IMPACT OF THE CORONAVIRUS ON DEBT FINANCING TRANSACTIONS ON THE POLISH MARKET

The COVID-19 epidemic may pose a challenge for existing relationships between parties to transactions for financing in the form of facilities and bonds.

In Poland, as at the date of this briefing (16 March 2020) there are no known cases of notice to terminate or modify facility agreements or present bonds for immediate redemption because of the threat of the epidemic. However, in the current situation there are reasonable concerns about maintaining the liquidity and creditworthiness of borrowers/issuers in certain sectors, which is a result of the general situation and the legal measures the government is taking in connection with the threat. Consequently, both banks and state institutions have made announcements of support for borrowers affected by the consequences of the epidemic. In this briefing, we look at selected issues concerning debt financing granted to entrepreneurs in Poland in the form of facilities and bonds and the legal risks the parties to the transactions (debtors and creditors) should take into account when analysing the currently situation.

FORCE MAJEURE, EXTRAORDINARY CHANGE OF RELATIONS, MAC CLAUSE, ABUSE OF A RIGHT

Force majeure

The occurrence of an epidemic is often analysed in the context of the term ‘force majeure’, which although not defined in law appears in agreements and which legal scholars usually define as an external event which could not be reasonably foreseen and the effects of which could not be prevented. The occurrence of force majeure precludes or limits the liability of a party to an agreement for the performance of an obligation.

While force majeure clauses often appear in many types of agreements (commercial, construction, real estate development, etc.), facility agreements (in particular those based on the LMA standard form) and terms and conditions of bonds do not usually have any force majeure clauses that could
protect the borrower or issuer of the bonds. On the other hand, certain facility agreements may provide for specific events for which the borrower is liable, e.g. suspension of performance by a counterparty of the borrower owing to a force majeure clause (covering, for example, an epidemic).

**Extraordinary change of relations**

A sudden unforeseen outbreak of an epidemic as a result of which the performance of an obligation involves excessive difficulties or puts the party at risk of incurring a considerable loss could in theory be grounds for pursuing in court a claim for the adjustment of the contractual obligation to the new, altered conditions or, if that is not possible – for demanding termination of the agreement. Such a possibility is provided for in Art. 357¹ of the Civil Code (the so-called *rebus sic stantibus* clause). Modification of an agreement by a court may concern in this context the time and the method of performance through, for example, deferral of the payment date or spreading repayment of the debt into instalments.

Any modification of an obligation in this way generally applies only to agreements, therefore it could definitely apply to a loan facility agreement. It is debatable whether a court could in a similar way modify an obligation under bonds, which are not agreements. The prevailing theory among legal scholars and in case law is that a bond, as a negotiable instrument, arises as a result of an agreement between the issuer and the bondholder. It could therefore be argued that a lawsuit based on the extraordinary change of circumstances is also permissible in the case of bonds.

It is worth adding that it is only possible to invoke Art. 357¹ of the Civil Code in the case of agreements governed by Polish law; in the case of agreements governed by English law, this provision is not applicable.

The possibility of a borrower's invoking an extraordinary change of circumstances under Polish law should in any case be conditioned on the substance of the agreement, in particular the wording of a material adverse change (MAC) clause (if included in the agreement).

**MAC clause**

MAC clauses are present in many credit agreements and enable lenders to, for example, give notice to terminate the agreement (or, in agreements governed by English law, accelerate the facility) if an event or circumstance occurs that could have a material adverse effect on the borrower's business or its financial condition and that were not anticipated before the facility agreement was concluded and hence were not included as specific representations, covenants or events of default.

The ability to use a MAC clause in the context of Covid-19 largely depends upon the actual wording of the clause, which will need to be analysed carefully. There are many varieties of MAC clauses, some of which would be triggered if the circumstances “might” have a material adverse effect whereas others would only be triggered if an event “will” occur (a higher test to satisfy). Some MAC clauses grant lenders sole authority to determine whether or not a MAC has occurred whereas others contemplate an objective test. Prior to making a MAC claim, it would be worth consulting one’s legal advisers to seek their view. The question of whether a MAC has occurred is a question of fact ultimately determinable by the courts or arbitration as appropriate, and must be analysed under applicable law (noting that its wording may be interpreted differently under Polish law and English law).
It is worth noting that in agreements governed by Polish law, the MAC clause overlaps with a statutory criterion provided for in the Banking Law which refers to the loss of creditworthiness or “creditability”. Art. 75 of the Banking Law has a bank-friendly provision that is sometimes referred to as a “statutory MAC”, stating that a bank may give notice to terminate a credit agreement if the borrower loses creditworthiness, i.e. the capacity to repay the loan contracted plus interest on the dates set out in the agreement.

