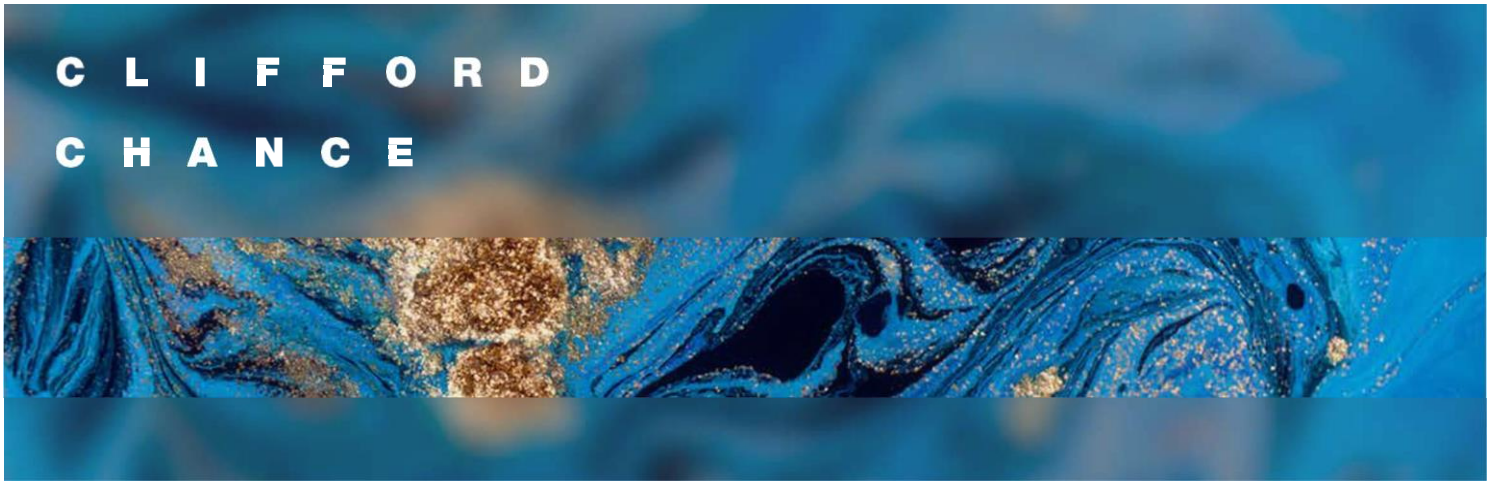

COVID-19: IMPACT ON FACILITY AGREEMENTS

The measures put in place by the Spanish Government as a result of the pandemic caused by the COVID-19 virus (the "**Current Scenario**") will have a dramatic impact on the income of many companies which may face serious difficulties in meeting their obligations arising from facility agreements entered into.

To determine the effects of the Current Scenario on a contractual relationship, we must analyse the contractual terms agreed, bearing in mind the laws that apply. The aim of this Briefing is to analyse in general the effects of the Current Scenario on the obligations arising from a facility agreement subject to Spanish law.

The Current Scenario does not in itself alter the rights and obligations of the parties under a facility agreement (the same would be true with an agreement of another type). Unless the parties can agree in this regard, the effects of the agreement can only be limited by the outcome of a court judgment.

Key issues

- The Current Scenario does not in itself alter the rights and obligations deriving from a facility agreement.
- Borrowers could invoke force majeure to temporarily avoid the effects of a default or breach.
- The Spanish Courts may mitigate the application of certain contractual clauses, including on termination in the event of a breach.
- Some commercial and insolvency obligations of receivers have been suspended in light of

This means that, in principle, the defaulting debtor must face the consequences of its breach (for example, the accrual of late payment interest or the creation of an event of early maturity or termination). And the longer the Current Scenario lasts, the more likely it will be that these consequences take on greater significance because the courts consider the Current Scenario to constitute a case of force majeure. It is important to bear in mind, however, that force majeure as a concept is temporary and its effects will cease when the Current Scenario ends, unless the parties agree otherwise.

Another concern may be whether creditors could refuse to authorise successive drawdowns or declare the early maturity or the termination of the agreement because of the Current Scenario. This will depend, in theory, on what was agreed. Nevertheless, the Spanish Courts may be receptive to mitigating the effects of the default or breach, for the reasons set out below.

