

COVID-19: What Can a Lender Do to Prepare for the Inevitable Defaults?

CREDITORS' RIGHTS AND BANKRUPTCY | CORONAVIRUS | MARCH 17, 2020



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The spread of COVID-19 across the globe has created immediate and dynamic concerns for the financial sector, which are beginning to trigger financial repercussions unlike anything since the Great Recession began in 2007/2008. With Carlton Fields' workforce online and operational across all our offices throughout Florida, New York, Georgia, Connecticut, New Jersey, Washington, D.C., and Los Angeles, we are assisting clients in navigating the most pressing issues emerging across the financial services industry.

We are currently addressing a number of common issues for our clients, including the ones below. We recognize that we are in a fluid and rapidly evolving environment and that many of our clients are in the process of adjusting their own internal policies and procedures to address these unprecedented circumstances and guard against reputational damage. To help you with these considerations, **we will host a webinar on Thursday, March 19 at 1 p.m. EST** to discuss these and other topics, such as the current and anticipated future state of the court system. We hope these and later communications will aid you in designing a path forward. Please feel free to reach out to us ahead of the webinar to address any specific pressing issues.

Evolving issues include:

- Continuing advances on lines of credit. Under what circumstances can a lender stop advancing under a material adverse change or other loan provision?
- Non-monetary defaults. At what point should you declare a non-monetary default based on a financial covenant?
- Pre-and post-bankruptcy issues. How do today's actions (forbearance or otherwise) affect a preference or other prejudice in a future bankruptcy or assignment for the benefit of creditors?
- Force majeure. Do the loan documents contain a force majeure provision that may excuse a party from performing its contractual obligations that become impossible or impracticable due to an event that the parties could not have anticipated or controlled? Whether COVID-19 excuses a borrower from payment obligations is solely determined by the specific contract provisions. There is no universally accepted definition of "force majeure" or "acts of God," nor are there any common law implied contractual protections from liability due to events that are beyond the reasonable control of the parties. While some agreements incorporate "pandemics" or "epidemics" into a definition of force majeure, the majority do not. The applicability of a force majeure provision may be dependent on whether the contract includes a broad/non-exclusive definition of force majeure. We anticipate parties arguing that some or all of the following often-included examples apply:
 - Epidemics and quarantines such as SARS, MERS, and COVID-19.
 - "Acts of God," which is rarely defined and implies natural disasters not otherwise listed within the force majeure definition.
 - Civil unrest.
 - Government action, including condemnation, changes in laws or regulations, and government delays.
 - Interruptions due to shortages of power, supplies, or transportation.

Whether the current circumstances trigger a force majeure provision is dependent on the specific language of the contract and state law.

- Due diligence. Secured creditors should review their perfection documents now as businesses start to run out of liquidity. Secured creditors should cure any perfection issues now to avoid potential bankruptcy preference exposure.

- Forbearance issues. Lenders should make sure to send a reservation of rights letter in connection with any payment received after any type of default has occurred. In this type of situation, waiting on the execution of a pre-negotiation letter may not be advisable; using a short form communication, which simply includes non-waiver of rights language, may be advisable.
- Foreclosure issues. Whether secured creditors should seek judicial remedies now or delay may depend in part on the specific jurisdiction they are in and loan document provisions. A cottage industry of borrower's counsel developed overnight in the last financial crisis, prepared to take advantage of either situation, and they will likely be back again this time. It is important to think through these issues first before taking action.
- The state of the judicial system. Courts are currently responding to increased shutdowns, while balancing the demands for access and due process. The current and anticipated future demands on the judicial system will continue evolving daily and factor into evolving litigation strategies.

We hope the webinar and later communications will aid you in designing a path forward. Please feel free to reach out to us ahead of and after the webinar to address any pressing issues.

Carlton Fields remains fully operational. We have implemented a remote access program to permit, as needed, our offices around the country to remain open for business, working hard to avoid any interruption in service during this critical time. That includes approximately 50 professionals with distressed asset and insolvency experience. We are ready to assist you with any legal needs that may arise, including assistance with portfolio and risk assessment, negotiation, and litigation.

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