

COVID-19: Financing Issues

April 9, 2020

Material Adverse Change

Most real estate loan agreements will contain a material adverse change (MAC) clause which specifies an event of default where “*any event or circumstance occurs which, in the opinion of the Lender, has or is reasonably likely to have a Material Adverse Effect*”. “*Material Adverse Effect*” typically includes events which has a material adverse effect on the business, operations, property or condition (financial or otherwise) of the borrower or the ability of the borrower to perform its obligations under the finance documents.

In the context of COVID-19, borrowers might naturally be fearful their lenders will reach for the MAC clause and decide to withhold funding or even ‘*accelerate*’ (repayment of the loan) in circumstances where cash flow is about to or already has become challenged. And, whilst case law suggests the key reference materials for assessing MAC, in the absence of drafting to the contrary, are a borrower’s existing financial information rather than external market changes, lenders are likely to adopt a wait-and-see approach for the time being. Lenders also will need to consider reputational issues with borrowers and the wider public in assessing whether to rely upon MAC as a footing for exercising their rights. And, in any event, enforcing on some assets at this point, for MAC reasons or simply non-payment, seems unlikely if the result is that the lender becomes responsible for the asset. Especially for businesses where the costs of keeping them secure whilst empty are significant.

Coronavirus Business Interruption Loan Scheme

Katten is frequently asked by clients how the Coronavirus Business Interruption Loan Scheme (CBILS) is working in practice, and how forthcoming the ‘*Approved Lenders*’ are. Anecdotally, the experience seems to be that banks are approaching these very differently and with varying levels of understanding of the scheme. We understand even existing relationship banks have been reluctant to consider an application from existing customers. It appears that banks are unfamiliar with the CBILS, or are exercising their credit decisions on normal bank criteria without regarding the government guarantee scheme.

In light of the political will during the pandemic lock-down to safeguard small businesses, to relax insolvency regulations for trading businesses, to impose moratorium on landlords’ forfeiture for non-payment of commercial rent, etc., and the recent Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) statements to banks regarding capital adequacy and forbearance on covenant breaches due to COVID-19, borrowers probably have nothing to lose short term in taking a robust stance with existing lenders regarding payment holidays, interest roll-up, cash reserve release and/or waivers of breaches. This could include a forceful approach to short term cash flow assistance whether by a CBILS or otherwise, or by utilising a CBILS loan to finance existing debt service (as well as general working capital).

COVID-19: Practical Steps for Effective Document Signing

Finally, in instances where businesses remain operational, and/or where negotiations are currently being finalised, leading to agreed-form documents ready for signature, we set out considerations relating to effective completion in the current isolation climate of ‘working from home’.

How can we ensure continued effective completion of transactions, including signing documents?

There are significant challenges around signing documents in the current conditions and how this can be addressed will depend on a variety of factors, including whether those documents need to be signed as:

- **an agreement** — which are more easily executed as they typically only require execution by one signatory and without a witness; or
- **a deed** — which in the current climate of social distancing, deeds can be trickier to execute properly as they will either require two signatories to sign (for corporates), or a signature in the presence of a witness (individuals and corporates).

Additionally, there is the question of any particular requirements of specific Acts or regulations (e.g., the Companies Act or Land Registry Rules). Set out below are aspects we have discussed with clients:

- **Two directors signing separately** — there is no legal authority on whether two signatories signing separate execution pages is valid, and there is currently doubt as to whether the Land Registry would accept such an approach. But will it, in fact, be more practical to have to have corporate documents signed by a sole signatory with a witness?
- **A personal signatory of one director signing in presence of a witness** — the difficulty here would be that usually best practice is that witnesses should be over the age of 18 and not a relative to ensure credibility should the validity of the execution of a document, ever be **questioned**. There is, however, no statutory requirement for the witness to be independent or an adult and, therefore, no prohibition on a signatory's spouse, co-habitee or civil partner from acting as a witness or indeed a minor (e.g., son or daughter). But any minor would have to be capable of giving evidence as to due execution. Please note, however, that a counter-party/another party to a deed cannot act as a witness.
- **E-signatures** — in September 2019, the Law Commission produced a report which concluded that an electronic signature is capable in law of being used to execute a document (including a deed), provided that the signatory is able to show the relevant intention to formally sign the document. However, before proceeding to execute documents via e-signature, one needs to check that:
 - the signature is applied with the requisite intent and appropriate authority;
 - for a legal entity, there are no restrictions on the use of electronic signatures in its constitutional documents;
 - for an overseas (non-UK) legal entity, the law of the place of its incorporation permits electronic signatures; and
 - there is nothing in the contractual terms themselves that stipulates something else.

What will be easy to sign are agreements without a witness (and the Crown Estate, for example, are accepting short term residential leases signed using e-signatures (using DocuSign software)).

However:

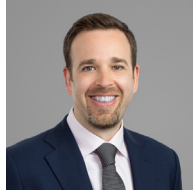
- **Land Registry Practice** — the Land Registry currently takes a more conservative approach and does not accept electronic signatures for deeds, unless the document specifically caters for execution electronically, and satisfies numerous requirements of the Land Registration Act 2002.
- **Witnesses** — the difficulty with applying electronic signatures for deeds is that there is currently very little guidance on how those signatures can be effectively witnessed — particularly when social distancing. The 2019 Law Commission report suggested a requirement for the witness to be physically present, however, it is not clear how a witness can be physically present when a signature is applied electronically.

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