Nestor Nestor Diculescu Kingston Petersen
ATTORNEYS & COUNSELORS

Legal & Tax

30 years anniversary

COVID-19
Legal & Tax Resource Center

RESTRUCTURING RESOURCE CENTER

April 2020

BUCHAREST
201 Barbu Vacarescu St., Globalworth Tower,
18 floor, District 2, Bucharest, 020276, Romania

T +40 21 201 1200, +40 31 225 3300
F +40 21 201 1210, +40 31 225 3310
E office@nndkp.ro, www.nndkp.ro

The restructuring resource centre – up-to-date information and insights on restructuring and turnaround issues in Romania

There is an intense debate on the Romanian market right now with regard to measures to be taken in the context of the abrupt economic downturn, which is rapidly unfolding in the aftermath of the coronavirus prevention measures.

Voices range between very conservative/austerity prone, basically underlining the low capabilities of Romania to take measures similar to states which are more wealthy, to others, more progressive, which are far more vocal with regard to ramping up liquidity measures through fiscal and monetary measures, and including some asking for a bold increase in public debt, for immediate but also for longer ranging objectives (funding large public projects to take the country out of recession on the medium term), in an attempt to counterbalance the loss in internal demand by an increase in government spending and investment.

Regardless of the debate, there seems to be a large consensus that business continuity must be assured, after the medical crisis is over. That is, that businesses will be able to "restart" properly and quickly, without shutting down forever, as "collateral damage" of the war against the virus.

As a direct and indirect result of the medical crisis and the safety measures being taken, the whole economy is coming to a halt. There is a liquidity crisis (as pressure on cash flows is mounting) as well as an actual economic crisis (recession), due to a drop in both in demand and supply (simply less value is being created).

Financial vs economic crisis

First, liquidity is being addressed. However, even assuming this is being resolved by the state, the banking system and the corporate sector (which is a very ambitious assumption), we will still be left with the reality of a smaller economy, when this is all over. We've been through a *financial* crisis about a decade ago (focusing chiefly on absence of liquidity), but this one is likely to be an *economic* crisis.

Absence of very substantial increases in government spending and large infrastructure investments in all areas (hospitals, schools, energy), come September it is likely that we will have a smaller economy, and the financial intermediation within that economy needs to be restructured, re-correlated with the new reality.

Too early vs too late in restructuring

The conclusion of standstill agreements between companies and banks to first address liquidity is necessary, particularly because of risks. Following the liquidity issue, restructuring, including substantial debt restructuring will be a feature of the Romanian economy.

If that is already clear now, there are actual effective steps which need to be taken now. Important steps. Much like in the medical crisis, the volume of non-performing companies for which there will be no solution at the end of the year depends on what is done now to prevent that.

Please check out our resources

› You can check legislative and administrative measures and official communications **(here)**.

› Read about important issues affecting restructuring here:

  › **A New Wave of Insolvencies? Possible Preventive Restructuring Measures in the Implementation of the European Directive on Preventive Restructuring (here)**

  › **How the "coronacrisis" is causing insolvency and financial difficulty and the law does not (yet) address this (here)**

  › **The world will be "under water" for the next 6 months. Is your organization "watertight"? (here)**

› Access our Emergency Financial Restructuring Kit **(here)**

and

› get in touch with our Financial Restructuring Support Team **(here).**

NOTE

To go back to the previous page after accessing a bookmark link in this document, please use the following buttons on the keyboard:

ALT + Left Arrow Key (←)

A New Wave of Insolvencies? Possible Preventive Restructuring Measures in the Implementation of the European Directive on Preventive Restructuring

A New Wave of Insolvencies? Possible Preventive Restructuring Measures in the Implementation of the European Directive on Preventive Restructuring

This legal analysis focuses on the typical case of a company that although it is not directly targeted by the measures established in order to prevent the spreading of the novel coronavirus, it still registers a decrease of demand, of the level of proceeds and of the production of goods and services.

Therefore, we will refer to the main categories of creditors of a company and the fact that the regulations instated so far in order to prevent the financial impact of the coronavirus pandemic, do not suspend the debtor's insolvency filing duties.

Budgetary creditors

Budgetary creditors play an extremely important part in deciding the evolution of a company. According to the Law 85/2014 (the "**Insolvency Law**"), a claim for opening the insolvency procedure may be filed only if the level of the amounts owed to State budget is lower than 50% of the total declared debt of the relevant debtor. Therefore, it is obvious that an insolvency claim is highly dependent on the level of amounts owed to budgetary creditors.

Following the measures recently enacted by the Romanian government, we note that the due date of fiscal obligations has not been postponed. Moreover, the amount thereof has not been diminished – at least, this is the case for those due on March 25th.

The most important fiscal relaxation in place is that no penalties will be calculated with respect to these obligations and no enforcement measures will be ordered. However, the immediate consequence of these measures is that the State will have uncontested and liquid debts against the companies that do not pay.

Whether these receivables are indeed "not due" can generate complex debates, due to the fact that these continue to be, in general, receivables that may be subject to enforcement, given that this derogation is assumed by creditors only temporarily, and may nevertheless be raised by a third party. Additionally, these receivables may be taken into consideration when a company is subject to insolvency claims and financial difficulty verifications set forth by the law, as well as when drafting the consolidated list of creditors in the insolvency procedure.

