TURNAROUND INSIGHTS

Workout Workshop: A Guide to Navigating Problem Loans

BY MARK FAGNANI AND DANIEL FIORILLO

Many ABL professionals little to no workout or bankruptcy experience thanks to the past ten years of relative calm. This article details the anatomy of an ABL workout and serves as a primer for many readers and a refresher course for more experienced lenders.

If you are in the asset-based lending ("ABL") space, either as a lender or an advisor, you may well look back on the last ten years (and very possibly beyond) as the halcyon days of loan portfolio management. Problem loans have been few and far between, and borrower bankruptcy filings were a rare occurrence. Workout departments were downsized or eliminated. Even during the early, dark days of the COVID pandemic, an abundance of stimulus money and a lack of pressure from regulators, combined with a fairly robust economy, kept most loan portfolios in good shape. Yes, there were a spate of retail- and hospitality-related bankruptcies, but many of these were resolved quickly and, in some cases, successfully.

That's the good news. The downside of all of this is that many ABL professionals have acquired little to no workout or bankruptcy experience, and those professionals who are more "seasoned" have had little practice in recent years. This article will describe the usual anatomy of an ABL workout in some detail, and hopefully will serve as a primer for some, and a refresher course for others. The authors recognize the diversity of the ABL market (e.g., small- market deals, middle-market deals, large sponsor-driven deals and leveraged loans), as well as the many industries that utilize ABL facilities for liquidity. As such, considerations for how to deal with any workout situation may be driven by many factors. This article does not attempt to address every contingency. That said, there are some issues and considerations that are common to most ABL workouts, for which the authors hope this article will provide some guidance.

The Scenario

So, let's start with a typical scenario. Your borrower has defaulted on a financial covenant for the last three reporting periods. You have granted waivers and charged a fee each time. That's fine, but the underlying issues causing the events of default have not been addressed or resolved. Liquidity starts to erode, or perhaps is entirely gone. When this occurs, there will be a request for an overadvance. Quite often in these situations, a review of the borrower's accounts payable aging will reveal deterioration, i.e., payables are stretched to key vendors and suppliers. This will have an impact on inventory mix, quantity and pricing. You may not see it without a field exam and/or an appraisal, but once the payables become stretched, your borrower's inventory will eventually deteriorate. Cherry picking, or selling off the best, most desired inventory, is common in these situations to generate short-term liquidity, but without adequate vendor support, replenishment becomes difficult or impossible. This causes your overall inventory mix to erode and vitiates whatever appraisal on which you were relying. (Note: At this point, if you have not previously done so, familiarize yourself with all of the underlying assumptions of the appraisal, as you may well discover that the facts have already changed and the appraisal will not hold.) The decline in the accounts receivable performance may follow as short shipping or discounting becomes more prevalent as a result of inventory issues. Turnover (or DSO) slows and dilution increases. Fraud risk also increases at this point, as some borrowers may be tempted to misrepresent or obscure adverse financial or collateral activity in desperation to save the business, but this article is not about fraud, so assume that fraud does not occur. For those of you who have not yet witnessed this scenario, it is coming. The writers cannot say precisely when, but you can be reasonably assured that this scenario or a similar one will begin to appear in portfolios as supply chain issues, inflation, labor shortages and a weakening economy take hold. So, what do you do?

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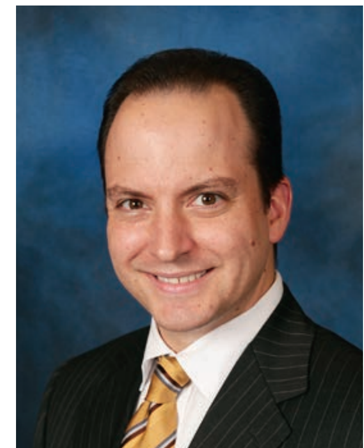

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Initial Steps

First, meet with your borrower again (presumably you have been meeting routinely) and be prepared to have a pointed and candid discussion. Can your borrower identify the root causes of the problems and offer plausible, remedial steps? Can your borrower produce a business plan that details a viable turnaround strategy which adequately addresses the company's liquidity needs (without relying on overadvances) and contains reasonable assumptions relative to the condition of the business? Is your borrower prepared to pursue alternative paths that

result in a material liquidity event or refinancing of your loan? If the borrower cannot satisfactorily answer or address these questions, it may be time to give the borrower a list of turnaround consultants acceptable to your organization and suggest they hire one of them as a condition for continued cooperation.

