THOMSON REUTERS
Westlaw®

Considerations for lenders during and after COVID-19

By Monique Almy, Esq., Randall L. Hagen, Esq., Scott Lessne, Esq., and Mark Lichtenstein, Esq., *Crowell & Moring**

MAY 6, 2020

As the COVID-19 pandemic continues to wreak havoc on global markets and businesses for the foreseeable future, lenders will be confronted with difficult choices and often no-win situations and may be forced to choose among exercising rights and remedies, honoring their existing obligations through debt restructures, and protecting their interests in extending new credit through traditional or government-sponsored programs.

This unprecedented health crisis has caused nearly every business to take stock of its cash flow and operations, as well as to develop contingency plans to survive disruptions that may have already occurred.

Government regulators have issued guidance strongly encouraging lenders to work with borrowers impacted by COVID-19, and lenders need to be prepared to assess funding requests and quickly evaluate the rapidly changing credit risk to their portfolios caused by the coronavirus and the national and international efforts, including shutdown of business operations, to slow COVID-19's further spread.

POTENTIAL LENDER LIABILITY

First, do no harm. Because of the speed with which the coronavirus has spread, causing the immediate shutdown of ordinary business operations, a lender must be careful not to expose itself to a charge of lender liability.

A lender who engages in protecting and preserving its rights, as well as carrying on a good faith dialogue with a borrower about difficult choices, is unlikely to be exposed to lender liability risk; however, lender liability may arise, or at least be alleged, if the lender exercises excessive control over a borrower's affairs or engages in inequitable or fraudulent conduct with respect to a borrower or its creditors.

In the current COVID-19 environment, and in light of massive effort and investment by government authorities to keep businesses afloat until employees can return, lenders should be particularly sensitive in dealing with commercial customers.

For example, in communicating with a borrower, the lender must take care to avoid saying anything that could be interpreted as coercive, threatening or controlling.

Even a discussion of potential enforcement actions and remedies should be portrayed as necessary to protect the lender's rights and interests rather than exhibiting an adversarial posture toward the borrower.

Although a lender is entitled to exercise contractual remedies, in these sensitive times it is prudent to establish a record (i) justifying the remedy, and (ii) communicating with the borrower in a non-threatening manner.

ADMINISTRATION OF LOAN PORTFOLIO

With this "do no harm" mentality, a lender should review whether it can safely and soundly administer its loan portfolio with the expediency required by the COVID-19 pandemic.

In communicating with a borrower, the lender must take care to avoid saying anything that could be interpreted as coercive, threatening or controlling.

For example, can a lender still timely process draw requests and deliverables under loan documents? Is greater caution being shown to data security with so many employees working remotely? Are third-party vendors (*e.g.*, appraisers, auditors, etc.) able to stay open and perform tasks the lender has outsourced?

Now is the time for a lender to "get its ducks in a row" as the COVID-19 shutdown will continue to affect the lender's portfolio and customers' worsening economics.

LOAN FUNDING ISSUES

On a regular basis (and certainly more frequently than in the pre-coronavirus era), a lender should review its portfolio to determine which facilities are likely to see a draw request, and then consider whether any draw requirements include as a condition the absence of a material adverse event (MAE) or material adverse change (MAC).

If there is such a condition, the lender must determine whether the MAE/MAC clause includes forward-looking language or a carve-out for *force majeure* events that would exclude anything arising from general economic conditions or a government-ordered closure.

REPRESENTATIONS, COVENANTS AND EVENTS OF DEFAULT

A lender should review whether any items in the loan documents trigger a bring-down of representations and covenants, which could inadvertently trigger a default or event of default.

For example, would any representation or covenant (as well as any event of default) triggered by an MAE/MAC rely on the actual event having occurred or is there less-literal language such as "could be reasonably expected to result in a Material Adverse Event/Change"?

> A lender should review whether it can safely and soundly administer its loan portfolio with the expediency required by the COVID-19 pandemic.

Is there a representation or covenant concerning the borrower's "insolvency," and, if so, is the lender concerned about the truth of such statement in general or at the time of a funding request, particularly with the impact of COVID-19 on the borrower's industry, supply chain, or demand for products or services?

SHUTDOWN OF THE BORROWER'S BUSINESS

Hopefully any closure would be temporary, but if caused by a government's shutdown order, does the borrower have business interruption insurance, and, if so, has it been reviewed for coverage and has the borrower made a claim or tried to access benefits?

Is the borrower planning layoffs, and, if so, has it reviewed applicable employment laws, such as the federal WARN Act and similar state laws dealing with mass layoffs?

A lender should determine whether there has been a covenant default caused by the borrower's failure to continually operate. Even if a business remains open to some degree, would substantially all the employees working remotely from home constitute a violation of this covenant?

A lender should ensure that the borrower knows of the recently passed CARES Act economic stimulus legislation, including (i) the Main Street New Loan Facility (MSNLF) that provides terms and conditions for low interest unsecured term loans to "Eligible Borrowers" made by "Eligible Lenders" *after* April 8, 2020, and (ii) the Main Street Expanded Loan Facility (MSELF) that provides terms and conditions for increases to existing loans to "Eligible Borrowers" made by "Eligible Lenders" *prior to* April 8, 2020.

Lenders should consider how existing loan agreements should be modified to accommodate the newly created COVID-19 SBA loan programs as well as loans through the MSNLF and the MSELF.

THE LENDER'S COLLATERAL AND LIMITATIONS ON EXERCISE OF REMEDIES

A primary focus of any portfolio review should be collateral perfection deficiencies. This requires the lender to obtain an up-to-date lien search on a borrower's personal and real property and cure deficiencies as soon as possible. Pro-active actions here may mitigate later collateral loss should there be a bankruptcy filing.

> A lender should determine whether there has been a covenant default caused by the borrower's failure to continually operate.

In this regard, a lender should also determine whether there are material assets that the lender determined at an earlier date were not worth perfecting a lien on but for which the lender has either (i) the discretion to perfect, or (ii) the right to perfect during the pendency of a default. If so, the lender may want to begin the process of perfecting its lien on such assets.

CONCLUSION

COVID-19 has created a business atmosphere unlike any other, and lenders need to stay on top of rapidly changing circumstances, including credit assessments to ensure it can fulfill their obligations to customers and anticipate issues before they arise.

This article first appeared on the Westlaw Practitioner Insights Commentaries web page on May 6, 2020.

ABOUT THE AUTHORS

   

(L-R) **Monique Almy**, a partner in **Crowell & Moring**'s Washington office, uses her business and litigation experience to counsel creditors and debtors on issues related to today's economic environment. **Randall L. Hagen** is counsel in the firm's Washington office and focuses on commercial bankruptcy and creditors' rights litigation, as well as representation of asset-based lenders and financial institutions in debtor-in-possession loans, restructurings and out-of-court workouts. **Scott Lessne**, also based in Washington, serves as senior counsel with the firm and represents debtors and lenders in debt facility workouts, restructures and modifications and other matters. He also provides prebankruptcy creditors' rights counseling, including enforcement options, for secured and unsecured creditors. **Mark Lichtenstein** is a partner in the firm's New York office who represents PE funds and family offices in the out-of-court restructurings of their portfolio companies in the restaurant, hospitality, e-commerce, and retail sectors, as well as purchasers and sellers of distressed assets in bankruptcy cases, sales under the uniform commercial Code and foreclosure proceedings. Each author can be reached via crowell.com. This article was first published April 16, 2020, on the Crowell & Moring website and reflects the situation at the time it was written based on the rapidly changing nature of the COVID-19 pandemic. Republished with permission.