Credit institutions

The recent decision of the Supervision Committee of the National Bank of Romania comprises a series of interpretation elements. Among these, credit institutions and non-banking financial institutions are allowed not to set up provisions in certain conditions for the deferred

payment and restructuring of certain loans, as well as not to access the reserves created, in accordance with the European regulations. However, there are many elements and interpretations to be taken into consideration in this respect.

In the same context, the Romanian Government adopted an emergency ordinance intended to ensure the deferred payment of installments related to loan agreements and leasing contracts concluded with credit institutions or non-banking financial institutions. The ordinance addresses to both natural and legal persons that were affected by the measures taken in the context of the pandemic outbreak.

The suspension of the payment of the installments may be obtained, only upon request, for a period ranging from one to nine months, but will, in any case, be granted only until December 31, 2020, at the latest.

For more details in connection with the provisions regulating this measure, please consult the document available **here**.

We should bear in mind that credit institutions and non-banking financial institutions that will conclude bilateral deferred payment agreements will not be protected from the actions of the other creditors that may take measures against the debtor companies.

It is well known that Romania has the lowest level of financial intermediation in the European Union, and, at the same time, an extremely high level of supplier credit. Therefore, preventing banks to take measures against the debtors will not end the supplier credit obstruction and, as a consequence to this obstruction, the process of companies entering insolvency.

Utilities providers, registered office owners

The Government Emergency Ordinance 29/2020 (”**GEO 29**”) provides certain measures for small and medium-sized companies that (totally or partially) interrupted their activity pursuant to the decisions issued by the relevant authorities and were issued an emergency situation certificate. These companies may be granted a deferred payment facility for utilities suppliers and for the payment of the rent for the real estate property used as registered or secondary office. Nevertheless, these facilities are granted only *for the period of the state of emergency*. Consequently, when this is over, the utilities suppliers will continue to calculate penalties and may instate enforcement measures or file requests to initiate the insolvency procedure. Furthermore, even when a cause to be exempt from liability (such as force majeure) is invoked, this cannot prevent the instatement of precautionary measures (attachments), which may cause a chain reaction.

Other unsecured creditors, including affiliates

Other creditors, such as suppliers and affiliates are not subject to any measure. Therefore, they are still entitled to resort to all the available contractual and legal measures (collection of interest, enforcement).

Obligations related to the initiation of the insolvency procedure

The Insolvency Law has not been amended so far, following the instatement of the state of emergency. Hence, a debtor which becomes insolvent still has the obligation to file in court a request to initiate the insolvency procedure, within a term of 30 days from the occurrence of

this state. Nevertheless, if the debtor participates in good faith in out-of-court negotiations having as subject matter the restructuring of its debts, the company only has the obligation to file the relevant request in court within 5 days after the negotiations have failed. Furthermore, we note that the law somehow intends to ensure a safeguard for the debtor by prohibiting the initiation of the insolvency procedure after the approval of the arrangement with the creditors (in Romanian "*omologarea concordatului preventive*").

Failure to comply with the legal terms established for filing the request to initiate insolvency triggers criminal liability, in accordance with Art. 240 of the Romanian Criminal Code. Thus, for companies that met the requirements for declaring the state of insolvency the situation is slightly clearer, given that it is not specifically set forth otherwise. However, the legislative framework completely lefts out companies whose financial situation deteriorates during this state of emergency.

Considering the above and the fact that all the available instruments were maintained at legislative level, there is a clear possibility that the number of requests to initiate the insolvency procedures will increase. Furthermore, in accordance with Decision 417/2020 of the Superior Council of Magistracy, requests filed pursuant to Art. 66 para. (11) of the Insolvency Law are considered as urgent requests, and debtors and creditors that met the legal requirements at the date when the decree instating the state of insolvency was published on March 16, may file requests to initiate the insolvency procedure and obtain, until these are resolved, the temporary suspension of the enforcement procedures.

Claims with respect to the arrangements with the creditors (in Romanian "*cererile de concordat preventiv*") – the only currently available preventive restructuring instrument – due to financial difficulty reasons, have become even more difficult to exercise. That is due to the fact that the temporary stay of enforcement proceedings initiated before the approval of the arrangement with the creditors, and the approval procedure itself requires the intervention of a court of law. Given that the decision of the Superior Council of Magistracy did not deem these causes urgent, in the current context, debtors in financial difficulty cannot invoke the relevant legal provisions.

Consequently, there are no adequate means of restructuring and insolvency prevention that may be resorted to by debtors in financial difficulty, as a result of the crisis caused by the novel coronavirus pandemic outbreak. On the contrary, based on the actual measures instated, the only option is to declare insolvency.

At the same time, fiscal and banking creditors are exposed to possible adverse actions initiated by the unsecured creditors, which does not seem to have been intended when the current measures were instated.

Anticipating the potential wave of insolvencies, Germany considered that it is necessary to suspend the insolvency fillings until 30 September 2020. Consequently, Romania should adopt as well more specific regulatory measures in this field, especially during the state of emergency.

