

Best Practices Series – Distressed Debt: **Forbearance Agreements**

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1. Lender incentives for entering into forbearance agreements
 - a. Create a clear road map going forward
 - b. Less costly way to “exit” the credit
 - i. Borrower has additional time to obtain a refinancing
 - ii. Borrower has more time to voluntarily liquidate collateral
 - c. Quietly clean up past “mistakes” (proper perfection; proper scope of lien in collateral; etc.)
 - d. Obtain release of threatened claims
 - e. Enhance position vis-à-vis the borrower (e.g., admissions of default; waiver of defenses; consent judgment; deed in lieu of foreclosure; etc.)
 - f. Obtain additional collateral
 - g. Receive payments from otherwise uncollectible sources (e.g., a guarantor uses 401(k) or IRA monies to make key loan payments in exchange for forbearance agreement)
 - h. Provide clear road map on how, when and where collateral is liquidated and who assists in the liquidation (e.g., Debtor agrees to hire CRO)
 - i. Obtain additional critical information through reporting requirements (e.g., timely identification and reporting of all account debtors such that collection of A/R may be more easily done in the event of a default)
 - j. Provide a way to fix the relationship
2. Borrower incentives for entering into forbearance agreements
 - a. “The price of a parachute goes up once you fall out of a plane!”
 - b. Live another day to refinance

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- c. Orderly liquidation to maximize asset value
- d. Sell the business as a going concern
- e. Minimize or eliminate guarantor obligations
- 3. Risks the lender faces with a forbearance agreement
 - a. Borrower will just continue to be delinquent
 - b. Borrower (a) avoids an immediate foreclosure but (b) later files for bankruptcy and attempts to cram down the loan
 - c. Borrower files for bankruptcy and avoids payments and/or collateral provided to lender as part of the forbearance agreement
- 4. Common forbearance agreement provisions
 - a. *Make the agreement very clear and easy to understand!*
 - b. Whereas clauses
 - c. Obligor acknowledgements
 - i. Fully perfected nature of loans
 - ii. Amount of debt
 - iii. Confirmation of default
 - iv. Continuation of loan agreements
 - d. Conditions precedent
 - i. Execution and delivery of documents related to the forbearance agreement (e.g., pledge of additional collateral, signed consent judgment, deed in lieu of foreclosure, etc.)
 - e. Releases and waivers
 - i. Obligor release of any and all claims against lender
 - ii. Obligor waives any defenses to enforcement of the loan documents
 - f. Forbearance provisions
 - i. What lender agrees to forbear from doing
 - ii. Duration of forbearance
 - g. Interest rate
 - h. Loan agreement amendments
 - i. Obligor requirements
 - i. Payment obligations (including principal and/or interest; attorney's fees and costs)
 - ii. Liquidation obligations
 - iii. Other obligations
 - j. Obligor reporting requirements (e.g., financial statements; budgets; identification of account debtors; etc.)
 - k. Obligor representations and warranties
 - i. Appropriate corporate authority to enter into forbearance agreement
 - l. Payment of fees
 - m. Reaffirmation of guaranties
 - n. Indemnification provisions
 - o. Events of default
 - p. Remedies upon an event of default
 - q. Consent to jurisdiction in case of dispute

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- r. Applicable law in case of dispute
- s. Waiver of jury trial right in event of default/dispute
- t. Notice requirements
- u. Misc. provisions
- 5. Bankruptcy specific provisions
 - a. Agreement not to oppose stay relief in the event of a bankruptcy filing
 - b. Agreement to assume the forbearance agreement as an executory contract
 - c. Prohibitions against right to file for bankruptcy
 - i. Agreement not to file
 - ii. Unanimous director consent required for filing and lender appoints one of the board members who is directed to oppose any bankruptcy filing
- 6. Bankruptcy risks caused by forbearance agreements
 - a. Preferential transfers
 - b. Constructively fraudulent conveyances
- 7. Other forbearance agreement issues
 - a. Type and conditions of the collateral
 - b. Market conditions
 - c. Guarantor problems
 - d. Other secured loans
- 8. Common pitfalls for lenders
 - a. Internal lender pressure and dynamics
 - b. Lender obtains “too much” control of borrower and is deemed to be in a fiduciary capacity
 - c. “Running” the borrower’s business
 - d. Becoming the borrower’s advisor
 - e. Acting suddenly or erratically
 - f. Failing to honor the terms of the forbearance agreement
 - g. Obligor raises claims of economic duress, negligent and/or fraudulent misrepresentation by lender, etc.
 - h. Debt calculation errors (e.g., forbearance agreement identifies the specific amount owed and is signed by both parties, but it later turns out the lender miscalculated the debt). The lender will likely be estopped from seeking a higher debt amount

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