**Extraordinary change of circumstances vs MAC clauses – in the case of loan facilities**

Typically, a MAC clause is drafted as one of the events of default, in which case it is implied that the risk and consequences of its occurring are borne by the borrower. Therefore, in agreements governed by Polish law it could be argued from the perspective of lenders that the intention of the parties to a facility agreement containing a typical MAC clause was to contractually prevent the borrower from invoking the “extraordinary change of circumstances” clause included in the Civil Code. Generally, contractual exclusion of the Civil Code clause is considered permissible and effective by legal scholars and in case law, however there has been no precedent case in relation to this specific issue and the outcome of a potential dispute is not clear.

Even if we accept that a specific facility agreement could be modified based on the statutory extraordinary change of circumstances clause, for practical reasons (especially the uncertain outcome of the proceedings and the time necessary for obtaining a court judgment), a lawsuit of this type is not the optimum solution. A quicker and more effective way of modifying an obligation seems to be contractual (consensual) restructuring, and if that is unsuccessful – court restructuring proceedings (obviously provided the statutory eligibility criteria are met).

**Extraordinary change of circumstances vs MAC clauses – in the case of bonds**

The above conclusions also apply to the terms and conditions of bonds in which grounds for early redemption are also seen (although less frequently), including the occurrence of events and circumstances defined in a similar way to MAC clauses in facility agreements.

Assuming that a lawsuit based on the statutory extraordinary change of circumstances clause is permissible in relation to bonds, it will be necessary to analyse the substance of the terms and conditions of the bonds, and in particular whether they contain a MAC clause that could preclude that possibility. It will also be necessary to determine how effective this option would be, taking into account the time needed to obtain a court judgment.

In the case of a debtor whose business is financed by both credit facilities and bonds:

- if the terms and conditions of the bonds do not state the grounds for early redemption related to a MAC clause but the facility agreement provides for a MAC-based event of default, it will be necessary to check whether any use of the MAC clause by the lenders would be a “secondary” criterion for
early redemption of the bonds incorporating a cross-default or cross-acceleration;

- it is always necessary to examine how the mutual relationships between creditors and their relationships with the debtor are affected by the processes and conditions of making acceleration decisions that are provided for in the documentation for both types of financing. Syndicated lenders may make decisions in a less formalized manner than bondholders (who must hold a formal bondholders’ assembly, convening of which requires a minimum notice period). On the other hand, if the facility agreement is governed by Polish law, lenders are bound by statutory time limits and procedures concerning termination notice, in contrast to the absence of such restrictions in relation to bonds.

**Abuse of a right**

Giving notice to terminate a facility agreement or demanding early redemption of bonds may be subject to analysis in the context of a potential allegation of abuse of a right by creditors on the basis of Art. 5 of the Civil Code. Lenders and bondholders should make decisions in this regard with appropriate caution, especially if their decision to accelerate is to be based on general contractual clauses (such as MAC) or general statutory criteria (such as the loss of creditworthiness). On the other hand, the borrower or issuer considering taking advantage of that allegation must prove to the court that the creditors exercised their rights in a way that was in conflict with their socio-economic designation or the principles of community life. Therefore, similar practical considerations as those relating to the extraordinary change of circumstances clause apply (i.e. the uncertain outcome of the proceedings and the time necessary for obtaining a judgment).

**OTHER EVENTS OF DEFAULT OR EARLY REDEMPTION EVENTS**

The COVID-19 epidemic and the measures taken by the government to contain it could result in certain events of default (as described in the facility agreement) or early redemption events (as described in the conditions of the bonds), which could be grounds for giving notice to terminate the facility agreement or demand early redemption of the bonds.

For example, compulsory suspension or other restriction on the business of a borrower/issuer running restaurants or shops in shopping centres could be an event of default under the facility agreement or an early redemption event, but the lender’s or bondholders’ right to declare an event of default in such circumstances may depend on the duration of the suspension of business or the extent to which business is restricted.

On the other hand, such circumstances are very likely to trigger other events of default, for example by affecting the borrowers’/issuers’ ability to comply with financial covenants.

**INFORMATION REQUIREMENTS, FINANCIAL COVENANTS AND AGREEMENTS WITH CREDITORS**

Borrowers and issuers may wish to review the deadlines by which they are obliged to deliver financial statements, compliance certificates and other documents required under the facility agreement or terms and conditions of the bonds. The outbreak of the epidemic and related travel restrictions and difficulties in ensuring business continuity could affect timely preparation of the
documents by the auditors. At the same time, if an analysis of the impact of the epidemic on the condition of the borrower/issuer indicates that there was an event of default in the meaning of the facility agreement or an early redemption trigger event in relation to the bonds, then, that information should be promptly communicated to the creditors with a description of the remedial action taken. Usually, borrowers are obliged to give immediate notification of an event of default, even if the documentation allows it to be remedied and the agreed cure period has not expired.

