

## Commercial Update April 2020

### **Loan Termination and COVID-19; Can the bank terminate my business loan due to the COVID-19 crisis?**

*This is our third briefing note prompted by questions we are receiving from clients in reaction to the business impact of the COVID-19 outbreak and the policy response to it. In this note Alden Legal looks at key issues for companies to be aware of related to continuity of funding under typical loan documentation that may apply in the current circumstances.*

#### **Communicate with your bank**

We would recommend that any company should engage in early and open communication with their bank if they have concerns about their business performance and continued access to existing loans, overdrafts or other credit products (including corporate credit cards). Major UK banks have publicly aligned themselves with Government policies to support businesses through the crisis and have a range of potential concessions and products available that can assist affected firms. Banks are sensitive to negative publicity at the best of times and this is especially the case now meaning that otherwise sound businesses are likely to get a positive reaction to open dialogue about the sudden business challenges brought on by this crisis. Banks are more likely to cooperate and even assist if they are aware of decisions or issues beforehand rather than after the event. This is particularly the case for SMEs but also applies to larger companies and those with more sophisticated credit facilities.

This note concentrates on existing finance arrangements rather than the Government backed support schemes and any particular bank's crisis response. If needed, you should contact your bank directly to discuss what may be available for your company's circumstances.

#### **Key points to consider**

- **The bank can only terminate or demand repayment if it has the right to do so – the crisis itself is not a reason for a loan to be called.**
- **Familiarise yourself with the terms and defaults in your loan documents and supporting guarantees and security.**
- **Meet information, consent and notice requirements under your agreements.**
- **Is your loan facility near to termination and are there renewal conditions?**
- **Early and open communication with your bank is key if the crisis is adversely affecting your business and its ability to perform loan obligations and especially repayments.**
- **Seek to negotiate any termination to mitigate effects.**

#### **Practical Questions**

Check whether your loan facility is close to expiry and whether there are any renewal conditions such as giving notice to extend within a minimum time prior to termination or maybe renewal fees apply. Bank's often have discretion as to renewing and early discussion about your circumstances will be key to ensure that credit facilities do not expire just when they are needed most.

Bank account general terms and conditions will almost certainly contain set-off rights allowing the bank to set-off outstanding liabilities for principal, interest and fees owing under loans or overdrafts across credit balances on bank accounts. Banks do not generally employ these rights other than as previously agreed or notified or as a last resort.

Good practice for managing bank borrowings would in any event be based on sound understanding and familiarisation with the terms of your banking agreements. If the current crisis is affecting, or may in future affect, the business' financial performance it is even more important that directors are aware of the borrower's obligations and the bank's rights in order to manage the communications with the bank effectively and mitigate against risk.

## **Overdrafts compared with loans**

Overdrafts are generally "on demand" facilities which means that the bank has the right to cancel availability and make demand for repayment of the debit balance at its discretion at anytime. Case law has confirmed that "on demand" means just that so, although a bank may allow a period for repayment, it is permitted for them to expect payment straightaway. Banks will usually communicate with customers in advance if they are concerned about overdraft reliance in the crisis and its effect on their business. Engagement with the bank is key to avoiding overdrafts being called or reduced unexpectedly just when overdraft availability may be more important than usually the case.

Although some loans are made available on an "on demand" basis, most loans are committed credit facilities which means that the bank is obliged to continue to make the loan available for utilisation and cannot call for early repayment other than as provided for in the agreement. If the borrower complies with its obligations, the bank cannot unilaterally terminate the loan and demand early repayment.

## **Compliance with terms**

Key areas of concern to banks and the associated rights commonly held by banks under their agreements with corporate borrowers are as follows.

- Meeting scheduled repayments along with timely payment of accrued interest and fees.
- Compliance with undertakings, representations and financial covenants.
- Requirements to provide information to the lender. These will be very important to lenders in this situation and failure to comply (or perceived reluctance to comply) with information requests or timeframes for provision of financial or other information as required in your loan documentation will raise concern at the bank and lead to more extensive scrutiny.
- If your company's decision making in the current crisis requires actions which your loan agreement stipulates needs prior bank consent, ensure that you comply with such requirement for consent. There may also be requirements for the company to give a bank notice of the occurrence of certain events (eg. termination of key customer or supplier contracts, litigation or closure of business activities). If actions are taken or notice is not given that puts you in default under the loan agreement, the bank then has control over the loan and discretion as to its next actions. Activities such as raising further finance from third parties, granting security, making disposals or acquisitions of assets will often require prior bank consent.
- Be aware of so-called "cross default" clauses in your agreement which can be triggered if you default under a separate finance agreement unrelated to your main bank loan (eg. a rent deposit bond, a performance guarantee related to a customer contract or the hire purchase of manufacturing or office equipment). Similar rights may be dependent on continued availability of partner funding through grants or

other incentive arrangements from public authorities.

- Many loan agreements contain a “Material Adverse Effect/Change” (**MAE**) clause which allows the bank to call a default if the general performance or outlook for the business is adversely affected for any reason. This is a catch-all clause that banks rarely ever need to rely on but could become more important to lenders at times of exceptional circumstances such as the current crisis. The right to use MAE depends on the precise wording of the clause and the facts of the case at hand. Banks only look to MAE clauses as a last resort and it is usually the case that other undertakings would have been breached if MAE is in question and those breaches will be the bank’s preferred causes.

## Related agreements and obligations

Borrowers should remind themselves that many corporate loans will have been made available on the condition that guarantees and security are provided as collateral in support of the loan. Compliance with the terms of these documents also needs to be maintained to avoid giving the bank the right to call a default which can lead to loan cancellation and enforcement action.

Directors who have provided personal guarantees, possibly with supporting security over their house or other personal assets, should be especially focussed on managing their business’ loan and the banking relationship.

## Enforcement actions

Banks have a number of courses of action open to them in a default situation brought on by the crisis. Negotiation of a restructured loan may be possible if communication about the crisis and its impacts on the business is successfully undertaken with sufficient time. Payment holidays, extensions to tenor, rolling up of interest or the provision of extra collateral are some of the options which might be considered.

If the bank decides to exercise its right to terminate, the borrower may be able to limit this to a “drawstop” or cancellation of availability of undrawn amounts under a committed loan with an agreed repayment plan for existing borrowings.

The last resort will be a demand for repayment of outstanding amounts which could ultimately lead to liquidation or administration of the business and the calling of guarantees and security as part of related enforcement action. Banks will, however, be cautious about terminal drastic action in the face of a desire to be seen to be supporting otherwise perfectly viable businesses and especially at a time when the potential for a bank to recover loans through liquidation is itself much reduced by the wider economic downturn meaning there are potentially less purchasers of distressed businesses and assets.

## Regulatory implications

Enforcement action against a licence-holder by the bank could adversely affect a licensee’s ability to comply with UK Space Agency (**UKSA**) licence conditions or its Ofcom filing conditions and may also impact the affordability of premia for mandatory insurance. If this is the case, we would recommend early and open communication with UKSA and/or Ofcom to seek resolution of the issue.

This briefing considers typical bank loan provisions in use under English law and is intended for guidance purposes only. It does not constitute legal advice. Specific legal advice on relevant contract terms or issues should be obtained if you have concerns or questions to address.

This briefing does not consider questions of insolvency and related duties of directors related to wrongful trading which require timely and separate legal advice to avoid potential infringements by companies and directors and incurring financial and other sanctions.



**Alex Monk**  
Partner and COO  
[alex.monk@wearealden.com](mailto:alex.monk@wearealden.com)