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# COVID-19 – IMPACT ON ROMANIAN LAW GOVERNED FINANCING AGREEMENTS AND POTENTIAL SOLUTIONS

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## Synopsis

In the context of the new coronavirus outbreak, numerous legal concerns may arise in connection with the future performance of contractual obligations derived from financing agreements such as credit agreements, leasing agreements and alike.

While in certain states such as Hungary some radical measures were taken by the Government such as the suspension of loan payments until the end of the year for all private individuals and businesses who took loans prior to this period, the Romanian Government announced mainly measures to provide State guarantee and increase access of micro enterprises and SMEs to investment credits, credits or credit lines for financing working capital, in view of allowing the access of SMEs to further financing to face potential liquidity issues.

Beyond any special measures meant to allow credit institutions to further lend to debtors which could face liquidity issues due to the COVID-19 outbreak[1], in principle, it is recommendable that adapted responses are implemented by the relevant credit institutions based on the existing general legal framework (including the Civil Code and legal concepts such as hardship) within the limits of the amended prudential requirements rather than the same being subject to special rules established by means of emergency Government ordinances. Considering the measures taken by the Government sofar, this seems to be the path chosen in Romania for addressing this type of issues.

## 1. Relevant Romanian Legal Framework

### 1.1 Limited Applicability of the Special Emergency-Related Legislation to Financing Agreements

In the context of the establishment of the state of emergency in Romania by Presidential Decree no. 195/18 March 2020 (the „**Decree**") and the provision by such Decree of the possibility of the Ministry of Economy to issue certificates of state of emergency upon request of legal entities whose activity was affected by COVID-19 (without any further details), there were numerous discussions in the public space around the possibility of such certificates to be used also in the ongoing contractual relationships with credit institutions or other credit providers (e.g., the non- banking financial institutions), as well as on the legal effects that such certificates could have on the ongoing contracts.

Following the entry into force of Government Emergency Ordinance no. 29/2020 on certain economic, tax and budgetary measures on 21 March 2020 (the „**Ordinance**"), it is rather clear that such certificates do not seem to be of much relevance for the financing agreements, not even for the agreements

[1] The potential adjournment of certain instalment payments during the state of emergency in case of consumers, is currently under discussion, as announced by the Ministry of Public Finances in the press.

concluded with small and medium enterprises (SMEs)[2], practically the authorities leaving the parties to establish and negotiate the effects of the current circumstances on a case by case basis.

Thus, in connection with contracts other than utilities and lease contracts, the Ordinance only aims to limit, to a certain extent,[3] the possibility that *force majeure* clauses are invoked against SMEs under the ongoing agreements. At the same time, Article X para. 3 of the Ordinance seems to provide for the conditions in which an SME may invoke a *force majeure* event in connection with the COVID-19 outbreak, providing that it is presumed to be a *force majeure* the event resulted from the actions of the authorities imposed in order to prevent and fight against the COVID-19 outbreak and which affected the activity of the SME, as certified by the certificate of state of emergency. In a reasonable interpretation, such certificates could be used only in connection with contracts entered into before the establishment of the state of emergency by the Decree, as the Ordinance provides that the measures which will be implemented following the Decree establishing the state of emergency will not be deemed enfoceable. The Ordinance sets forth a rebuttable legal presumption of *force majeure* (if the aforementioned conditions are complied with), which may be rebutted by any means of proof.

Or, in principle, *force majeure* is not the legal concept that seems to be able to protect debtors (including SMEs) under ongoing credit and other financial contractual arrangements from potential defaults. As such, generally the creditors look at MAC/MAE clauses and various specific defaults under the contract, while debtors usually aim at renegotiating/obtaining the restructuring of the agreements including by reference to hardship and its legal consequences. This is even more so by reference to Article 1634 para. 6 of the Civil Code establishing that in case the obligation has as subject matter fungible assets (such as obligations to pay amounts of money), the debtor may not invoke the fortuitous impossibility to perform its obligations triggered *inter alia* by *force majeure* events. Also, in certain such contracts, the relevant debtors expressly assumed the risk of *force majeure* and related consequences.

However, the aforementioned legal provisions do not prevent debtors (including consumers and SMEs) from using the general legal concepts regulated by the Civil Code such as hardship and trying to obtain the renegotiation of the agreements in order to adapt them to the current exceptional circumstances.