Simultaneously, ask your counsel to perform a legal file review. Do you have all your ducks in a row? For example, do you have landlord and other third-party waiver agreements or appropriate reserves for all third-party controlled collateral locations; deposit account control agreements on all bank accounts; intercreditor or subordination agreements, if appropriate ; and licensor consents to dispose of licensed inventory? Have you documented and noticed the borrower of the events of defaults with letters prepared by counsel? Have you recently conducted a UCC search to verify your filings are in place and confirm there are no other surprise UCC filings?

Depending on the circumstances, counsel may suggest entering into a forbearance agreement. This is a very powerful tool. It requires the borrower to acknowledge the events of default that have occurred, as well as the validity, amount, priority and enforceability of your debt and liens. As the name suggests, the secured lender agrees to forbear from exercising its rights and remedies in respect of the acknowledged defaults for a stated period of time, in exchange for various terms and conditions, which may include: requiring the borrower to retain a financial advisor or chief restructuring officer on acceptable terms (note: it is good practice for the lender to suggest several preferred financial advisor/chief restructuring officer candidates from which the borrower should choose); increased loan pricing; raising additional funds or providing additional collateral or credit support for the loan; hiring an investment banker to run a sale or refinancing process in accordance with certain milestone dates; maintaining a stated level of availability (or not exceeding a stated over advance limit); and amending the loan agreement to eliminate those borrower-friendly negative covenant baskets. Also requiring an immediate field exam and an appraisal update as part of any forbearance would be prudent at this point, as you may be asked to make daily funding decisions and you will want to be certain that you understand exactly where you stand in terms of updated collateral values and advance rates.

If you don't already have cash dominion, and there is a "springing" feature for cash dominion in your loan documents and the trigger for doing so has been met (and presumably, events of default would trigger cash dominion), you may consider activating the lock box or collection accounts and sweeping the cash. As discussed below, a distressed borrower with access to its cash collections can pose problems for you in the event the borrower decides to file for bankruptcy without your cooperation, so springing cash dominion in these situations (while likely unpopular with your borrower) may prove critical in protecting your recovery prospects.

This might also be a good time to require more frequent borrowing base reporting and/or reducing advance rates, particularly on the inventory (for the reasons noted above). To ease the impact on liquidity, you could propose a gradual and steady reduction in inventory advance rates, such as a half of a percent reduction per week, until the desired, lower advance rate is met. The key here is to be proactive and to consider what may be happening to the company, your loan and your ability to recover full principal and interest, and to plan accordingly.

As noted above, many of these measures will be wildly unpopular with the borrower and should be explained in clear terms and, if possible, in a spirit of cooperation. The borrower is not your enemy, but your priority is to protect your organization while trying to work with the borrower to maximize your recovery prospects. Why work with your borrower, who violated your deal? Well, a non-cooperative borrower can lead to a costly fight to wrest control over your collateral, and then, when you win that "fight", your reward is realizing on your collateral at forced liquidation values—not exactly consistent with your appraised values as discussed above. So, it's a delicate balance, but this is where creativity, instincts and experience all come into play. As we will discuss later in this article, how this is handled may have important consequences if there is a bankruptcy filing.