As for the legislative measures recently put in place, currently no changes have been made to the contractual framework of companies that have entered into facility agreements, in contrast to the case of consumers. Provisions have so far only been established that are designed to temporarily suspend the commercial and insolvency obligations deriving from the existence of grounds for the company's mandatory dissolution or situation of insolvency.

1. THE STATE OF EMERGENCY

As a result of the health crisis situation caused by the COVID-19 virus, the Spanish Government declared a state of emergency by means of Royal Decree 463/2020, of 14 March ("**RD 463/2020**"), initially for a period of fifteen days and since then extended by Parliament until midnight on 12 April 2020.

2. VALIDITY OF AGREEMENTS AND LIMITATION OF THE EFFECTS OF DEFAULT

The Current Scenario does not in itself entail the suspension of the effects of a facility agreement, nor does it grant borrowers a moratorium on the payment of principal or interest. For such a suspension to occur, the parties would need to agree to it or the creditor grant a unilateral release, or a court pronounce in that regard.

Consequently, a debtor breaching its obligations (including payment obligations), will be in a situation of default.

But we will go on to analyse the possibility of the effects of a default or breach being limited, in light of the concept in legal doctrine known as *rebus sic stantibus* and the provisions set out in the Spanish Civil Code on force majeure.

- **The concept of "*rebus sic stantibus*"**

The Spanish Courts have developed a concept in case law known as *rebus sic stantibus* (literally "things thus standing") which has permitted, in exceptional cases, the balance between contractual obligations to be re-established when that balance is upset due to a radical change from the circumstances the parties had foreseen when they entered into the agreement.

This concept is based on a scenario of reciprocal obligations (for example a lease) wherein the balance must be re-established in light of a change in circumstances. This is not the case with loans, where there is only one payment obligation assumed by the borrower. It could be the case of a facility agreement, where the borrower has still not drawn down the entire principal amount. However, this legal doctrine is not very likely to apply in this case, since the change in circumstances also entails an increase of the risk to the creditor.

- **The concept of force majeure**

According to traditional Spanish legal doctrine, force majeure is an inevitable event that the parties could not have foreseen or prevented, even had they foreseen it.

Force majeure precludes the liability of borrowers for default during a certain period of time, i.e. until the force majeure event ends.

Facility and loan agreements sometimes contain force majeure provisions, usually in relation to payment. For example, the parties may have foreseen an IT system being down, making payment impossible. This example demonstrates how force majeure justifies a delay in payment for a certain period of time (in this case until the IT system is back up).

If the agreement covers such circumstances, it would be difficult to come to any conclusion other than that its provisions on force majeure must be observed.

In the absence of such provisions, the borrower could attempt to invoke force majeure in light of the Current Situation. Should the situation persist (the state of emergency is currently set to last at least a month), the courts may be receptive to applying this concept.

For this to occur, the borrower would have to demonstrate: (i) a direct impact on its ability to pay arising from the Current Situation (e.g. if the premises it operates have had to close to the public) and (ii) that it has done everything possible to mitigate the damage (certain businesses allow for partial continuity). In the event of partial continuity, if the borrower pays an amount towards what it owes in proportion to the impact on its flow of income, it could ask the court to exempt it from the consequences of the partial default on the basis of force majeure.

Force majeure may also apply to obligations other than payment, such as the fulfilment of financial ratios. In Spanish law, the validity of such provisions in corporate facility agreements is above reproach, but they are not often applied in practice because the courts may consider their breach not to be materially significant. Consequently, there would be even greater uncertainty in invoking such provisions in the Current Situation, since a court could later decide that the default or breach was due to force majeure.

As we have stated, the effect of force majeure is limited. In Spanish law, borrowers are automatically in default when they fail to make a payment by the deadline, regardless of the reason. Force majeure would only temporarily preclude liability

for default, i.e. late payment interest would not accrue and early termination could not be declared while the force majeure event persisted. Once it ended, however, the borrower would be in default, with the consequences that this entails, unless it had reached an agreement with the creditor stating otherwise.

Lastly, we must emphasise that exemption from default due to force majeure would only occur if a court declared it so in judicial proceedings, if no agreement existed between the parties.

3. ACCESS TO FINANCING AND EARLY MATURITY OR TERMINATION

A further concern is whether the Current Situation would allow creditors to refuse to authorise further drawdowns or even to declare the early maturity or termination of the agreement.