In the context in which Romania is in the process of implementing the Directive on Preventive Restructuring and considering the absence of legal provisions favoring the restructuring of debtors in difficulty, we consider it is recommended to consider the following measures:

- **A dramatic simplification of the preventive restructuring framework** (the current arrangement with the creditors) consisting in allowing to **conclude extrajudicial preliminary agreements suspending payments and enforcement procedures that precede the actual** restructuring, especially when there is an agreement from the fiscal and bank creditor, in cases where the level of these debts exceeds certain limits;
- **Acknowledgment of non-financial causes**, such as the loss or suspension of a key contract for the debtor's activity (cause expressly set forth in the Directive on Preventive Restructuring) or a significant decrease of the demand in the past 30 days.

These may significantly affect a company, as they may determine the capacity of a debtor to meet its current or future obligations, while avoiding a serious materialization of the situation in the following months.

- Implementing with priority the measures intended to ensure the actual restructuring of debts towards the State budget, by cancelling them or by extending their term, while maintaining the currently employed workforce – a first step in this direction was made by GEO 29 which, in order to revitalize and avoid the initiation of the insolvency procedure against debtors in difficulty, offers the possibility to restructure debts towards the State budget, while extending the term within which debtors may notify the fiscal bodies (October 30, 2020);

As a matter of fact, this aspect should constitute a priority of the fiscal creditor that would have multiple benefits resulting from the prevention of bankruptcy and the maximization of long-term State budget income ensured by the fact that companies are maintained in operation.

- Establishing a minimum payments interim plan (in order to maintain the supplier chain), for a period that is established in advance in order to ensure the continuity of the debtors' operations, with the final objective of revitalizing their activity;
- Appointing a restructuring expert that will have duties to supervise, provide information to the creditors in order to ensure an actual transparency framework and stop/report unlawful or illicit operations, and prepare a restructuring proposal.

In the current context, we notice a natural preoccupation for prioritizing sanitary measures and those having an immediate impact over the activity of the companies affected by the imposed restrictions.

However, we reiterate that it is essential to pay immediate attention as well to the economic measures intended to ensure the viability of small and large companies involved in a complex series of contractual relations. Such measures would also ensure to maintain the workplaces offered by the relevant companies.

Accelerating, at this early stage, the issuance of legislation that would create an efficient restructuring framework is one of the measures that might prevent the occurrence in many companies of a serious state of degradation, which may cause the closing or bankruptcy thereof.

How the “coronacrisis” is causing insolvency and financial difficulty and the law does not (yet) address this

How the "coronacrisis" is causing insolvency and financial difficulty and the law does not (yet) address this

Let's think of the typical company on the market which is now experiencing both a drop in liquidity and in demand, and is faced with multiple challenges in the supply chain.

Insolvency

The company in question may be formally in insolvency, according to legal definitions. This includes both actual and imminent insolvency. Law no. 85/2014 regarding the insolvency prevention and insolvency procedures ("**Insolvency Law**"), provides that a debtor is presumed by law to be insolvent if it does not pay its debt (an outstanding debt of at least RON 40,000) within 60 days as of the maturity date (we can call this "*actual insolvency*"). On the other hand, the insolvency of a debtor is *imminent* when there is evidence that the debtor will not be able to pay the debt at maturity, due to lack of available funds (we'll call this "*imminent insolvency*").

Therefore, the main difference between the two types of insolvency is the fact that an imminent insolvency does not require an outstanding debt, but rather proof that at the maturity date the debtor does not have enough funds to meet his obligations.

The procedure may be initiated upon the request of either: (i) the debtor which is insolvent or in a state of imminent insolvency; or (ii) any creditor which has a certain, liquid, due and payable claim out-standing for more than 60 days. In both cases, the outstanding debt must be of at least RON 40,000 (approximately EUR 8,000).

A debtor is obliged to file for insolvency within 30 days as of the date the company becomes insolvent. However, it is important to note that pursuant to the Insolvency Law, should a debtor be involved, in good faith, in out-of-court negotiations at the end of the 30 days period, he must file an insolvency claim with the relevant court only within 5 days after the negotiations have failed.

Failure to file such claim within 6 months after the expiration of terms mentioned above is a criminal offense for the debtor's directors. On the other hand, if insolvency is imminent rather than actual, the debtor does not have a legal obligation to file for insolvency (but is entitled to do so).

As the coronavirus outbreak already takes its toll on the economy, there are several companies that may find themselves in an insolvency scenario. Therefore, the question that raises is: are there any effective approaches available?

Among the measures taken by the Decree No. 195/2020 on the declaration of the state of emergency on the territory of Romania (the "**Decree**") it is important to highlight that:

(a) enforcement activities have not been restricted by the Decree insofar as they do not pose a threat to the sanitary measures taken by the National Committee for Emergency Situations[1];

(b) for the duration of the state of emergency, the statute of limitations is suspended; and

(c) all litigation is suspended, save for matters that are deemed *urgent*.

The legal deadlines provided under the Insolvency Law with respect to filing for insolvency are not affected by the provisions of the Decree. Therefore, debtors that fulfil the conditions required by the Insolvency Law are then still bound by the obligation to file a claim. Similarly, in the event all legal requirements are fulfilled, a creditor may still file a claim with the relevant court and the insolvency procedure can be opened.

However, given that all litigation is suspended during the 30 days period of the state of emergency, are the courts of law going to resolve any insolvency claims?

