

# Coronavirus disease (COVID-19): Business interruptions and resulting effects in the global economy (Global)

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By: Daniel M. Simon | David E. Avraham | Elissa Barratt

Businesses across industries are bracing and planning for – and in many instances, already experiencing – the economic and social impacts of the coronavirus disease (COVID-19). Even before the World Health Organization escalated the description of the outbreak as a pandemic on March 11, 2020, several governments had already imposed restrictions including mandatory office closures, full or partial lockdowns and travel bans.<sup>1</sup> These restrictions are expected to continue, and on larger scales, in the coming days and weeks. Many businesses have also shuttered stores,<sup>2</sup> canceled conferences<sup>3</sup> and stopped or delayed shipments.<sup>4</sup> And major sporting events have been cancelled or postponed. Unfortunately, such measures have already begun to impact financial markets and pose a significant threat to the stability of large and small businesses alike, particularly in those industries that involve more extensive human contact and interaction.

In light of these unprecedented circumstances, some contract parties are taking the position that the outbreak constitutes an event that excuses nonperformance of contractual obligations under a “force majeure” (or “superior force”) clause. Many lenders are also conducting comprehensive reviews of their credit agreements to determine

whether they can accelerate their borrowers' repayment or refuse to make further advances, in reliance on material adverse change clauses, and related credit-agreement provisions. In short, parties are carefully examining their agreements to determine who bears the risks of the economic impacts of COVID-19. While uncertainties abound over the financial and social consequences of this pandemic, it remains all but certain that the ripple effect of these actions will have lasting impacts on virtually every small and large business around the globe.

At bottom, while the overall scope and duration of the economic impacts are difficult to forecast, there will undoubtedly be a significant increase in workouts, restructurings, rescue financings, forbearances, and other similar activities over the coming months. Given our Restructuring group's broad and wide-ranging experience across all industries and spanning the globe, DLA Piper is highly qualified to strategically and proactively assist clients on these critical issues.

### **Contracts: force majeure clauses**

A force majeure clause is a contract provision that relieves the parties from performing their contractual obligations when certain circumstances beyond their control arise that make performance inadvisable, commercially impracticable, illegal, or impossible. Whether and when a party may utilize a force majeure clause to excuse nonperformance depends on the terms of the specific contract. These provisions may cover natural disasters, terrorism and medical epidemics. Courts tend to interpret force majeure clauses narrowly; often, only the events listed in the specific clause may excuse nonperformance.

The business interruptions resulting from COVID-19 and the various reactions to it, may prompt the invocation of force majeure clauses. These interruptions may aggravate the problems a contracting party already faces in satisfying its contractual obligations. Parties who experience business interruptions as a result of the coronavirus should consult with their legal counsel to review the wording and scope of any force majeure clause in the specific contract before deciding not to perform their obligations (if they indeed have a choice).

### **Impact of invoking force majeure clauses**

A company that invokes the terms of a force majeure clause to excuse its contractual nonperformance should also look beyond the terms of the specific contract to determine the overall impact of this action. Such an event not only could trigger other contractual obligations in connection with that contract, but could also impact other agreements, legal obligations, financial agreements and/or disclosure obligations (such as those required of public companies) through cross-default, material adverse effects or similar provisions. For example, the China Council for the Promotion of International Trade issued a "force majeure certificate" to a manufacturing company unable to meet its contractual obligation with Peugeot's African plant, for which the plant would have a significant damages claim.<sup>5</sup> As a result, the manufacturer could find this created a default in its credit agreement, which could trigger substantial additional disclosure obligations.<sup>6</sup>

Regardless of whether a party can successfully invoke a force majeure clause to excuse non-performance, the reality remains that the contract has not been performed and the counterparty has not received the goods or services they expected. Businesses who are not party to canceled contracts may still be exposed to risks if counterparties struggle to have other contracts fulfilled, creating a potential domino effect which can threaten the viability of other, poorly (or well) capitalized companies, within the same industry.

### **Financing agreements: material adverse changes and covenants**

If a borrower is a party to a contract where force majeure has been invoked, this alone may violate a covenant or term in a financing agreement, especially if the unperformed contract was significant to the borrower's business. However, even in the absence of a party invoking a force majeure clause, the coronavirus could disrupt a borrower's business and impact its ability to comply with the terms of a credit agreement. For example, if certain suppliers are unable to fulfill their contracts, the competition over available suppliers could increase the price of those goods, eating into profits and preventing a borrower from meeting a business performance covenant. The failure to fulfill the obligations in a contract could impact a financing agreement by creating a "material adverse change" ("MAC") or violating a covenant.