### 1.2 The possibility to rely on general Civil Code concepts (including the hardship doctrine)

Hardship is regulated under the provisions of article 1271 of Romanian Civil Codeoffering a way out of the situation in which the parties find themselves in exceptional circumstances, without the fault of either party, further to the conclusion of their agreement, in circumstances which they could not have reasonably anticipated at the time of concluding the contract.

The hardship defense offers the parties an adaptation or an opt-out instrument from contractual agreements arising when a supervening event (e.g., the state of emergency established in relation to the COVID-19 outbreak) occurs, without the fault of either party, that transforms the outstanding contractual obligations the parties have undertaken into something radically different from what they could have reasonably contemplated upon the execution of their agreement, such that it would be unjust to hold them to their outstanding obligations in the new circumstances.

The application of the hardship doctrine implies prior amicable settlement, very important these days considering the current circumstances, which, if no agreement is obtained, may lead to judicial proceedings (considering the general suspension of the activity of the courts of law, it is likely that such

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[2] Small enterprises are enterprises having between 10 and 49 employees, with a net annual turnover or total assets of up to 10 million euros, equivalent in RON and medium-sized enterprises are enterprises having between 50 and 249 employees, with a net annual turnover of up to 50 million euros, equivalent in RON, or total assets not exceeding the equivalent in RON of 43 million euros. The Ordinance applies the same type of provisions set forth in Article X thereof also to certain professions fulfilling public interest services such as notary public, lawyers, court bailiffs whose activities are affected by the measures meant to address the COVID 19 outbreak.

[3] Conditioning such possibility on the actual attempt proven in writing to renegotiate the contractual clauses in order to adapt them in consideration of the exceptional circumstances triggered by the emergency status

judicial proceedings will not be viewed as urgent and will be available only after the end of the state of emergency).

In case a debtor finds itself in a hardship situation in which its performance becomes extremely onerous due to exceptional circumstances which would make it manifestly unfair to oblige him to enforce its obligation, a court of law may dispose: (i) the adaptation of the contract, in order to equitably distribute the losses and benefits resulting from changing circumstances or (ii) the termination of the contract.

Nevertheless, in order for the hardship to be triggered and a party's non-performance to be excused, the debtor must comply with the following conditions:

(a) it must not be at fault or have undertaken the risk of changing circumstances (an assessment on the risk actually assumed must be made),

(b) it must not reasonably be considered to have accepted the risk of the change in cricumstances into account at the time of the conclusion of the contract (which must be proved based mostly on objective criteria), and also

(c) it must prove that it tried, within reasonable time and in good faith, to negotiate under reasonable and equitable terms the adaptation of the contract.

In order to assess whether a debtor is facing a radically different situation, one must not only rely on the general exceptional circumstances triggered by COVID-19 outbreak, but rather on the actual effects on the debtor's current overall patrimonial situation of such circumstances. The assessment of the impact of COVID-19 outbreak on the debtor's particular patrimonal situation should consider a multitude of factors, including not only the turnover and financial indicators decrease, or other negative impact caused by the various restrictive measures imposed by the authorities (such as mobility restrictions and alike), but also the potentially beneficial impact of some exceptional national measures meant to address the economic impact of COVID-19[4].

Prior to going to court (when such access will actually be available – probably after the end of the state of emergency as indicated above), in order to be able to invoke the hardship defense, a debtor must follow certain steps after proving the circumstances underlined above, such as:

(a) act in good faith with the lender, e.g., notify the lender on the onerous and exceptional circumstances faced, with relevant proof such as suspended or cancelled requests / agreements for its ongoing business;

(b) verify any clauses in the relevant financing agreements related to hardship and exceptional circumstances in the relevant contracts and whether they were duly consented to or waived or whether they could be considered to cover the COVID-19 outbreak;

(c) negotiate in good faith with the relevant lender the contractual situation (e.g., rescheduling terms) and try to settle on reasonable and equitable grounds on the contract amendment considering the exceptional circumstances as also recognized on an international and national level, including through the Decree and goverment emergency ordinances.

## 2. Initial Measures of the EU and Romanian Banking Competent Authorities

On a more general level, it is noteworthy that the strain the effects COVID-19 generated over the economy already attracted reactions at the level both of the European banking industry and its regulators. On 11 March, the European Banking Federation issued a letter calling for certain measures from the competent authorities which would support banks to continue lending to sound borrowers facing liquidity difficulties generated by the COVID-19 outbreak, without detriment to their prudential

[4] Including the increase of credit ceiling guarantees for SMEs, the State guarantees offered for investment loans and working capital assurance, tax rectifications etc.

evaluations. On 12 March, announcements on packages of measures to be taken by the relevant authorities (the European Central Bank – the ECB and the European Banking Authority – the EBA), some of which are already in effect, followed.

