FINANCIAL DIFFICULTIES TRIGGERED BY THE IMPACT OF CORONAVIRUS: ISSUES FOR STAKEHOLDERS

The financial impact of Coronavirus (Covid-19) on businesses which operate, or are reliant upon suppliers or customers, in affected areas has been widely reported. Whilst certain sectors including airlines, manufacturing, retail and tourism appear to be worst affected, others will undoubtedly be impacted if the Coronavirus cannot be contained in the timeframe originally forecasted.

Many companies will be robust enough to withstand the financial implications, at least in the short term. However, for others which are already financially stressed or whose businesses are particularly dependent upon affected territories, the story may not be so simple. In such situations, it is not only the affected company, but its directors, owners, lenders, suppliers, customers and other contractual counterparties which will be grappling with the resulting difficulties.

Companies

Businesses affected by the outbreak may encounter a range of financial consequences. The most obvious is the immediate impact on liquidity of any slow-down in business activity. However, solvency concerns can be exacerbated if the situation results in working capital lines being blocked, financial covenants being breached, events of default occurring and/ or the triggering of termination payments or other contingent liabilities for non-performance.

In the first instance, companies suffering (or anticipating) such difficulties should consider proactively engaging with creditors and other stakeholders with a view to negotiating short term breathing space and ensuring the business is able to continue trading. This is often possible through contractual waivers and forbearance, but certain jurisdictions offer statutory moratorium procedures designed to insulate a business from claims and actions whilst solutions are explored.

The available options and the conditions to any support will depend on the severity of the company's difficulties, the terms of its financing and trading arrangements, the attitude of its stakeholders and the jurisdiction(s) in which it operates and a careful analysis of the facts would be required in order to chart the best course of action. The availability of business interruption insurance could have a material bearing on both the availability of working capital in the short term, and the shape of any eventual solution.

Financiers

It is important that lenders to businesses impacted by the Coronavirus have a clear understanding of the rights afforded to them by their financing documentation. We expect lenders will wish to focus on rights arising from liquidity difficulties and the potentially material impact that Coronavirus may have on the ability of the company to continue operating in the ordinary course.

Given the continued uncertainty regarding the extent and duration of the Coronavirus, lenders are unlikely to be in a position to agree longer term, substantive solutions. Instead, we would expect lenders to be focused on short term arrangements which balance the need to (i) stabilise the affected business, and (ii) protect their own position. Getting a clear line of sight on the impact that the outbreak is having on the business (by requiring increased financial and other reporting) will be essential and should be made a condition to any support.

Suppliers, customers and other counterparties

We expect the most pressing issue for suppliers, customers and other counterparties to be whether and how they can reduce their financial exposure to the affected business, or at least continue to trade with the company in a manner which does not increase their financial exposure.

In most cases this will depend solely upon the terms of the contract they have negotiated with the affected business. However, that may not be the whole picture. For example, in certain jurisdictions counterparties can be compelled to continue supplying a company which enters into a formal insolvency process and will be unable to rely on the insolvency as a basis for terminating the relationship.

Directors

Against the backdrop of potential financial difficulties, it is critical that directors of an affected company understand the scope and extent of their statutory and fiduciary duties, particularly when they are operating in the “twilight zone” (i.e. when there is a real and obvious risk of insolvency).

Generally speaking, directors are required to exercise reasonable care, skill and diligence, and to act in the best interest of the company. These duties are typically owed to the company, however, when a company is under financial stress the directors’ duty to act in the best interest of the company requires them, at least in certain jurisdictions, to prioritise the interests of the company’s creditors over those of its shareholders.

Directors may also find they risk personal liability if their actions during the “twilight” period cause additional loss to creditors. As a result, directors may be inclined to pursue more conservative strategies which place greater emphasis on minimising loss to creditors.

Lastly, if financial difficulties become particularly acute, directors need to be aware of any legal obligation to commence insolvency proceedings. In certain jurisdictions the period for compliance can be as short as 21 days.

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