A MAC clause in a financing agreement enables a lender to declare a default and accelerate the loan's repayment terms (or refuse to make contractually obligated advances) if a borrower experiences an unforeseen adverse

change in its position or circumstances, regardless of whether the borrower is current on its obligations. Events which constitute a MAC are typically conditions that have, or would reasonably be expected to have, a material adverse effect on the borrowers' business, with certain exclusions. Whether and when a lender can use a MAC clause to trigger a change in the terms of repayment depends on the terms of the financing agreement. However, often such provisions require not only that a material adverse change has impacted the company's business, but that it be *adversely* impacted as compared to other companies in the industry. This fact alone may make it difficult for MAC clauses to be triggered, given the broad-ranging financial impacts being felt by virtually all companies in a given sector.

In addition to the representation and warranties in a financing agreement, which commonly include a MAC clause, a borrower may have agreed to covenants it is unable to keep due to market disruptions. If a borrower cannot meet a covenant, the lender's options will depend on the terms of the specific financing agreement.

Ultimately, businesses that experience interruptions as a result of COVID-19, and their lenders, should consult with their attorneys to review the language of their financing agreements to determine their rights and options and the implications of their actions or inaction.

### **Specific market impacts**

**Disruptions to manufacturing and retailers:** A wide variety of unprecedented factors are disrupting supply chains, including lockdowns, ill or quarantined key employees and cautious consumers. Although preliminary data from China indicates that these conditions are potentially improving, further analysis will be required to determine the lasting effects of these issues. To be sure, these disruptions are already creating problems for manufacturers and direct-to-consumer and retailing companies who may need to seek alternative suppliers.

Malls, shopping centers and other landlords to these retailers may feel the secondary effects of these disruptions if these retailers bear the risk of nonperformance and can no longer pay their rent. Bricks-and-mortar retailers in the United States already operate in an extremely vulnerable market, with 9,300 store closings announced in 2019 and over 2,000 stores predicted to close in 2020.<sup>7</sup> As a result, retailers may be unequipped to weather these supply chain disruptions. Perhaps most concerning is that this issue can be greatly exacerbated by the possibility that consumers may want to avoid public areas altogether.

**Disruptions to carriers:** If suppliers, assemblers or retailers cannot fulfill their obligations, they may also invoke a force majeure clause to cancel the delivery of goods. These effects can already be observed in the shipping industry. According to the American Association of Port Authorities, the cargo volume at many ports during the first quarter of 2020 may be down by 20% compared to 2019.<sup>8</sup>

**Disruptions to the hospitality industry:** Many companies have banned all "non-essential" travel, canceled conferences and suspended international travel.<sup>9</sup> Individual travelers have also canceled vacations, cruises and their attendance at events with large gatherings. This has directly – and will continue to – impact travel companies, airlines, hotels, convention organizers, food and beverage suppliers and all companies that depend on and service tourists and in-person meetings. Ripple effects of these issues will undoubtedly be felt by most businesses; yet the magnitude of this impact remains to be seen.

**Disruptions to general business activity:** In addition to the segments discussed above, market volatility, canceled contracts and the risk of ongoing disruptions could create exposure for even the healthiest businesses. There are risks in the short term as products are not timely moved and employees are not able to work, but also in the long term as companies miss out on the benefits of growth and the opportunities to deepen and expand business relationships.

### **The consequences for your business**

The impact on your business will vary widely based on your market, your business's current health and financing structure, and the terms in your contracts, leases, trade and supply agreements. Although lower federal interest rates may ultimately help stimulate the economy, the benefits on any business and its financings will vary.

The following is not legal advice, but may enhance your analysis of risk factors and options to avoid or ameliorate the costs of COVID-19 on your business:

- **Contractual agreements.** As market circumstances change (often dramatically within a short period of time), and risks shift through force majeure and other contractual provisions, the leverage between two parties to an agreement will also change. Understanding these changes in leverage (whether real or perceived) provides opportunities to renegotiate contracts and leases on more favorable terms. Even the fact that both contractual parties know that leverage will continue to change can be a point of leverage to negotiate a new agreement. Similarly, companies may need to proactively devise defense strategies to minimize or shift the risks of anticipated disruptions.
- **Solvency and financing.** Determine how many quarters your business could continue as a going concern were the markets to remain as volatile as they are today. Contingency plans or options should be created or revisited to proactively plan for your cash runway, including seeking alternative financing in the event that market downturn outlasts your business's solvency. Market disruptions mean that lending could tighten as funding partners may perceive additional risks with your business, or the wider market, and be unwilling to lend or lend on unfavorable terms. Market volatility could also threaten your business's compliance with existing covenants. However, these disruptions could also provide opportunities to renegotiate credit agreements, restructure funding, extend or revise payment terms or reset covenants.
- **Business planning.** Even if you believe that your company has no direct or immediate exposure, your affiliates and customers may need to lower their spending. Conversely, your business may see unique opportunities in the changing market.
- **Business restructuring.** Assess whether the impacts to your business may be broad or limited in scope. Review your business organization as a whole and consider downsizing unprofitable, surplus entities. Ultimately, the sale of certain business assets may be the preferred approach to protect a business facing distress in the current market. For some businesses, the best long-term strategy may involve an informal or formal restructuring (or even a wind-down) of what are now underperforming and risky business elements.