If/when a consulting firm is retained by the borrower, you will want the consultant to oversee the preparation of a 13-week budget. This will help you identify the borrower's funding needs, as well as projecting your collateral levels and loan balance over the ensuing weeks. A 13-week budget, once developed and approved by all parties, can provide a funding framework for the near term, and optimally, a road map for the execution of the borrower's workout or turnaround plan that will either de-risk your loan or, hopefully, repay it in full. It customarily measures cash receipts and disbursements, as well as other categories that the deal may require (e.g., sales, loan balance, availability, etc.), and is typically incorporated into the forbearance agreement with agreed-upon variances to be measured for some specified period (e.g., on a weekly, cumulative basis up to four weeks, and then on a rolling four-week basis going forward), and tested on a weekly basis for the applicable measurement period with some agreed-upon degree or percentage variance.

While your forbearance agreement will typically contain a covenant requiring the borrower to comply with the budget, the development of a budget is an imperfect science, and it is possible to miss top line (revenue), collections or borrowing needs in any one week. That is the purpose of the permitted variance for either a periodic and/or cumulative basis. It is expected that over time, weekly misses will be made up, and the borrower will stay within the acceptable variance over time. If budget compliance, with permitted variance, cannot be achieved, a revised budget (and perhaps new game plan) is likely needed, with an understanding of why the original budget failed. Readers should note: asking for a 13-week budget assumes you and the borrower are cooperating on some level and that you perceive there is still time to develop the information necessary for both a budget and an action plan. If that is the case, a turnaround, or a sale or a refinancing may be achievable strategies to de-risk your position. On the other hand, if you have waited until the borrower has no liquidity and you are not willing to extend additional funding, you now have a crisis on your hands. All of the action steps described above are still relevant, although the timing will certainly be accelerated and the ability to pursue alternative paths will be limited. Be aware that if you are declining to fund a budget or buy the borrower some time that (a) the relationship with your borrower may become adversarial and (b) your borrower may be contemplating a Chapter 11 filing.

During a workout situation, you as a lender need to think strategically, quickly and under duress. You need to weigh all options in real time, and think about all possible outcomes. And you need to do this all the time, even every day, if necessary, as the situation evolves or devolves. What seemed like a good strategy on Monday may be out the window by Thursday. What's next? Have you considered any other options and their likely outcomes? Has the borrower been cooperating? Is this a sponsor deal where relationship considerations may impact your decisions? It's a lot to consider, and these decisions are made under pressure, usually with imperfect information. As such, workouts are not for the timid or faint of heart. That is precisely why many lenders have dedicated workout groups to ensure the right people are assigned to the problem loan when relationship management turns into crisis management. With the right workout specialists in place, a workout also presents a unique opportunity to train less-experienced portfolio managers and as such, they should always be included in this process. There is no training like hands-on training.

Communication is Key

As with any workout, there is a distinct possibility that things may get "ugly" with your distressed borrower. To be clear, it's not a crime, or cause for civil liability, for a lender to have made a bad loan. However, your borrower may take an adversarial approach to your attempts at working out the loan, and while the scope of this article is not to address how to identify and avoid lender liability claims, it is good practice in a workout to consult periodically with your counsel before communicating or memorializing anything with, or about, your borrower. Many times, it may even be appropriate or necessary to have your counsel engage the financial or crisis consultants on your behalf. While not totally insulating, having your counsel engage your turnaround or crisis consultant may shield certain communications and work product of the consultant from being discoverable in a litigation. Bottom line here is that you should be in constant contact with counsel, and your counsel should really have workout and insolvency expertise. If they do not, no matter how much you like your existing counsel, consider moving the file to counsel with loan workout experience.

Speaking of communications, you should also be in constant contact with the borrower. Going radio silent on your borrower during a workout will likely result in your borrower taking precipitous actions, such as filing for bankruptcy without providing you with advance notice. Depending on the circumstances, an unexpected or non-consensual bankruptcy filing by your borrower can have materially adverse consequences for your loan recovery prospects and will deprive you of the many rights afforded under your loan agreements. As stated above, the key to a successful workout is balancing the need to work cooperatively with the borrower while taking the steps necessary to de-risk your position. In many cases, a bankruptcy filing is not the best way to maximize your recovery (i.e., out-of-court restructuring transactions and "friendly foreclosure" sales are usually cheaper alternative workout strategies), but if your borrower is left to their own devices, they will usually choose a path that does not maximize your recovery. So, no matter how frustrated you may be with your borrower's poor performance, you must keep those communication channels open to best position yourself for a full loan recovery.