It would be worth borrowers' issuers' considering presenting to creditors their forecasts and analyses of the impact of the spread of the epidemic on their business and the (positive and/or negative) changes to their financial condition, indicating the expected time frame and any remedies (subject to, in the case of public companies, the requirements to report financial forecasts in accordance with MAR).

If it led to the conclusion that the financial covenants, rating requirements or other obligations would not be performed or achieved in the future, the borrowers may consider applying to the creditors in advance for a waiver and appropriate amendments to documentation or for a temporary standstill.

This is because although a mere forecast of the non-performance of such covenants may not usually be a reason for giving notice to terminate an agreement or early redemption of bonds, failure to perform them by the prescribed deadline could lead to a cross-default under their other financings.

Finance parties may want in turn to consider using the right vested in them under the finance documentation to require debtors to provide information on the current financial and operating condition. Based on that, they will be able to estimate to what extent current events affect the business of the relevant entrepreneur and to what extent the parameters of the financing granted (in particular the repayment schedules/redemption schedules and financial indicators) need adjusting (if at all).

Furthermore, the finance parties may wish to consider whether, in light of the deterioration in the condition of their debtors, it is justifiable to require additional security against the consequences of an event of default under the facility agreement.

DEADLINES AND DATES STIPULATED IN FINANCING DOCUMENTATION

It is possible that the development of the situation related to the epidemic will affect proper determination of payment dates. In many facility agreements and terms and conditions of bonds, a “Business Day” is defined as a day, other than a Saturday or Sunday, on which banks are open and conduct general banking business. However, it may be that additional days off work will be introduced, which, in turn, may affect the determination of the date of the disbursement or repayment of a facility, redemption of bonds, interest payment, interest periods, dates for service of documents or other important dates. This may be particularly problematic in a situation where a “Business

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1 A preference for agreeing on consensual solutions to financial difficulties experienced by borrowers is stressed in the recommendation of good practices in restructuring processes adopted by the Polish Bank Association in December 2019 and available at: https://www.zbp.pl/ Aktualnosci/Stanowiska-i-komentarze/Rekomendacja-ZBP-d dotyczaca-Dobrych-Praktyk-Procesow-Restrukturyzacji-Przedsiębiorstw
Day” has been defined in relation to a foreign financial centre (e.g. London or New York).

ACCELERATION AND TERMINATION OF A FACILITY AGREEMENT

The lender’s right to accelerate the repayment of a facility should be examined in light of the provisions of the law governing the facility agreement. Under English law, the parties may agree (and usually do so) that in the event of the occurrence of an event of default, the facility may be subject to acceleration and outstanding loans may become subject to repayment “on demand.” In such a case, the repayment date is determined using the “payment mechanism” test, pursuant to which the borrower is entitled to only a short period of time – no more than several hours from the demand for payment – to make a transfer, and not the time justified by the need to procure funds to make the repayment (e.g. by way of refinancing or disposal of assets).

Under Polish law, an approach much less favourable for banks has been adopted in Article 75 of the Banking Law. In order to accelerate the repayment of a facility, the bank must terminate the facility agreement by giving notice of at least 30 days or seven days (in the event of the borrower’s being threatened with bankruptcy). Moreover, under Article 75c of the Banking Law, an additional payment demand procedure applies, which results in the borrower’s being granted an additional cure period of at least 14 days. If the borrower is in delay with the timely discharge of the payment obligation, the bank is first obliged to demand that the borrower make the payment within at least 14 business days. Within 14 days of receiving such a demand for payment, the borrower may file a motion to restructure the debt, and the bank is obliged to give the motion due consideration. Only after the lapse of this deadline, may the bank terminate the agreement, subject to the (respective) 30-day or seven-day notice period.

It is worth stressing, however, that the notice period does not apply to the lender’s right to reduce the amount of the facility granted (but not yet disbursed), if the terms and conditions of the facility are not complied with.

PRESENTATION OF BONDS FOR EARLY REDEMPTION

Bondholders are not bound by limitations similar to the prerequisites and conditions described above for the acceleration of a facility agreement. The “acceleration” of bonds (i.e. demanding their early redemption) is not subject to the notice periods arising under the Banking Law or the obligatory procedure enabling the restructuring of liabilities.