Since the Decree only provides that litigation is not suspended for urgent matters, on the 24th of March the Superior Council of Magistracy has issued a decision (the "**SCM Decision**") further detailing the claims that are going to be resolved throughout the state of emergency period. According to the SCM Decision, only claims based on article 66 (11) of the Insolvency Law are specifically deemed urgent and, at a first glance, it may seem that claims with regard to opening the insolvency procedure are not.

The same SCM Decision provides that the county court may resolve as well claims of exceptional nature, which are considered to be of special urgency, even though they are not expressly stated in the SCM Decision. Thus, a court of law shall determine on a case-by-case basis if the insolvency claim submitted by a debtor meets the urgency standard required by SCM Decision and the Decree.

Moreover, taking into consideration that enforcement proceedings related matters are expressly stated among the matters that are deemed urgent, it is obvious that throughout the state of emergency, companies can still be subject to proceedings against them.

As a consequence of the abovementioned, in the near future, we may witness a great deal of situations such as companies filing insolvency claims one against another - on one hand companies throughout the supply chain and on the other, as a result of loans granted between companies. Even though the Romanian Government has taken measures whereby debtors can request to postpone their reimbursement obligations under the financing granted by banks (please see our extended article on the Government Emergency Ordinance no. 37/2020 (the "**GEO 37/2020**") addressing bank debt **here** – this includes regular updates on the competing legislation adopted by Parliament and in the final stages of the legislative procedure), there

[1] Since the Decree: (i) enforcement of debts towards the state budget have been halted by EGO 29/2020 (unless these were already confirmed by court decision in criminal cases) for a period ending 30 days after the end of the state of emergency; (ii) evacuation and direct enforcement measures (such as physically removing goods to their rightful owner) have been halted by the Enforcement Officers National Union; and (iii) while public auctions sales have not been explicitly restricted – organising them is problematic given the ban on public gatherings of any more than 3 people.

still is an issue with regard to companies that do not fulfil the conditions provided in the GEO 37/2020, as well as with the debt incurred between companies themselves.

Given the impact of the coronavirus pandemic on the economy and on the companies' financial situation, the state must have a firm stance with regard to the applicability of the insolvency legislation. However, there are no clear guidelines or legal provisions with respect to the approaches to be taken by affected companies, leaving entrepreneurs to fight alone with the unknown, giving them almost no chance against the financial crisis approaching.

If we do not want such consequences, the law must state that, and it does not. The simple fact that creditors will agree to postpone is not sufficient, as in the context of such crisis, it is important that there are clear and simple guidelines/legal provisions to be followed.

Financial difficulty

Assuming the company in question is not formally insolvent, it may still risk an abrupt downturn because of covenants which start to be "broken" in its financing and/or as a result of either maintaining payments or performance of obligations throughout the supply chain in very onerous terms.

This, notably, includes fiscal obligations which have not been removed, albeit some measures have been taken.

The Government Emergency Ordinance no. 29 of 18 March 2020 ("**GEO 29/2020**") provides certain fiscal measures. However, there is still a great deal of concern with regard to the approach of the fiscal authorities in the aftermath of the coronavirus pandemic.

While they are postponed during the state of emergency period, we note that they still exist and they are going to be due at another point in the future, without really resolving the financial crisis the companies are going to experience.

Furthermore, this may trigger events of default under certain financing agreements, as the respective company will find itself with unpaid fiscal debt.

Therefore, even though companies may still survive this downturn and not become insolvent, they may still find themselves in financial difficulty.

The Insolvency Law provides that companies in financial difficulty may resort to a formal procedure setting out an arrangement with the creditors (*concordat preventiv*). A company is considered to be in financial difficulty when even though it is capable to fulfil its current payment obligations, it does not have long-term funds and/or it has a high degree of indebtedness which cannot be covered by the resources generated through its operational activity/financial activity.

Based on such arrangement, a debtor may be able to stay the proceedings initiated by creditors against it without formally entering into the insolvency procedure. However, it must be taken into consideration that this process implies the intervention of a court[2]. Consequently, given

[2] Of course, companies may also reach out-of-court arrangements with creditors, but unless a company can effectively "round up" all its creditors and get them on board, those creditors which are not party to the arrangements can still take enforcement or

the provisions of the Decree, it certainly is difficult for a company to obtain such a court decision in the current climate.

Following the SCM decision, enforcement proceedings related matters (such as suspension of enforcement proceedings, challenges to enforcement, orders of enforcement) are deemed urgent and therefore litigation is not suspended[3]. However, preventive action, such as a creditor arrangement (*concordat preventiv*), do not seem to be viewed as urgent. Therefore, a court of law cannot rule with respect to matters such as the approval of such arrangement (in Romanian *omologarea concordatului preventiv*) or the stay of enforcement proceedings against the debtor granted prior to the approval of the arrangement. Consequently, companies have every chance to see proceedings initiated against them, without an effective possibility of entering into the formal arrangement (*concordat preventiv*) provided by the Insolvency Law, in order to prevent other serious financial consequences.

Consequently, it may even seem that preventive restructuring is not encouraged as debtors are left to see their financial situation deteriorate to the point they can file for insolvency.

We can agree that the Insolvency Law, in its current form, does not take into account economic downturns caused by a state of emergency situation, giving companies no alternatives when it comes to obtaining an out-of-court stay of the enforcement proceedings.