The above is relevant from two main perspectives. Firstly, in such times of crisis, it is apparent that the intention of the lenders is not to declare defaults where sound borrowers are experiencing temporary difficulties in respecting the repayment schedule due to the shocks they are facing on their liquidity. If anything, the intention is exactly the opposite, to prevent such temporary setbacks from becoming definitive and ultimately leading to insolvency-related defaults. Secondly, with their prompt actions, the regulators showed support to the very same intention, putting in place measures designed to ease the pressure from banks and, ultimately, the lenders.

ECB announced[5] a series of measures designed to compensate any scarcity which may occur in liquidity levels, to increase the banks' lending capacity (either by making more favorable existing facilities, enabling new ones, or by allowing banks use buffer capital) and to provide some operational relief for the banks including :

(i) the easement of conditions for targeted longer-term refinancing operations (TLTRO III) including by means of ECB Decision 2020/407;

(ii) the longer-term refinancing operations (LTRO) to bridge any immediate liquidity necessities banks would have until the settlement of TLTRO III;

(iii) capital relief to banks in support of the economy (banks being allowed to temporarily operate between the level of capital defined by the Pillar 2 Guidance, the capital conservation buffer and the liquidity coverage ratio), the national macroprudential authorities being expected to ease the level of the countercyclical capital buffer as well and

(iv) an EUR 750 billion Pandemic Emergency Purchase Programme (PEPP) to be launched, covering purchases concluded until the end of 2020[6].

At local level, the NBR issued[7] a package of monetary policy measures (the reduction of monetary policy rate, the adjustment of interests rates on standing facilities, contemplated purchases of RON-denominated government securities on the secondary market so as to maintain a structural liquidity in the banking system) and announced working on some amendments to the regulation on applicable prudential requirements.

At the same time, and more importantly, the NBR clarified by public release on 24 March 2020[8] that the adjournment of the payment of certain instalments as a consequence to the current circumstances does not need to be associated to a financial difficulty of the client and the credit should not be reclassified and related provisioning measures should not be taken as a consequence to such rescheduling[9]. At the same time, the creditors (banking and non-banking financial institutions) may adjourn the payment of credit instalments for persons affected by COVID-19 outbreak, without applying the conditions set forth by NBR Regulation 17/2012 on certain crediting conditions regarding the indebtedness degree, the restrictions on the credit depending on the value of the collateral and the maximum duration of consumer credits.

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5 https://www.ecb.europa.eu/press/pr/html/index.en.html

6 Such launch is accompanied by an extension of the range of eligible assets under the corporate sector purchase programme and an adjustment of the main risk parameters of the collateral framework so as to ease the collateral standards

7 https://bnro.ro/page.aspx?prid=17616

8 https://bnro.ro/page.aspx?prid=17639

9 In line with EBA Guidelines on the application of the definition of default under Article 178 of Regulation (EU) No 575/2013

Also, in connection with credit institutions, the NBR decided to allow such entities to temporarily use (until a date to be further announced) the capital buffers already created, in compliance with the legal conditions set forth by the relevant legal framework for such flexibility, in order to allow the banks to support the economy. Similarly, in line with the actions adopted at a European level, the NBR allows the banks not to comply with the minimum level of the liquidity ratio with the purpose to use such reserves in order to ensure a good functioning of the banking sector and allow the banks to ensure sufficient liquidities to corporates and consumers[10].

Finally, the restructuring of credits granted to persons affected by COVID-19 outbreak through the suspension/freezing for a period of the outstanding credit instalments by non-banking financial institutions registered with the General Registry does not trigger automatically the requirement to specific credit risk provisioning, as such mechanism will not be deemed to trigger delays in the payment of the instalment. Also, in case of credits granted by non-banking financial institutions registered with the Special Registry and subject to additional prudential requirements, the restructuring of credits extended to persons affected by COVID-19 outbreak does not trigger the automatic classification of such loans in an inferior credit risk category, nor additional provisioning requirements. In case of temporary non compliance by such institutions with the applicable limits regarding credit exposures set forth by NBR Regulation 20/2009 caused by the implementation by the creditor of certain measures to support debtors or to increase the crediting in the context of the COVID-19 outbreak, this is deemed as an exceptional well justified case that the relevant institutions will notify to the NBR in order to agree a deadline for compliance.

[10] A further communication from the NBR in connection with the limits of application of aforementioned flexibility measures will follow.