

Wednesday, May 13, 2020

The COVID-19 Storm and Recession Aftermath

Landfall: Forbearance and Early Stage Workout Structures

2020 Recession

- Commercial loans in default and many businesses will not survive.
- Recovery will likely take years.
- Plan now for a flood of workouts.
- Last week's webinar focused on initial steps, including loan document review and lessons learned from the Great Recession of 2007 and 2008.
- This webinar will focus on early workout structures with an emphasis on the utility of forbearance agreements and proper documentation.

First Steps

- Create list of loans likely to end up in workout.
 - By category of loan (i.e. retail, restaurant, service, and real estate), and specific loans. Some industries are being harder hit than others.
- Develop an action plan for defaulted loans.
 - Examine loan documents and collateral for deficiencies.
 - Determine whether your borrower will be cooperative, combative or indifferent. (“Here are the keys. Good luck!”) Type of Borrower will greatly affect your action plan.
 - Collect as much financial information as possible from borrowers and guarantors before taking action (if possible). Condition agreement on receipt of current information.
 - Borrower to create plan for reopening and getting back on track. Good plans will need to forecast through second quarter of 2021.
- Make demand and start collection?
 - Considerations.
 - Practical and legal limitations.
 - Market forces on value of collateral.
 - Best to wait for dust to settle, identify problems, and collect information before pulling the trigger.

Loan Default & Enforcement Scenarios

There are a number of possible ways to resolve defaults, with varying pros and cons. As a general matter, the following are ranked from best to worst in terms of cost, timing, and exposure to the lender:

- **Forbearance**: A consensual workout which avoids the need for court intervention or lengthy proceedings. This also presents an opportunity to tighten terms, enhance collateral pool, and impose additional reporting and oversight requirements on the borrower.
- **Foreclosure and Collection**: Both in and out of court proceedings are available to enforce lender rights, but either involve additional cost and delay. Borrowers may assert counterclaims against lender, and collateral may not be sufficient to cover indebtedness.

Enforcement Scenarios (continued)

- **Receiverships, ABCs, and State-Court Liquidation**: Involves liquidation of entire company for benefit of all creditors, not merely lender. Although lender generally has exclusive claim to collateral, deficiency claims share in process with all creditors. Administratively expensive and prolonged.
- **Bankruptcy**: Provides borrowers with broadest powers to alter lender rights. Subject of next week's webinar.

Initial Workout Documentation

- Reservation of Rights Letter
 - Informs borrower of existence of defaults and preserves all rights of the lender.
 - Allows time to gather information and develop a plan while helping to avoid a waiver argument.
 - Pre-Workout Agreement
 - Some lenders require them before beginning discussions with borrower and guarantors.
 - Establishes written record of ground rules for the negotiation of the terms of a forbearance agreement or loan modification.
 - No agreement to agree or amend.
 - Reservation of rights – negotiation not a waiver of defaults and lender is entitled to take any action related to defaults.
 - Right to collect information from third parties.

Documentation (continued)

- Not relying on lender's willingness to negotiate to the borrower's detriment (i.e. Borrower acknowledges that it is not putting all of its eggs in one basket. Borrower should continue to explore other opportunities – refinance, capital sources, etc.)
- Communications during negotiation not binding on lender, or to be relied upon by borrowers or guarantors as a promise, and shall not be used against the lender in litigation or bankruptcy.
- Confirm validity and enforceability of loan documents, existence of and materiality of defaults, and rights of lender to take action.
- Affect of acceptance of partial payments during negotiation.
- Not a joint venture and lender not controlling business.
- Prerequisites to negotiation – e.g. delivery of updated financial information and affidavits of financial condition.
- Agreement to pay lender fees and expenses.
- Release of all claims against the lender and affiliates.
- Integration clause.
- Payment of a fee prior to negotiation?

Forbearance Agreements

- A forbearance agreement provides a borrower in default time to repay the loan under terms dictated by the lender, without the lender having to foreclose on collateral or pursue other collection activities.
- The goal is to have the loan repaid in full or reinstated under specific terms by a date certain by any number of possible methods including:
 - i. an orderly sale of collateral,
 - ii. refinancing the loan with another lender,
 - iii. paying off the loan through other methods, or
 - iv. Effectively enacting plan to reopen and develop business to pre COVID or acceptable level.