But can that company do something about it? The current situation is not clear.

Conclusion

Our analysis indicates there is no legal protection for companies (and indirectly for banks) against a "pile-up" of debt of various kinds, various claims and formal defaults under various contracts.

The idea of "stopping the clock" for 3-6 months obviously is not followed by current legislative measures.

A very simple solution would be to make the preventive procedure far simpler between banks and companies, out-of-court, and more accessible and preventive for this period, ensuring both companies that they will not be facing a disaster and also assuring banks that by adhering to such arrangements they are not "punished" by the regulator and are effectively maximizing return on the long term.

If a company agrees with financial creditors (banks) to standstill and not incur penalties for 3 months, it would be logical that no other creditor should be able to enforce against that company or for the company to incur penalties. But that is not the law right now.

---

insolvency action. Furthermore, it is likely that even those who are party to out-of-court arrangement could still successfully take action – however they will face the risk of contract breach and damages towards the debtor company.

[3] The current form of the law adopted by Parliament which is not yet in force at the date of this writing includes provisions on suspension of enforcement proceedings, the full scope of which is yet unclear. This is an area constantly under development which we will continue to monitor.

Whether or not such initiatives will happen in the near future, companies and banks need to be mindful and take measures to organize dialogue within a framework of cooperation.

Even if we assume that liquidity measures will be perfect, it is still a reality that business in itself is being heavily impacted (simply less value is created in the economy due to reduced demand and supply) and restructuring will be needed.

For even more details regarding this issue, check out our article: ***A New Wave of Insolvencies? Possible Preventive Restructuring Measures in the Implementation of the European Directive on Preventive Restructuring*** (**here**).

Also, please see our guide entitled ***The world will be "under water" for the next 6 months. Is your organization "watertight"?*** (**here**)

Beyond Non-Payment: How Are Credit Agreements Impacted by COVID 19 measures? (here)

The world will be “under water”
for the next 6 months.
Is your organization “watertight”?

The world will be "under water" for the next 6 months. Is your organization "watertight"?

Probably the usual situation faced by many companies in Romania is an abrupt fall in both cash and effective demand, thus causing a dual effect on both immediate (cash flow) and long term prospects of the company (balance sheet).

Companies and financial institutions are impacted, and the situation could "spiral" out of control, causing unintended consequences.

In our article ***How the "coronacrisis" is causing insolvency and financial difficulty and the law does not (yet) address this*** (you can access it **here**) we have argued that businesses and banks are basically exposed, because the current law is not protecting them.

We have outlined below a number of practical steps that companies and banks can take right now to prevent this unwanted outcome.

For companies

Check your legal status and your obligations

Is the company in insolvency or in imminent insolvency?

According to the legal definition, the Insolvency Law regulates two types of insolvency:

(a) presumed insolvency: a debtor does not pay its debt within 60 days as of the maturity date; and

(b) imminent insolvency: there is already evidence that the debtor will not be able to pay the debt at maturity, due to lack of available funds.

The procedure may be initiated upon the request of either the debtor or any creditor which has a certain, liquid, due and payable claim out-standing for more than 60 days. In both cases, the outstanding debt must be of at least RON 40,000 (approximately EUR 8,000).

Given that the current measures in place do not provide a suspension of the debtor's insolvency filing obligation, it is essential that companies carefully asses their financial situation and their payment obligations.

In case the company finds itself in an insolvency scenario, it should timely take all actions required by law, as debtors are obliged by law to file for insolvency within 30 days as of the date the company becomes insolvent. It is important to note that pursuant to the Insolvency Law, should a debtor be involved, in good faith, in out-of-court negotiations at the end of the

30 days period, he must file an insolvency claim with the relevant court only within 5 days after the negotiations have failed.

Failure to comply with the legal terms provided by the Insolvency Law is a criminal offense for the debtor's directors. However, this is the case only for presumed insolvency – on the other hand, a debtor in imminent insolvency, while it is entitled to file a insolvency claim, it does not have a legal obligation to do so.

Is your financing impacted?

The current measures taken in order to prevent the spreading of the novel coronavirus will most likely have an impact on financing agreements as well. As all activities are brought to a halt and companies witness a dramatic drop of demand, it may consequently be difficult for a company to comply with the provisions of its financing arrangements.

While failure to comply with payment obligations is the most common, there may be several other provisions that can deal a blow to a company's financing.

For more information on the impact of the coronavirus pandemic on credit agreements clauses, please see our in-depth analysis *Beyond Non-Payment: How Are Credit Agreements Impacted by COVID 19 measures?* (you can access it **here**).

Are you in financial difficulty?

We have already pointed out that absent of clear legislative measures assuring a quick access to a an out-of-court procedure to stay enforcements and block claims, the company needs to give serious consideration to contractual measures – basically concluding standstill agreements with key counterparties, most importantly banks.

Are you subject to hardship or force majeure?

Face to the rapidly deteriorating economic climate, most companies think of ways to construct their defence. That is why there is a large debate with respect to the possibility of invoking force majeure or hardship in case the company is not able to timely fulfil its obligations.

More on hardship and force majeure can be also accessed **here**.

Taking preventive action

One of the most important steps is ensuring an appropriate standstill agreement is in place between the company and its main creditors and partners, ensuring stability during the following 3-6 months.

