Managing COVID-19 and its fallout

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These are unprecedented and uncertain times. Everywhere, the COVID-19 pandemic has strained revenue streams and asset prices, shaken investor and consumer confidence, and caused overall financial conditions to deteriorate. Everyone is asking the same question: *How do we deal with the financial fallout of COVID-19?*

In many cases, parties are working together to overcome these financial challenges, preserve value and navigate a mutually beneficial path forward.

Below is a brief summary of some key issues debtors and creditors (of all types) must work through to deal with the financial fallout of the COVID-19 pandemic. We use the terms "debtor" and "creditor" broadly, and the same issues apply to any business relationship with obligations by one party to the other (and *vice versa*). That said, these issues will be particularly relevant to industries hardest by the COVID-19 pandemic, including real estate developers and operators, hotels and hospitality, and sectors where cash flow is directly impaired by the government-imposed shutdowns or related credit risks.

What you need to know

- Generally, debtors and creditors are working collaboratively to preserve business relationships and long-term value, to the extent the nature of the business and financial distress permits it.
- Depending on the anticipated duration and severity of a debtor's financial distress, different types of agreements can help determine a path forward:
    1. For short-term financial distress, or where the nature of the financial distress is unclear and will take time to determine, debtors and creditors can enter into short-term **waivers** of covenant breaches (including waivers or deferrals of payment obligations as they become due). We have seen many instances of such agreements in borrower-lender and landlord-tenant relationships, which we will discuss below.
    2. Where a debtor can obtain financial support from a parent company, sponsor, or shareholder, **keepwell agreements** (an agreement between a parent company and its subsidiary to maintain solvency and financial backing) may provide a temporary path through financial distress.

3. Where financial distress is anticipated to endure, debtors and creditors can enter into **forbearance agreements** , formalizing a strategy to tackle and eventually overcome their financial distress.
4. In cases of systemic financial distress, but where the business relationship is nonetheless valuable in the long term, debtors and creditors can enter into a **restructuring agreements** or otherwise **amend and restate** the particulars of their business relationship entirely.

- Unfortunately, accommodation and compromise is not viable in all circumstances. This may necessitate enforcement proceedings by the creditor, or the debtor seeking creditor-protection or commencing wind-up proceedings.

Preliminary information: What creditors and debtors must consider in light of COVID-19

If the parties are going to work collaboratively, information sharing is important. The nature and extent of the information required will depend on the particular relationship, but common questions creditors will ask (and debtors should expect to answer) include:

As between borrowers/lenders

- Lenders should consider how COVID-19 affects the liquidation value of their collateral and their debtor's ability to repay over time.
- Borrowers should consider how they might restructure their obligations, business and affairs going forward, and whether they can take the necessary steps on an informal basis or whether they require formal proceedings to do so.
- Many lenders will request additional due diligence from the borrower, including:
  - a review of the fundamentals of the borrower's business, including pre-COVID-19 structural issues, to ascertain whether there exists a viable business model post-COVID-19l
  - a basic value proposition, supporting why the relationship should continue despite the financial distress caused by COVID-19, and why that's preferable to the lender's alternatives (including, for example: (i) seizing its collateral, (ii) appointing a receiver, or (iii) petitioning the debtor into bankruptcy);
  - updated or supplemental financial disclosure, both on an immediate basis and going forward, showing the projected financial effects of the COVID-19 pandemic over time and a comparison of actual performance versus projected performance; and
  - updated information regarding a borrower's assets and property, with an eye to securing additional security or collateral, and preserving existing collateral and enterprise value.
- Both lenders and creditors should consider what (if any) government relief programs may be available. It should be noted that government relief may not be available to businesses that had solvency problems prior to the COVID-19 pandemic. For more information on these continuously evolving relief programs, see our COVID-19 Resource Centre.

Tenant/landlord relationship

- Landlords should confirm whether the tenant intends to remain in the premises for the term of the lease, or whether the COVID-19 pandemic has completely frustrated the viability of the tenancy.
- Both landlord and tenant must consider whether rent abatement or deferment are possible, and whether government relief options may be available to sustain such an arrangement. Read more on rent deferments.
- Landlords should consider whether their remedies outside an accommodation (for example: distraining against the tenant's assets or terminating the lease) are viable or satisfactory, particularly in light of COVID-19. Landlords should consider the potential consequences of a tenant bankruptcy where, among other things, they will likely have limited recovery.
- Tenants should consider how they might restructure their obligations, business and affairs, and whether they can do so informally, or whether a court-supervised insolvency process would be beneficial (for example: to terminate leases, or assign leases to another party, in each case without landlord consent).
- Read more on landlord/tenant relationships in light of COVID-19.

Buyer/supplier relationships

- Many businesses have critical suppliers. Both buyers and their suppliers should assess the financial health of their counterparty, and consider how COVID-19 may undermine that counterparty's ability to pay for, or deliver, the supplies in question.
- To minimize risk, suppliers may request purchasers to pay in advance, grant security, or work with their lender to issue letters of credit, in each case to protect the purchase price of goods or services supplied.
- In certain circumstances, suppliers may have super-priority rights to the goods sold under applicable personal property security legislation, and can take certain steps to protect those super-priority rights.