Forbearance Agreements (continued)

- A well-crafted forbearance arrangement will:
 - i. document reasonable conduct of bank and clear understanding of situation/arrangement in order to deter or provide support in defense of lender liability suit;
 - ii. contain releases by borrower and guarantors against bank and agents for all matters relating to the loan, the documents, and actions up to the time of execution; and
 - iii. contain waivers of certain rights in the event of bankruptcy (such as agreement not to oppose a motion for relief from the automatic stay filed by the bank).
- Entering into forbearance agreements is a concession made by the bank. Banks should take the opportunity to condition the agreement on fixing documentation or collateral perfection issues, and take additional collateral.

Elements of the Forbearance Agreement

- **Recitals**: Describe loans, documents, collateral, parties; define critical terms; describe existing defaults. Establish consideration for concessions given by the borrower (e.g., additional collateral, fixing collateral issues, correcting loan documents).
- **Affirmation of Loan Documents**: Obligors (borrowers and guarantors) affirm legality and binding effect and acknowledge full and timely performance by lender of obligations under loan documents.
- **Affirmation of Collateral**: Obligors affirm title to assets and validity of lender's liens.

Elements (continued)

- **Acknowledgment of Defaults and Amount Due**: Obligors acknowledge occurrence of defaults and agree to outstanding amounts of obligations, including principal, interest, default interest, penalties, late charges, fees, etc. and acknowledge liability for attorneys' fees and costs.
- **Structural Changes**: In a workout agreement, this is where substantive changes to loan terms are described. That could include changes to interest rates, changes to maturity dates, grants of additional collateral, addition of guarantors, establishment of lock box, deferral of payment obligations, new reporting obligations, termination of lines of credit, etc.

Elements (continued)

- **Obligors' Covenants**: This is where the borrowers obligations are described. Should be clear and measurable. If there are collateral or document deficiencies that need to be remedied, the specific things that the obligors must do (execute particular documents, deliver particular collateral) are identified, with deadlines (typically concurrently with execution of the agreement). Other obligations not already in or different from the obligations in the loan documents are included. These can include, sales of assets, hiring of restructuring professionals, production of turnaround plans, reductions in indebtedness, infusions of equity, reporting, payment of forbearance fees, etc.
- **Lender's Obligations**: Lender agrees to forbear from exercising remedies for existing defaults (perhaps, in a full blown workout agreement, waives existing defaults). Perhaps forbearance lasts as long as obligors perform under loan documents and forbearance agreement without further defaults; perhaps until a date certain with requirement that obligations are paid in full at end of forbearance period. Consider covenants in loan documents that will likely be breached during forbearance period. Address here.

Elements (continued)

- **Deeds in Lieu and Consents to Judgment:** The Lender may require the Obligors to execute and deliver to the Lender deeds in lieu of foreclosure and consents to foreclosure to facilitate liquidation of collateral following a new default. Best to avoid describing such documents as having been delivered “in escrow.” Better for Lender to agree not to do anything with them unless a new event of default has occurred. Consider whether deed in lieu is appropriate.
- **Effect of New Defaults:** Exercise of Remedies: Is notice required? Is there a right to cure? Cross default to existing loan documents.
- **Bankruptcy Provisions:** Agreements by Obligors not to file for bankruptcy are unenforceable as a matter of law. Agreements by obligors to consent to relief from the automatic stay in the event of bankruptcy may be enforceable in limited circumstances, but expect challenge from other secured creditors, unsecured creditors and U.S. Trustee. Similarly, agreements concerning what will be required as adequate protection may be helpful, but will not be binding on the court, which will make its own determination of what constitutes adequate protection.

Elements (continued)

Other:

- Release of Lender
- Indemnification of Lender
- Reservation of Rights; No Waiver (or waivers limited to specific defaults)
- Affirmation of Lender-Borrower Relationship; Disclaimer of Duties
- Reps and Warranties
- Waiver of subrogation and contribution
- Jury trial waiver
- No oral modification
- Boilerplate

Elements (continued)

- Time of essence
- Survival
- Integration
- Interpretation
- Governing law
- Further Assurances
- Notice
- No third party rights

The background is a solid teal color. On the left side, there are white geometric shapes that appear to be overlapping or layered, creating a sense of depth. A thin orange horizontal line runs across the bottom of the teal section.

Questions?

The information within this presentation may not account for all specifics of your particular situation. It is not confidential legal advice and does not create an attorney-client relationship. Responsive inquiries are also not confidential and do not create an attorney-client relationship. You should always consult a legal professional to determine how the law may apply in your specific circumstances. We welcome the opportunity to discuss providing you with legal advice pursuant to a mutually agreeable written retainer agreement.

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