Let's be clear here. Very often the optimal solution for you and the borrower is the borrower's return to financial health and retention of the relationship. Company management by themselves, or more likely with the help of a consulting firm, may formulate a plan that includes expense reductions, gross margin improvement, SKU rationalization yielding better inventory turns, etc. Often, it may be possible to work out payment arrangements with vendors that provide for receipt of fresh materials while making a slow steady stream of payments designed to reduce the vendor payables exposure. This takes time and requires patience. Your senior management, regulators, investors and/or warehouse line providers may insist on a quick exit, in which case, a refinance may be possible if a quick turnaround plan that bridges you to close the refinancing is feasible. However, as noted above, if you have waited until the borrower is in crisis mode, none of this may be possible without funding overadvances or bringing in a more aggressive lender willing to make additional advances behind you or on different collateral classes. That is why it is so critical to be proactive in monitoring your portfolio. A plan as described above, with oversight of a consulting firm and an agreement between the parties that establishes both time frames and measurable metrics may effectuate the desired turnaround and a return to a more fruitful relationship.

However, if the borrower is resistant to change or uncooperative, or if the patient is too far gone to be saved by a turnaround plan, the borrower may have no choice but to pursue a sale of the business or liquidate in a bankruptcy proceeding. So, let's talk about what that bankruptcy might look like and how that transpires for all parties.

Bankruptcy

The first, most important step you can take when your borrower advises you that it intends to file for bankruptcy is engaging with the borrower in an attempt to negotiate a consensual path in bankruptcy that will result in maximizing your loan recovery prospects. Many of the same steps discussed above regarding the approach toward working out your loan outside of bankruptcy apply here as well. For example: Has the borrower engaged bankruptcy counsel and restructuring advisors to assist in structuring the business plan for which the bankruptcy is intended to effect, e.g., business reorganization and emergence from bankruptcy, sale of the business as a going concern, or orderly liquidation? Has the borrower prepared, and have you vetted with your counsel and financial advisor, the 13-week budget covering the bankruptcy? Have you updated your field exams and appraisals, done a loan documentation file review through counsel, and to the extent permitted or applicable under the loan documents, triggered cash dominion? The success or failure of any workout in bankruptcy is mainly determined by your pre-bankruptcy preparation. This also stresses the importance of staying in front of your borrower at all times once the loan is in default.

Quick primer on bankruptcy basics for secured lending: bankruptcy is governed by a set of federal laws called the Bankruptcy Code. For our purposes, there are two types of bankruptcy proceedings your borrower could commence (or in some cases, have involuntarily commenced against it): a Chapter 7 case (which effects a total shutdown of the business and appoints a Chapter 7 trustee to liquidate the bankrupt company's assets, administer claims of the company's creditors and

pursue actions to recover money for distribution to the company's unsecured creditors), and a Chapter 11 case (which permits the bankrupt company to continue operating in the ordinary course to pursue a reorganization or restructuring transaction, as well as selling its assets in a going concern sale transaction or in an orderly liquidation). If your borrower files for Chapter 7, your borrower's management team decided it was unable or unwilling to continue operating the business in bankruptcy to pursue an orderly process to maximize value for its creditors, and your recovery prospects will likely look dim, as Chapter 7 translates into a forced liquidation scenario. In all cases, the commencement of a bankruptcy case will impose an "automatic stay" on all creditors of the bankrupt company, which enjoins all of the company's creditors from taking any actions to collect or enforce its claim against the company (so, for example, those swept collections from your triggered cash-dominion rights cannot be applied to your loan balance post-bankruptcy without authorization from the bankruptcy court).

As detailed here, the authors believe the recipe for successful loan workouts and bankruptcy proceedings requires proactive monitoring of each loan in your portfolio so that you identify problems early on when there is still an opportunity to fix persistent problems. Successful turnarounds or restructurings require time, patience and judicious funding.