Different solutions for different problems

Depending on the level of uncertainty or anticipated duration of the financial distress, certain types of agreements may be useful. We note these agreements are **not mutually exclusive** , and it may be appropriate to use them in tandem, or consecutively, depending on the circumstances.

1. Temporary Waivers

Waivers are short-term solutions. They are appropriate to deal with technical defaults, financial stress of a predictably short duration, or to "buy time" where the magnitude of financial distress is unclear. Waivers are commonly used to waive or defer payment obligations over a period of time.

Waivers will typically include provisions where (among other things):

- the debtor expressly acknowledges they are in default;
- the creditor confirms that the specific covenants relating to the default(s) are waived for a limited period of time; and

- the debtor typically agrees to provide supplemental financial information or reporting to the creditor.

In the lending context, waivers may contemplate a "**temporary payment holiday** ", with deferred payments either amortized and payable over time, or added to the amount paid at maturity. In most cases, interest will continue to accrue on the deferred payments until they are paid in full.

2. Keepwell Agreements

Keepwell Agreements are typically temporary solutions, but can be useful for more prolonged financial distress as well. They are appropriate where a debtor is supported by a sponsor, parent company, or major shareholder that is willing to financially support the debtor and guarantee the performance of its obligations to its creditor.

Keepwell Agreements will typically include provisions whereby (among other things):

- the parent company, sponsor, or shareholder injects capital into the debtor (either by subordinated debt or equity), to cure defaults as they arise over a pre-determined period, and to otherwise financially support the debtor while it works through its financial distress;
- an express subordination, postponement and standstill by the parent company, sponsor or shareholder regarding its advances to the debtor in favour of senior creditors; and
- the creditor reserves all rights to repayment of the obligations, and to enforce on any security (if any).

3. Forbearance Agreements

These involve a creditor forbearing from enforcing against the debtor, or from realizing on any collateral, for a set period of time. This provides both parties with "breathing room" to work through the financial distress, and will typically provide the creditor some additional comfort (such as security or increased visibility into the debtor's operations).

Forbearance Agreements are mid-to-long term solutions, and are appropriate where the nature of financial distress is relatively clear, but where the debtor is actively taking steps to either remedy the default(s), refinance, or otherwise repay the obligations in full.

Forbearance Agreements will typically include provisions whereby (among other things):

- the debtor and any guarantors expressly acknowledge the default(s) and the enforceability of any agreements, guarantees or security relating thereto;
- if appropriate, the debtor or guarantors may agree to provide supplemental security to the creditor;
- the parties clarify and confirm the nature of their commitments and obligations, and set out a plan to remediate the business relationship or terminate it over time;
- an agreement that all limitation periods are suspended for the duration of the term of the agreement (known as a "tolling" provision);
- typically, more robust financial reporting by the debtor and oversight by the creditor; and

- if appropriate, the debtor may agree to pay a forbearance fee. These fees typically reflect the level of risk, including the time-period of the agreement.

4. Restructuring Agreements

These are most common in the lending space. Restructuring Agreements are appropriate where the business is viable, but the financial strain is enduring or complex, or where multiple creditors are involved.

Where the relationship and underlying business are conducive to a restructuring agreement, debtors and creditors have tremendous flexibility.A restructuring agreement is a bespoke solution, and can permit the parties to be creative in reaching agreements that meet their needs.

Restructuring Agreements will typically include provisions whereby (among other things):

- the debtor raises working capital – either through subordinated debt or equity – to cure financial defaults, place the debtor on a more stable financial footing, and repay certain obligations to senior creditors;
- the debtor will restructure its balance sheet, either through a compromise of certain debt, or a conversion of certain debt into equity (occasionally via a court-supervised insolvency process);
- intercreditor agreements are entered into among the parties, to determine the priorities among senior and subordinate creditors (if any);
- certain creditors may exit the relationship with the debtor, and new creditors introduced; and
- the debtor is permitted to sell certain non-core or redundant assets, to help satisfy obligations or provide working capital.

5. Amendments and restatements of existing agreements

Amendments and restatements of the underlying agreement are appropriate where debtors and creditors want to preserve their existing relationship, but must redefine the terms of the underlying business agreement significantly to make the arrangement sustainable in the long term.

For example: A commercial landlord may face plummeting rent payments from its tenants in light of the COVID-19 shutdown. As a result, the commercial landlord may need to work with its mortgage lender to relax certain financial covenants, obtain a temporary decrease or waiver of principal or interest payments, or have the entire amortization schedule adjusted. The mortgage lender might be willing to accommodate, but may require additional guarantors from a parent company or related entity, supplemental security, or the commercial landlord to undertake certain internal reorganizations to make the relationship viable over time.

The complexity of these changes can be considerable, and an amendment and restatement of the underlying agreement may be appropriate to formalize these changes.

Practical (non-legal) considerations

In working through the unprecedented challenges posed by the COVID-19 pandemic, debtors and creditors should keep the following in mind:

- ***Try working together*** . Where the relationship and circumstances permit, debtors and creditors working collaboratively can maintain business relationships and preserve value.
- ***Timing is everything*** . If a collaborative approach is contemplated, quick action is usually beneficial so the parties can get ahead of potential issues, and focus on solutions. Legal and financial advisors can help identify options and solutions that are appropriate for your circumstances.
- ***Communication is key*** . In our experience, open communication and candour is often key to a successful and collaborative solution.

By

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