GOVERNMENT SUPPORT AND SYSTEMIC SOLUTIONS

On 16 March 2020, the Polish Bank Association announced a set of support measures agreed on between its member banks and addressed to borrowers affected by the COVID-19 epidemic. They are being promptly implemented by the banks. According to the announcement:

- banks will apply simplified procedures for deferring (suspending) the repayment of instalments of principal and interest for a period of up to three months, which will automatically extend the overall term of the facility by the same length of time, provided that the validity of the security for repayment of the facility is extended.

These measures will apply to mortgage loans, consumer loans for retail customers and loans for corporate customers. Borrowers who justify their need to defer (suspend) repayment of a facility due to their financial
The filing of applications is to be made less formal. It will not be necessary to submit additional documents or certificates confirming the current financial and economic condition of the relevant borrower in detail. Moreover, banks will allow applications to be filed remotely, i.e. by e-mail, online banking or over the telephone (even in a situation where the agreement with the bank does not provide for this, provided that it is possible to properly identify the customer). At the same time, banks will not charge any fee or commission for accepting and considering such applications;

- banks, which have a leasing or factoring company in their capital group, will take actions to defer the repayment of instalments by their customers on terms identical to those applied by banks with regard to the deferment of the repayment of loans;

- banks will provide support to all entrepreneurs affected by the COVID-19 epidemic who were rated creditworthy at the end of 2019, and for whom the term for the renewal of their existing financing expires in the next few months, in the form of a renewal of the financing on request for a period of up to six months;

- in relation to their corporate customers affected by the COVID-19 epidemic, banks have announced their willingness to facilitate access to short-term loans aimed at stabilising their financial situation. Details in this respect are to be provided shortly after the government scheme facilitating such support, has been proposed.

In exchange for participating in the support programme for borrowers, banks can expect certain regulatory parameters with regard to capital and fiscal scope or classification of non-performing loans to be eased. Support in this respect has been declared by the President of the National Bank of Poland.

The Polish government presented on 18 March a support programme for entrepreneurs and setting out instruments aimed at ensuring financial liquidity. Details of the government’s plans will be discussed in our separate briefing in due course.

**SOLVENCY TEST**

We wish to point out that none of the support measures for entrepreneurs being contemplated as at the date of publication of this briefing, anticipates interference in the solvency tests under the Bankruptcy Law and the Restructuring Law. We note that where the insolvency test is passed, the representatives of the debtor (under pain of criminal liability and liability to creditors for damages) are required to file a bankruptcy petition.

As a reminder, there are two insolvency tests:

- in the case of the liquidity test, a debtor is considered insolvent if he loses the ability to settle his liabilities as they fall due (it being deemed that such loss of such ability occurs when the delay in the settlement of financial liabilities exceeds three months);
• the balance sheet test applies only to debtors that are legal persons and to partnerships, where such debtor is also regarded as insolvent when its financial liabilities exceed the value of its assets, and this situation persists for longer than 24 months. Future liabilities (including liabilities subject to a condition precedent) and shareholder loans are not included in the financial liabilities for the purpose of this test.

In light of the foregoing, it is all the more important for debtors who, in the face of the epidemic, have found themselves in financial difficulties, to verify not only their binding obligations under finance documents (and the possibility of taking advantage of assistance based on the instruments offered by the government, parliament, or banks) but also whether they meet the insolvency criterion (in particular, the liquidity condition).

Such a verification should result in a review of the strategic options, as part of which it should be determined whether in the circumstances it will suffice to take advantage of the "credit vacation" offered by the government, commence talks with creditors as part of a consensual restructuring, or whether it will be necessary to seek court protection under bankruptcy or restructuring proceedings.

OTHER CLIFFORD CHANCE PUBLICATIONS

This article is limited to selected issues specific to financing transactions on the Polish market. We invite you to read our client briefing discussing in more detail support measures offered by the Polish Bank Association, which is available here: https://www.cliffordchance.com/briefings/2020/03/epidemia-covid-19--banki-zadeklaroway-pomoc.html as well as other Clifford Chance publications concerning the impact of the COVID-19 epidemic on financing transactions on international markets, which are available at:

https://www.cliffordchance.com/insights/thought_leadership/coronavirus.html

2 Except for companies in which at least one natural person is liable with all his property for the partnership's liabilities.

3 The Bankruptcy Law does not specify whether this applies to the market value or the book value, and this issue remains open to interpretation. Most probably (and in line with the intention of the legislators), it is supposed to be the market value, as the test should measure whether liquidation will ensure sufficient proceeds to satisfy the creditors.
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