DLA Piper has significant experience advising some of the world's largest companies to assess risks, develop proactive measures to manage new or exacerbated distress and navigate issues with strategic partners. Our global presence and experience positions us to advise on cross-border risks and solutions.

As the impact of COVID-19 continues to evolve, DLA Piper is available to assist in helping companies manage the various legal implications of the outbreak. Please visit our COVID-19 Resource Center and subscribe to our COVID-19 list here to receive alerts and webinar invitations on navigating this challenging time.

To contact any of the DLA Piper attorneys in the Restructuring Group, please click here.

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<sup>1</sup> See 85 F.R. 12855 (March 4, 2020).

<sup>2</sup> Holly Ellyatt, Italy closes bars, restaurants and most shops as coronavirus death toll jumps 30% (March 12, 2020) <https://www.cnn.com/2020/03/12/italy-shops-bars-and-restaurants-ordered-to-close.html> (March 12, 2020).

<sup>3</sup> Joey Hadden and Laura Casado, Here are the major events that have been cancelled or postponed due to the outbreak of the coronavirus so far (March 11, 2020) <https://www.businessinsider.com/major-events-cancelled-or-postponed-due-to-the-coronavirus-2020> (March 12, 2020).

<sup>4</sup> Jesse Newman and Jennifer Smith, Coronavirus Snarls Trans-Pacific Shipping and Ripples Through U.S. Business (March 5, 2020) <https://www.wsj.com/articles/coronavirus-snarls-trans-pacific-shipping-and-ripples-through-u-s-business-11583432172> (March 12, 2020).

<sup>5</sup> Georgina Lee, China offers force majeure escape clause for factories that breach supply contracts as coronavirus shutdowns leave assemblies idle (February 3, 2020) <https://www.scmp.com/business/china-business/article/3048767/peugeot-parts-supplier-risk-missing-overseas-orders-amid> (March 12, 2020).

<sup>6</sup> Jay Clayton, Proposed Amendments to Modernize and Enhance Financial Disclosures; Other Ongoing Disclosure Modernization Initiatives; Impact of the Coronavirus; Environmental and Climate-Related Disclosure (January 30, 2020) <https://www.sec.gov/news/public-statement/clayton-mda-2020-01-30> (March 12, 2020).

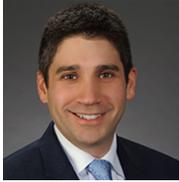
<sup>7</sup> Hayley Peterson, More than 2,600 stores are closing in 2020 as the retail apocalypse drags on. Here's the full list. (March 12, 2020) <https://www.businessinsider.com/stores-closing-in-2020-list-2020-1> (March 12, 2020).

<sup>8</sup> American Association of Port Authorities, Coronavirus Impacts Significant to Ports, Shipping, Logistics (February 28, 2020) <https://www.aapa-ports.org/advocating/PRdetail.aspx?itemnumber=22531> (March 12, 2020).

<sup>9</sup> Keiko Morris and Craig Karmin, Coronavirus Slams U.S. Hotel Industry's Global Operations (March 3, 2020) <https://www.wsj.com/articles/coronavirus-slams-u-s-hotel-industrys-global-operations-11583236802> (March 12, 2020).

## AUTHORS

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**Daniel M. Simon**

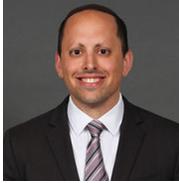
Partner

Atlanta | T: +1 404 736 7800

Chicago | T: +1 312 368 4000

daniel.simon@dlapiper.com

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**David E. Avraham**

Associate

Chicago | T: +1 312 368 4000

Dallas | T: +1 214 743 4500

Houston | T: +1 713 425 8400

david.avraham@dlapiper.com

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**Elissa Barratt**

Associate

Atlanta | T: +1 404 736 7800

elissa.barratt@dlapiper.com

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