Assuming you are working cooperatively with your borrower, and your borrower is seeking to file for Chapter 11, you might want to consider offering to provide debtor-in-possession ("DIP") financing to your borrower. A DIP financing facility can be an amended and restated version of your existing credit facility, or you may opt to replace your existing facility with a new credit facility, which may or may not contain materially different terms and conditions. Of course, this assumes that your borrower is unable to secure replacement financing as part of its bankruptcy filing preparation. Otherwise, a new DIP financing facility could be used to refinance your loan.

There are numerous benefits in providing DIP financing. The bankrupt borrower obtains an order from the bankruptcy court (the DIP financing order) that acknowledges the validity, priority and amount of your secured debt (subject to a limited investigation period); grants waivers and releases in favor of the DIP lender; permits the lender to charge additional fees and interest; grants the lender senior liens and super-priority administrative claim status to secure all DIP loan obligations; modifies the automatic stay to permit the lender to apply collections, administer the loan and enforce rights; converts or "rolls up" your pre-bankruptcy debt into post-bankruptcy debt (note: this "roll up" is very helpful in the context of a Chapter 11 case in which a consummated plan of reorganization is the goal of your borrower); and perhaps most importantly, it allows the lender to structure the DIP credit facility to guide the borrower toward a liquidity event or restructuring milestones that will provide the lender with assurances that the bankruptcy will yield a positive recovery. The DIP financing facility also helps the borrower, as it signals to trade vendors and material contract parties that it has the financial support to navigate through Chapter 11 towards its restructuring goal. As stated above, while the DIP credit facility is approved during the bankruptcy (usually, at the "first day" hearing of the bankruptcy case), all of the structuring and negotiating of the DIP financing terms occurs pre-bankruptcy, once again underscoring the importance of having open and ongoing communications with your distressed borrower.

An alternative means for your borrower to fund its Chapter 11 process is through the use of cash collateral—i.e., usually the use of collections from your accounts receivable and inventory collateral. Unlike DIP financing, use of cash collateral is not "lending" (note: you always need an order from the bankruptcy court to approve your lending during a bankruptcy). Instead, cash collateral use is provided for under the Bankruptcy Code as a means for a bankrupt company to use a secured lender's collateral to fund operations, so long as the secured lender "consents" to the use of its cash collateral, or the borrower is able to convince the bankruptcy court that it can provide "adequate protection" to the secured creditor for the use of its collateral (more on this topic below). This option is usually not ideal for the secured lender, as it means that the borrower believes it will have sufficient cash flow from the use of its cash collections to fund operations during the Chapter 11 (instead of using your cash collateral to pay down your loan), and because the borrower doesn't necessarily need your consent to use your cash collections, it gives the borrower more leverage in negotiating the terms of "consensual" use of cash collateral. Accordingly, cash collateral use does not necessarily provide the secured lender with the same benefits as DIP financing (e.g., less opportunity for increased

pricing, no "roll up" of pre-bankruptcy loans into post-bankruptcy loans, less control over the borrowing base, etc.).

Why would you consent to cash collateral use instead of providing DIP financing? First, you cannot force the borrower to accept a DIP financing proposal, so if the borrower believes cash collateral use is a feasible, preferred approach to fund operations in bankruptcy, you cannot force a different narrative (at least at the outset of the case). Second, in some cases, such as when your borrower is filing for Chapter 11 to conduct an orderly liquidation of your collateral, the end result of the bankruptcy is to generate enough collateral proceeds to repay your debt in full. So, rather than fight over the cash collateral use, you negotiate terms and conditions on your consent that may improve your position, such as scheduled paydowns of your outstanding principal, interest and fees, a cash collateral use consent fee, continued borrowing base reporting, compliance with the 13-week cash collateral use budget, and borrower achieving various milestone events that will assure progress towards your full loan repayment.