Typically, such agreements ensure three key aspects:

(1) Suspend enforcements against the company

(2) Ensure access to information by the parties

(3) Create the space for conclusion of an in-depth well-planned restructuring plan.

For more advice on how to successfully conclude standstill agreements, please contact our Financial Restructuring Team.

For banks

Our experience in restructuring and insolvency is that the more time passes for issues to become chronic without (i) access to information and (ii) coordinated action, the more the approach moves from managing going concern to planning liquidation.

With that in mind:

Actively identify key large corporate clients with significant impact on the supply chain

These clients are likely to be concerned that they have to file for insolvency, that are likely to enter into financial difficulty, that are problematic in terms of measures of stabilization and continuity.

Set up "clusters of protection" and conclude standstill agreements

The point of establishing clusters of protection is that, in any business ecosystem, it is not only the client which is affected, but usually a number of key suppliers and business partners of that client.

A very important point of a standstill agreement, besides the obvious relief of liquidity and enforcement issues, is the ramping up of information covenants, which are absolutely critical. Most often information is historical and unhelpful to gauge the actual impact on the client's business.

For more advice on how to successfully conclude standstill agreements, please contact our Financial Restructuring Team.

Start planning for preventive restructuring, following standstill period

Planning for a worst case scenario is fundamental and working collaboratively with clients in this respect has the advantage of committing the client to actions which in the long term are mutually beneficial.

Beyond Non-Payment: How Are Credit Agreements Impacted by COVID 19 measures?

Beyond Non-Payment: How Are Credit Agreements Impacted by COVID 19 measures?

As the coronavirus pandemic takes its toll on every economic sector, both companies and banks are revisiting their credit agreements in order to identify key next steps.

One obvious impact relates to companies having difficulties fulfilling their payment obligations under loans and under instruments creating financial indebtedness. This is temporarily addressed partly by the moratorium measures enacted by the Emergency Government Ordinance no. 37/2020 and its Implementation Norms, which essentially requires banks to delay payment of principal (and capitalize interest as far as companies are concerned) for a period of up to 9 months, upon borrower request. There is also a competing Parliament adopted law, which is not yet in force at the time of this writing, that provides a similar approach, though diverging in certain key areas. You can read more about these measures and keep yourself updated on developments by accessing our main article on this topic **here**.

While these measures essentially address non-payment risks, credit agreements often include a variety of provisions which may still render the borrower in default even if regular payments are being covered – the so called "event of default" clauses, which often extend beyond just non-payment.

This article includes a selection of key areas to look for in credit agreements, and also look at the legal position regarding other available reliefs such as force majeure and hardship.

I. Key Events of Default to look for

These provisions are not relevant only for companies facing the prospect of acceleration but also for companies having a undrawn portions of available facilities, or open revolving credit lines, as technical events of default may entitle the bank to cease financing, When it comes to acceleration, Romanian courts might be more sympathetic to a borrower where the event of default is not non-payment – but when it comes to closing the tap on financing, the court will have less leeway and is more likely to rule in favour of the creditor.

The occurrence of other events of default depends, mostly, on the description and the wording of the relevant clauses. Therefore, borrowers should maintain a close communication with lenders and should take into consideration revising their agreements in order to assess whether an event of default can be avoided by submitting waivers/consent letters with the lenders or even commence negotiation to amend the loan documentation. Syndication financing should be given particular attention, as there are certain requirements to the level of the lenders' consent on certain aspects.

(a) Financial covenants

Most commercial credit agreements include financial covenants which need to be met by the debtor. These essentially prescribe economic formulas to measure the health of the borrower looking at accounting data (value of assets, earnings, liabilities, etc.).

Borrowers should check their credit agreements to verify:

(1) when is the testing date for these covenants, and by reference to what data – it will be key to verify when exactly the performance for the second quarter of 2020 will be assessed according to the covenant calendar; and

(2) what ratios are applicable and whether based on the information at hand, these are likely to be breached;

(b) Misrepresentations

Most loan agreements cover a variety of legal and factual issues. If any representation is untrue or misleading, an event of default might occur. As well, borrowers may be mindful of the fact that sometimes there might be a condition precedent to any utilisation request that the representations are true – meaning that if there are available amounts in credit facilities not yet drawn, these may blocked until the misrepresentation is remedied.

In the context of the coronavirus pandemic, certain representations (such as the no default representations or the financial statements representations) may become untrue.

The borrower should carefully asses these clauses and timely inform the lender in order to find a solution.

(c) Cross-default

Many loan agreements provide that an event of default occurs whenever the borrower breaches or is in default under contracts it has in place with other parties. Usually, these clauses cover financial arrangements borrowers may have with other lenders, but more strongly worded clauses can even cover defaults with key commercial partners.

It is important that borrowers review their cross-default provisions to map out any risk of contamination of defaults from one contract to another. Equally, lenders should consider the extent to which other financial indebtedness of the borrower or other key members of that group may be impacted by a default.

(d) Insolvency

A prevalent event of default included in credit agreements relates to so called "insolvency events".