- **New drawdowns**

The Current Situation could preclude borrowers from making further drawdowns in those facility agreements with remaining funds.

This would be the case if one of the conditions for drawing down funds was the borrower satisfying the obligations established in the agreement (particularly financial covenants). In this case it seems logical to apply the contractual provisions, insofar as they designed to limit the creditor's assumed risk. In any event, it would still be possible for a court to limit such protections in the Current Situation.

A more difficult task would be to invoke the material adverse change clause ("**MAC clause**") in relation to the borrower drawing down funds. Although the validity of MAC clauses has been questioned in Spanish law (if open-ended, they could leave it to the creditor to determine whether an agreement is being fulfilled), in the Current Situation the creditor would not be refusing to provide funds merely on a whim, but because the reality is that circumstances have changed radically. That said, the outcome of a dispute revolving around a MAC clause would be more uncertain now than ever.

- **Early maturity or termination of agreements**

Lastly, another concern is whether creditors will be able to declare the early maturity (of a loan) or the termination (of a facility agreement), because of the Current Scenario.

For the reasons we have explained above (based on the concept of force majeure), we understand that the courts could mitigate the consequences of a breach that is a direct result of the Current Scenario, both when it concerns a payment obligation and when it concerns a default on financial covenants (such mitigation being more likely in the latter case, since the Current Scenario will bring with it a flood of defaults of this type).

The same will be true with regard to the MAC clause. There are hardly any precedents in Spain regarding the application of these clauses for the purpose of seeking early maturity or termination. This concept implies a material (having a very significant impact) and adverse (contrary to what the parties have foreseen) change (unforeseen circumstance). The existence of these requirements is in itself exceptional, and the creditor would have to prove that the case applies. In the Current Scenario, using the MAC clause as grounds to declare the early maturity or termination of the agreement requires more than ever a detailed analysis of the circumstances of the debtor, in light of the terms of the clause in particular. As we have said, a court could construe that the Current Scenario is not attributable to the debtor, but that it is in response to a case of force majeure.

It will always be important to bear in mind that the early maturity or termination of a facility agreement is a very severe measure, which may have irreversible consequences.

4. SPECIFIC MEASURES WITH RESPECT TO FACILITY AGREEMENTS

No measures have been adopted to date in Spain with a view to amending the terms of facility agreements, apart from the option available to certain debtors in a situation of financial vulnerability to apply for a moratorium with respect to their mortgage payments. However, Royal Decree-Law 8/2020, on urgent extraordinary measures to address the economic and social impact of COVID-19, establishes certain extraordinary measures for cases of dissolution and insolvency, among other aspects.

On the one hand, the period available to receivers to adopt measures in cases of obligatory dissolution (two months) has been suspended until the state of emergency is lifted. Although the legislation is not clear, compared to the provisions

established in relation to accounting obligations, the logical interpretation would be that this two-month period would recommence when the state of emergency ends, whereupon the receivers would once again have a full two months to adopt the measures stipulated in Royal Decree-Law 8/2020.

On the other hand, while the state of emergency remains in force, debtors in financial difficulties will not be obliged to apply for insolvency. As a result, courts will not process applications for insolvency filed by creditors until a period of two months has elapsed since the end of the state of emergency.

We can infer from the foregoing (although the wording of the legislation is somewhat confusing) that the two-month period in which to apply for insolvency recommences as soon as the state of emergency is lifted, as is the case with the period established for dissolution stated above. Obviously, this exception does not serve as grounds for a breach of such obligation to apply for insolvency by those debtors that should have done so before the publication of Royal Decree-Law 8/2020 (if the two-month period had already expired at such time).

CONTACTS

Iñigo Villoria
Partner

T +31 91 590 94 03
E inigo.villoria
@cliffordchance.com

Eduardo García
Partner

T +31 91 590 94 11
E eduardo.garcia
@cliffordchance.com

Javier Amantegui
Partner

T +31 91 590 75 76
E javier.amantegui
@cliffordchance.com

Epifáneo Pérez
Partner

T +31 91 590 94 80
E epifaneo.perez
@cliffordchance.com

Rodrigo Uría
Partner

T +31 91 590 94 08
E rodrigo.uria
@cliffordchance.com

Samir Azzouzi
Partner

T +31 91 590 94 75
E samir.azzouzi
@cliffordchance.com