The What Ifs

What if you are not holding hands with your borrower when it files for Chapter 11? Maybe you overplayed your hand in the pre-bankruptcy negotiations (e.g., cut off all funding, went radio silent and/or made impractical demands on the defaulting borrower it could not satisfy), or maybe you did everything the authors have suggested here, but your borrower, through the aggressive guidance of its restructuring professionals, have determined to run a Chapter 11 designed to increase your risk profile and erode your collateral position without your consent to achieve its restructuring goals. How did this happen? What can happen? What can you do?

The two scenarios in which this "stuff hitting the fan" can occur are when your borrower seeks to use your cash collateral without your consent, and when the borrower seeks to obtain DIP financing from another lender on a priming lien basis (i.e., subordinating your liens on the collateral in favor of the DIP priming lien lender). Usually, the precursor to either of these bad scenarios is when your borrower goes radio silent on you in the lead up to its filing for bankruptcy. This assumes, of course, that you had an idea that a Chapter 11 filing by your borrower was imminent, but either way, it usually represents a communication breakdown between you and your borrower during the workout.

Regarding non-consensual use of cash collateral, as discussed above, the borrower needs to demonstrate to the bankruptcy court that you will be "adequately protected" against the diminution in the collateral value occasioned by the non-consensual use of cash collateral. As many who have tested this concept on a contested basis before a bankruptcy court can attest, adequate protection the court is required to give is usually inadequate and offers little protection—at least from the standpoint of an ABL lender.

Adequate protection can come in many forms and, usually, a combination of various measures, such as granting replacement liens on assets created during the bankruptcy to cover the diminution of your existing collateral (note: your floating liens are cut off once the bankruptcy is filed, so liens on assets created after the bankruptcy must be authorized by the bankruptcy court); super-priority administrative expense claims in the amount of your collateral diminution; payment of interest, fees and expenses; paydowns of principal loan obligations; financial and collateral reporting (note: in a non-consensual context, the borrower is not required to continue providing any of the reporting or access to information contemplated under your loan documents); and granting liens on unencumbered assets, or encumbered assets with equity in the collateral, such as real estate with a relatively small mortgage. Adequate protection can also be in the form of the Court recognizing the secured lender's "equity cushion" in the collateral, which the borrower's expert witnesses will usually attest is a lot higher than the secured lender's view.

What is important to note about adequate protection is that the bankruptcy court is not required to protect against borrowing base deterioration. You are only entitled to have the extent of your secured claim status protected or, as a bankruptcy judge once advised one of the authors, "keeping you from going one penny undersecured" (or being one penny further undersecured, if you are coming into the Chapter 11 with an undersecured loan). The borrower will try to convince the court, by putting on expert testimony and submitting financial evidence on collateral valuation, that the expected use of cash collateral will not cause the secured lender's secured claim to incur irrevocable deterioration—even if your collateral coverage will inevitably erode during the Chapter 11, it won't erode enough to cause the lender not to be "adequately protected." As an example, if you have $10MM of accounts receivable against which you lend $8.5MM, and 10MM of inventory against which you lend $6MM, you regard the collateral as being worth or covering $14.5MM of your loan. The borrower will try to convince the judge that you have $20MM of collateral coverage for your loan. Every lender knows we never collect 100% of the collateral value and, depending on the final scenario, it is considerably less than 100%. Nevertheless, the court may deem you "adequately protected" based upon the gross numbers, leaving you as the lender vulnerable to loss.

While not black letter law, bankruptcy courts are generally more inclined to accept the bankrupt company's narrative on collateral valuation and adequate protection measures at the outset of the case, which means that you are likely going to lose the first cash-collateral "fight." However, your goal is to shorten the initial cash collateral-use period as much as possible, carefully monitor your collateral deterioration, and get back in front of the court as soon as facts show your collateral deterioration is outpacing the borrower's projections on collateral replenishment, in hopes that you can obtain better controls over the cash use and have a better ability to manage your collateral "burn", whether through negotiation with the borrower and/or by obtaining a favorable ruling from the bankruptcy court. Of course, the best way to address a cash-collateral fight is to avoid the situation entirely, as bankruptcy judges sometimes allow the borrower to sacrifice the secured lender's loan-recovery prospects for a "chance" to pursue a successful restructuring that saves jobs and provides other "feel good" results from the Chapter 11 (and your cash collateral is, quite literally, the money used to gamble for that chance). This is why springing cash dominion when the opportunity presents itself is an important tool to mitigate the risk of non-consensual use of cash collateral, as the borrower will not have a war chest of your cash collections to pursue this strategy.