Romanian insolvency laws, a contractual provision stating the "termination" (in Romanian: *desființarea*) of an agreement due to the opening of insolvency proceedings may be considered null and void. Accordingly, an acceleration under the facility agreement due to the opening of insolvency proceedings against the borrower may be in certain circumstances considered invalid, to the extent such acceleration would be construed by the insolvency court as a form of "termination" of an agreement.

But credit agreements provisions may not necessarily link these "insolvency events" to actual opening of insolvency procedures – some standard language used also covers instances where a borrower "admits inability to pay its debts as they fall due" – which arguably occurs when a debtor applies, for instance, for the moratorium regime implemented as a result of COVID-19 measures.

(e) Litigation

Events of default linked to the existence of litigation proceedings should be reviewed. In certain situations, the borrower does not have to actually have litigation proceedings commenced against it in order for the event of default to apply – for instance: (i) certain agreements do not refer only to actually commenced litigation but also "threatened" litigation; and (ii) certain agreements provide that litigation commenced against another member of the group can trigger a default on the borrower.

(f) Clauses regarding Material Agreements or Key Contracting Parties

Some credit agreements include clauses according to which termination or alteration of certain significant commercial agreements of the borrower without lender consent is an event of default. Sometimes these are singled out in the contract and other times they are identifiable by the amount of revenue regularly obtained through them (e.g. all agreements generating more than 10,000 Euros annually).

This exposes borrowers whenever key partners face difficulty themselves and seek to re-negotiate or terminate these arrangements, but is also very relevant when taking pro-active strategy decisions concerning ongoing contracts.

Borrowers should therefore urgently scan their credit agreements to identify and interpret this type of clauses and ideally consult with lenders where it is necessary.

(g) Cessation of business

Most commercial credit agreements provide that the suspension or cessation of all (and sometimes even part) of their business is in itself an event of default, exposing the borrower to the risk of lender acceleration of the debt.

Borrowers who have seen their activities grounded to a halt during this period are likely already in default on their credit agreements as a result of this clause and should seek to consult with lenders on next steps.

(h) Material adverse change clauses ("MACs")

It is fairly common for financing agreements to provide an event on default or a representation on MACs. Such clauses are usually included to protect against unexpected changes to the borrower's financial situation or market fluctuations, which could not have been duly anticipated in the representations/events of default clauses at the date of drafting the agreement.

More often than not, these clauses are subject to multiple interpretations, due to the fact that contracts do not provide for specific events that may trigger a material adverse change, but rather use general and sometimes even ambiguous language. The assessment whether the coronavirus outbreak can be viewed as an event triggering such clauses must be made on a case-by-case basis and it must take into consideration each agreement's specific language.

Therefore, the impact on the material adverse change clauses is ultimately to be determined by a court of law. What is more, there seems to be very little to no legal practice (both in Romania and other jurisdictions) with regard to triggering such clauses in the context of major adverse global political and economic events, and consequently one should be mindful when it comes to invoking MACs to accelerate the loans.

Additionally, the party relying on these clauses has to meet a high burden of proof and that is why parties may view calling a MAC as a last resort, encouraging them to negotiate and amend the loan documentation, rather than terminate the agreements.

(i) Other clauses:

It is important for the parties of the loan agreements to ensure that their obligations (such as making payments and serving notices) are not affected by state measures affecting business continuity. Therefore, definitions of terms such as "Business Day" may be revisited, as the parties may not have taken into consideration ad hoc holidays that are the consequence of a global pandemic when defining such terms.

Furthermore, it is also important for Borrowers to review the deadlines they assume(d) under their loan documentations in order to deliver financial statements, valuation reports etc, as they may be impacted due to the state of emergency measures taken following the military ordinances.

II. Considering force majeure

Unlike other jurisdictions, under Romanian law, force majeure may be invoked by the parties, even though they have not included such clauses in their agreements, but only to the extent they have not expressly waived their right to do so.

On the other hand, certain finance documents may provide that the occurrence of a force majeure cause would contractually entitle the finance parties to invoke the acceleration of the loan agreements. This is particularly prevalent in the case of development financings or project financings.

An event may be viewed as a force majeure if it fulfils the following conditions: (i) it is an external event, beyond the control of the party invoking it, (ii) inevitable, (iii) that could not have been foreseen, and (iv) whose effects could not have been avoided in any way.

We note that generally speaking, the issue with respect to the force majeure and/or of casus fortuitous being invoked by a borrower as a reason for not fulfilling its obligations (in particular its payment obligations) is a controversial one.

According to the Civil Code, this may not be possible, as the Civil Code states that when an obligation has an object fungible assets (such as money), the debtor may not invoke a fortuitous impossibility of fulfilling its obligation.

It is worth noting that the GEO 29/2020 did set out a rebuttable presumption of force majeure for small and medium sized enterprises, where a state of emergency certificate has been issued.

However, it remains to be determined by a Romanian court, on a case-by-case basis, if the event invoked by the parties can be seen as a force majeure, especially in the current context.

Romanian legal practice has stated many times that force majeure must be an event that could not have been foreseen by any person and not particularly by the debtor invoking it. However, courts seem to be divided with respect to the possibility of an economic crisis to be viewed as a force majeure event.

As the coronavirus crisis is a first for Romania, there is no legal practice when it comes to epidemics being considered a force majeure. Although other jurisdictions are not way too far ahead when it comes to this matter, there still are some French cases worth mentioning.

