

Quick Bites: Restructuring and Insolvency Finance Agreements in Times of Crisis

After the announced wave of insolvencies caused by COVID-19 failed to materialize for the time being, the Ukraine war and further global developments have raised the question of how long crisis-stricken companies will be able to absorb these effects on their own due to inflation, the war-associated increase in energy prices and further disruption of supply chains as well as shortages of raw materials.

The current developments therefore call for **careful** and, above all, **timely crisis management**, whereby a distinction has to be made between necessary measures with regard to **existing** and **future financings**.

Relevant Topics for (existing) Financing Arrangements

1. Material Adverse Effect / Force Majeure

As described above, the Ukraine war may have a material adverse effect on the ability of the Borrower to satisfy its respective obligations which 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 and risk of cancellation of existing commitments:
 - Requests may not be satisfied by Lenders/Agents.
 - Borrowers to doublecheck that repeating representations and warranties are still satisfied.

- Full compliance with formal requirements to receive required liquidity.
- Risk that Lenders cancel or /“freeze“ commitments if utilized facilities don't accelerate.(Ereignis der) Nichterfüllung
- (Event of) Default
 - MAE occurrence leads to acceleration of the respective facilities granted when its the case due to the generally broad definition of MAE and if the mentioned effects immediately lead to a MAE.
 - This leads to increased reputation and liability risk connected to undue acceleration.
 - Lenders may precautionally request from Borrower to apply for waivers possibly incurring due fees endangering the liquidity situation.
 - Cross-Default Risk if a MAE/MAC occurs under other financing arrangements.



- Force Majeure and Cross-Default
 - Clause can be relevant for Cross-Default provisions, but not standard in German law governed financing documentation.
 - Occurrence of Force Majeure depends on the respective definition in the documentation, the factual background and the case at hand must be analysed 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 entitle him to claim that the financing documentation be amended, respectively. (Proactive) Update of the Base Case Models

2. Compliance with Financial Covenants

- Due to the sudden decrease of incoming cash flows because of the remaining effects, there is a high risk of EBITDA/cash flow-related Financial Covenants (e.g., Leverage, DSCR, ICR, etc.) breach in the near future as the described effects have not been factored into the calculations. This may lead to (Events of) Default and, finally, acceleration of the facilities granted. Also value driven Financial Covenants (e.g. LTV) may be at risk due to decreasing market prices.
- 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, a waiver should be obtained instead of using cure rights if the respective waiver fees are not that high.

- If waivers are discussed, future influence on the Base Case Model shall be taken into account and respective Financial Covenants (Covenants Reset).

3. (Proactive) Update of the Base Case Models

- The borrowers may be obligated 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 to verify the data) and further decrease of the available liquidity.
- An update of the Base Case Model may provide a chance to openly discuss the situation with the Lenders and achieve waivers/Covenants Reset. Additionally, (if the respective figures do not show MAE/MAC) this can be used as a mitigation element to avoid acceleration of the facilities granted based on MAE/MAC.

4. Information requests by the Lenders due to potential (Events 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 request provision of information with regard to any impairment of the financial situation.



- Lenders are generally allowed to request information from the Borrowers if there is suspicion of some distressed situation. Such requests may incur further costs for the Borrowers as the latter usually have to bear the costs for the respective experts requesting and reviewing provided information.

5. Increased costs due to Decrease in Rating

- 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 lifetime 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 decreasing rating.

6. Deferrals

- Deferrals are a common method in case of acute liquidity problems. The question is whether such can be considered as a “default exposure” pursuant to the Capital Requirements Regulation if the deferral lasts for a long period time. This may lead to a significant increase of the regulatory capital requirements.
- Pursuant to the German regulator’s FAQ published in COVID-19 times, 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 remains to be seen whether these regulations will also apply in the current situation.

Relevant Topics for Future Financing Arrangements

- Representation that there is no MAE/MAC (on Borrower’s side).
- Agreeing on/amending of (pre-agreed) reasonable Financial Covenants and update of the Base Case Model as well as doublechecking the fulfilment possibility to avoid immediate (Event of) Default after conclusion of the financing documentation.
- Increase of costs (interest, fees) due to growing risks and rising interest rates for refinancing of the banks to be expected.

Key Takeaways

- Expenses Control/Reduction to receive and secure liquidity;
- Preventive legal support (compliance and regulatory matters) as well as early-stage communication with lenders/agents; and
- Structured long-term strategy to avoid liquidity shortages.



We are happy to support you regarding all legal challenges the Finance Agreements in times of crisis involve at present and in the future:



Olexiy Oleshchuk
Counsel

T +49 89 5434 8074
olexiy.oleshchuk@osborneclarke.com



Arsen Dutka
Associate

T +49 221 5108 4487
arsen.dutka@osborneclarke.com



Irina Kharag
Associate

T +49 89 5434 8148
irina.kharag@osborneclarke.com