Regarding DIP priming financing, Section 364(d) of the Bankruptcy

Code permits a company in Chapter 11 to obtain financing on a senior-secured basis, thereby subordinating the liens of all existing secured creditors on the collateral securing the DIP priming financing. As with non-consensual use of cash collateral, the bankrupt borrower has the burden to demonstrate to the court that the secured lenders being primed are "adequately protected" from the effects of the priming lien financing. However, establishing adequate protection for a primed secured lender is made more difficult because the primed lender's collateral diminution is at least equal to the outstanding amount of the DIP priming financing, which must be paid before the primed lender's loan balance is entitled to repayment. As such, while the threat to prime an incumbent ABL lender is sometimes used by the borrower to create leverage in the pre-bankruptcy negotiations, it is not easily accomplished. That said, being primed can and has happened (albeit rarely). Usually, it occurs when you have a combination of an ABL lender with a material amount of cushion in the borrowing-base collateral, and/or additional collateral coverage in the ineligible collateral pool, and a complete breakdown of pre-bankruptcy negotiations or communications between the borrower and the lender occurs, leaving the borrower to come up with its own liquidity solution to operate in bankruptcy, which, as discussed above, is usually going to be adverse to your loan recovery prospects.

So, why don't more borrowers filing for Chapter 11 seek non-consensual cash collateral use or priming lien financing (assuming the facts permit)? Well, for one, bankruptcy is expensive. Fighting with your secured lender, on top of the professional fees of the borrower and the official committee of unsecured creditors (who get their own set of attorneys and advisors for which the borrower is responsible to pay) makes an already expensive process prohibitively expensive. Plus, professional fee "carve outs", i.e., agreements by existing secured lenders to subordinate their secured claims to the payment of a certain amount of professional fees of the borrower and creditors committee, are not extended in cash collateral or DIP priming fights, so the borrower's restructuring advisors are incentivized to cut a deal with the existing secured lender to ensure these carve outs are included in the financing arrangements. If the borrower is pursuing a restructuring transaction, fighting with the existing secured lender will not instill confidence among the vendor community and other business relationship parties that the borrower will survive the Chapter 11, so again, making peace, not war, with the incumbent secured lender is in the best interest of the borrower.

Key Takeaways

As detailed here, the authors believe the recipe for successful loan workouts and bankruptcy proceedings requires proactive monitoring of each loan in your portfolio so that you identify problems early on when there is still an opportunity to fix persistent problems. Successful turnarounds or restructurings require time, patience and judicious funding. By reacting early and decisively, you leave yourself and the borrower the best chance for a positive outcome. Communications with the borrower may become difficult and strained but are essential to the process. The borrower needs to understand clearly what you are willing to do, but also what you are unwilling to do, in connection with the workout. Strategies need to remain flexible, as the situation is dynamic and changes rapidly. Being locked into one paradigm or course of action will most likely not be helpful. The use of expert professionals – lawyers, financial advisors, appraisers – is costly, but essential. Finally, entering into a consensual DIP financing facility is better than every other alternative even if it means making some additional concessions to get the borrower and their team of professionals to go along. Instincts, experience, creativity (and a fair amount of luck) all come into play in workouts which, for many of us practitioners, makes them challenging, but extremely gratifying when orchestrated correctly.

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Fagnani is a frequent lecturer and panelist. Most notably, he spoke on behalf of the World Bank and the Secured Finance Network in China, instructing over 250 bankers on asset-based lending.

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