French courts considered that an epidemic is not sufficient to invoke force majeure in several cases, for example:

(i) A Nancy court[4] ruled that Dengue fever epidemic could not be invoked as force majeure as this is an event that has been recurrent every year since 1980 – moreover, even though in 2007 there has been an unusual number of cases, this is not an event to be deemed unforeseeable;

[4] Nancy Court of Appeal, 1st Civil Chamber, Judgment of 22 November 2010, n° 09/00003

(ii) Another court[5] ruled that the H1N1 virus is not a force majeure event since it has been foreseen, largely announced and even health measures have been taken;

(iii) The Paris Court of Appeal[6] ruled that the Ebola virus did not in fact make the party's obligations impossible to perform and therefore this cannot be viewed as a force majeure event;

(iv) Furthermore, the same Court of Appeal[7] ruled that the SARS epidemic was not a force majeure event due to the fact that at the date in question there were not cases of SARS in Thailand, even though measures have been taken by Thai authorities to avoid the spread of the virus.

Of course, none of these events have caused such an intense change in our day-to-day lives as the coronavirus. Therefore, depending on the measures taken by authorities, courts may have a different approach this time around. Nonetheless, it remains to be seen on a case-by-case basis (and even on a court-by-court basis) how the coronavirus pandemic will stand the test of the force majeure conditions.

For more information with respect to the applicability of force majeure, please read the following **article**. Moreover, with respect to the approval of the force majeure during emergency state, please see our colleague's article **here**.

III. Is hardship an option?

Should the performance of an agreement become excessively onerous, hardship may be considered. However, in order to invoke hardship, the following conditions should be fulfilled:

(i) *a change in the contractual circumstances has occurred after signing and it is not/could not have been reasonably foreseen at the date of signing the agreement* – if the signing date is relatively distant from the date of the virus outbreak, this condition is likely to be easily fulfilled;

(ii) *the party invoking hardship did not assume/cannot be considered to have accepted the risk brought by the change of circumstances* – this will largely depend on the terms of the contract because some "standard" contracts include a waiver of hardship for the debtors; unless the debtors contracted out of such a waiver in the negotiation of the contract, than hardship will likely be excluded;

(iii) *the party claiming hardship reasonably and in good faith attempted a fair and reasonable revision of the agreement* – this is why conduct during this phase, and

[5] Besançon Court of Appeal, 2nd Commercial Chamber, Judgment of 8 January 2014, n° 12/02291

[6] Paris Court of Appeal, Judgement of 29 March 2016, n° 15/12113

[7] Paris Court of Appeal, Judgment of 29 June 2006, n° 04/09052

especially cooperation and negotiation with creditors is essential for the prospect of a successful hardship claim.

Nevertheless, given the current situation, hardship is deeply dependent on the parties' negotiation, as failure of such negotiation will require a claim before a court of law.

Some credit agreements include provisions excluding the application of the Civil Code's hardship provisions. If adequately worded and enforceable, these exclusions are likely to be upheld in a court of law on the basis that the Civil Code provides that the hardship regime only applies if the debtor has not undertaken the risk of change in circumstances and could not reasonably have been deemed to undertake such risk.

Legislative and administrative measures and official communications

Legislative, administrative measures and any other official communications

- **Government Emergency Ordinance no. 37/2020** on granting facilities for the loans issued by credit institutions and non-bank financial institutions to certain categories of debtors and amending certain normative acts (**here**);
- **Government Decision no. 270/2020** regarding the approval of implementation norms of the emergency ordinance no. 37/2020 on granting facilities for the loans issued by credit institutions and non-bank financial institutions to certain categories of debtors and amending certain normative acts (**here**);
- **Government Emergency Ordinance no. 29/2020** on certain economic measures (**here**).

Emergency Action Kit

Emergency Action Kit

Critical due-diligence

This can include an analysis of:

- debt exposures, risks and key provisions, major contractual problems;
- key commercial relations, analysis of provisions and risks;
- employment issues; and
- tax issues.

Standstill Agreements

Indispensable tool for "stopping the clock", ensuring cooperation and mutual access to information in real time.

For more advice on how to successfully conclude standstill agreements, please contact our Financial Restructuring Team.

Monitoring

Fast reporting of changes in legislation specifically impacting the client, including the measures taken during the coronavirus crisis buy government, authorities and courts

Ongoing support

Constant contact addressing any question related to the coronacrisis and any current impact

Dedicated Emergency Support Team, available 24/7.

The Financial Restructuring Team

The Financial Restructuring Team

Our dedicated Financial Restructuring Team includes finance, restructuring and insolvency, tax and employment specialists dedicated to protecting your interests.

We use a wide range of specialist knowledge and backgrounds and a single point of contact and coordination to make sure you get the best value as possible, as fast as possible.

Please meet our coordinators.

Alina Radu
Partner
Head of the Banking and Finance Practice
alina.radu@nndkp.ro
More details here.

Valentin Voinescu
Partner
Banking and Finance Practice
valentin.voinescu@nndkp.ro
More details here.

As the COVID-19 pandemic continues to spread across the globe, NNDKP has set up the **COVID-19 – Legal and Tax Resource Center** – a dedicated section on NNDKP website where you can access valuable knowledge and legal insights with respect to the implications of the coronavirus in various fields in Romania.