allege "force majeure" in order to stop a payment. On the contrary, in those exceptional cases in which a borrower has prudently and diligently acted but, still, the impact of the COVID-19 has unexpectedly hit its financial situation, the borrower will be entitled to request from the lender (and the lender will be obliged to renegotiate in good faith) new payment terms which provide a temporary solution for these exceptional circumstances. In such a renegotiation, the aim will be to reestablish a "balanced situation" i.e. a situation in which, in light of the situation of both parties (not only the situation of the borrower) the impact of the exceptional circumstances is not only assumed by the borrower.

Financial ratios: Financial ratios which cannot be complied with due to the exceptional effects of COVID-19 will not be considered direct breaches of the finance documents, if the borrower can provide sufficient evidence. For instance, those ratios breached due to the lack of sufficient rental income in a mortgaged property in which the tenants have stopped operations and payment of rents generally, or a drastic drop in the "profit & loss" account of the borrower during the COVID-19 linked to factors relating thereto, will probably be considered caused by "*force majeure*". Based on the "*rebus sic stantibus*" principles, a renegotiation in good faith will be convenient.

Other financial obligations: Such as providing financial statements, auditing reports, etc. will most likely suffer delays. In this context, it shall be borne in mind that the Spanish Government has authorized significant delays in the deadlines for approving annual accounts and complying with other corporate filing obligations as a result of the COVID-19 crisis and the State of Alarm.

Events of default and MAC clauses as grounds for the acceleration of a loan or credit facility: Events of default as grounds for the acceleration of a loan or credit facility are in general always subject to a restrictive interpretation in Spain, both in accordance with the laws (for instance the requirement of failing by the debtor to meet payment obligations equivalent to at least a three-month period before the enforcement of mortgages is possible, as envisaged in our Civil Procedural Act) and the case law, which has declared in numerous occasions that the cause has to be "relevant or essential" and "not merely "temporary". Furthermore, when the cause is linked to the attitude of the debtor, such breaching attitude by the borrower must be "clear". Otherwise, the principle whereby the contract shall remain in place shall prevail. The same could be said regarding application of MAC clauses for accelerating payments in loans and credit facilities: the substantiality of the adverse change is interpreted by the Courts in terms of essentiality and permanence.

Therefore, those events of default which are caused by the COVID-19 crisis, particularly if they are of a temporary nature, will generally not - at least not automatically- enable the acceleration of the loan or credit facility based on that specific circumstance. Again, the parties shall have the obligation to renegotiate in "good faith" and the lender shall have the obligation to permit adequate "cure periods" so to allow that merely temporary breaches exclusively linked to the COVID-19 crisis do not give rise to the drastic consequence of the early termination of the commercial loan or credit facility. Of course, the situation is different, where the lender can provide evidence that the situation is not merely temporary, but rather permanent and structural.

V. Court action

It must be said that civil and commercial Courts are not operating during the State of Alarm, except for very exceptional cases. Enforcement proceedings are not considered an exception. Usual terms for the filing of insolvency or pre-insolvency proceedings are also considered suspended for the duration of the State of Alarm.

In any event we recommend to lenders a prudent approach prior to deciding drastic measures such as accelerating loans and initiating enforcement procedures against debtors who cannot comply with the terms of a loan or a credit facility due to the COVID-19 crisis.

Each case will require a specific analysis. The spirit of all regulations passed so far during the crisis is to protect the businesses from this crisis. In addition to the potential reputational risks for lenders not following this principle, insolvency laws include tools to judge the role of creditors in the phases prior to the insolvency and, if it is evidenced that a creditor acted unreasonably and contributed to the insolvency, this can result in the loss of privileges or even in the liability of the creditor in the framework of the insolvency proceedings. In exceptional cases we also expect to see in the coming months (as we saw in the last financial crisis), civil liability claims brought by debtors against lenders for unreasonably terminating financial agreements or enforcing security instruments.

MARIMÓN
ABOGADOS

The impact of COVID-19 crisis on commercial loans and credit facilities

Marimón Abogados is a law firm founded in 1931 that offers legal services in all areas of law and has offices in Barcelona, Madrid and Seville.

For further information, please get in touch with our lawyers, all the members of our law firm are available to assist you.

Barcelona -
Aribau, 185
08021
Tel.:+34 934 157 575

Madrid -
Paseo de Recoletos, 16
28001
Tel.: +34 913 100 456

Sevilla -
Balbino Marrón, 3
Planta 5ª-17
(Edificio Viapol)
41018
Tel.: +34 954 657 896

www.marimon-abogados.com