

NAVIGATING TROUBLED WATERS, THE CHALLENGES FACED BY LENDERS AND BORROWERS DURING THE COVID-19 CRISIS

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By Marc E. Hirschfield and Marc Skapof

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The COVID-19 pandemic has and will continue to disrupt “business as usual” for most businesses in the United States and around the world. Even the most well-capitalized companies are likely to see constrained liquidity, and for those which lack significant cash reserves, lease and loan defaults are of primary concern. Additionally, these obligations often include personal guarantees for the businesses’ principals and compound an already difficult situation. In the current environment, all industries are feeling the heat, particularly in the retail, restaurant, travel, hospitality, entertainment and manufacturing sectors. Simply put, with large numbers of consumers, customers and employees “sheltering in place,” cash flow shortages are everywhere and have both lenders and borrowers wondering what to do to protect themselves and scrambling to review financial covenants and other loan document provisions regarding rights and remedies.

On the creditor side, lenders, landlords, vendors and contract counterparties are also feeling pressure from their investors and capital providers to “do something” to protect their positions or mitigate losses. Although the first instinct in these circumstances may be to immediately call defaults and exercise remedies, including judicial process, experience suggests that taking draconian steps early in a crisis often yields reduced recoveries. Instead, for lenders and borrowers alike, an approach that values open communication, transparency and working consensually to maximize stakeholder value typically produces better results than immediate liquidation at rock bottom prices. Further, negotiated outcomes typically mitigate legal risk and reduce the prospect of personal liability.

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Below is a list of some the actions that may be appropriate, depending on the particular facts and circumstances of each situation, including:

- Negotiating forbearance or similar agreements among borrowers and lenders to allow for sufficient time to work through the immediate crisis.

- Understanding the rights and responsibilities of borrowers and lenders under Article 9 of the UCC.
- Negotiating amendments to key agreements, including loan facilities, lease agreements and IP licenses.
- Negotiating out of court workouts, restructurings and non-bankruptcy alternatives such as state law dissolutions, Article 9 sales, assignments for the benefit of creditors and composition agreements.
- Consideration of in-court restructurings under chapter 11 of the Bankruptcy Code.

In the best of times, taking early and proactive steps in dealing with financial distress greatly benefits companies, borrowers, lenders and other constituents. In extraordinary times like now, the need for speed is even greater. In general, the party that initiates the dialog has a better chance of steering the outcome in a way that maximizes its bargaining position and ultimately the outcome. Put simply, it's better to act than to be acted upon and why we urge our clients to reach out to us before that happens. Based on our years of experience representing borrowers, lenders, landlords and general creditors, we can help you develop a strategic plan to navigate around today's challenges and be well-positioned to get back to business as usual when the storm passes.

PROFESSIONALS

Marc E. Hirschfield

Marc Skapof

CAPABILITIES

Business Restructuring & Bankruptcy