

# ASKING LENDERS FOR TIME TO DEAL WITH COVID-19 PROBLEMS

*Posted on March 31, 2020*

**Categories:** [Insights](#), [Publications](#)

We are living through an unprecedented global health crisis. Borders are closed, schools are furloughed, auto manufacturers have suspended production, “non-essential” businesses are being required to close, while social distancing and remote working (if you can) have become the new normal. The impact on the economy cannot be understated. Few businesses will emerge unscathed. While various levels of government are implementing different support measures to assist businesses and individuals in surviving the crisis, many borrowers will require additional relief from their bankers. That relief may be set out in a number of ways, including a loan facility amendment or an agreement known as a forbearance agreement. Here is how borrowers should approach discussions with their lenders, and what lenders may ask in return.

First, be thorough and proactive. Realistically assess the financial situation: what sales will be lost, or contracts terminated or suspended? How will your revenues be affected, and for what period of time? How will you control costs, and mitigate claims? How will that affect your ability to meet obligations owed to suppliers, customers, creditors and your employees? Do you have enough available credit to overcome temporary revenue shortfalls? Try your best in these uncertain circumstances to quantify the financial accommodations needed. These may include amortization payment holidays, extension of maturities, temporary increase in the borrowing limit, etc. Lenders typically want to see a cash flow forecast showing how cash and available credit will be used during the accommodation period, together with the assumptions used to develop it.

Review your credit and security agreements, and identify what other defaults have occurred, or may occur, as a result of this crisis. Relevant provisions of the loan documents may include financial covenants (ratios), material adverse effect clauses, and cross-defaults with other agreements. Businesses with pre-existing areas of concern may see their problems magnified by the crisis. Now is the time deal with them.

Second, consider your alternatives. When you approach your lenders to advise them of events of default or potential defaults, it is important to fairly present your situation and its impact on the bank, and what steps you are taking to address them. Preparation and making quality information available is key to successful discussions. Demonstrate that management is actively developing a realistic and viable solution. If you are not prepared or do not have reliable information, then you may face a lender that loses patience, or loses trust in

management. Obtaining outside financial and legal advice from credible advisors will help tremendously.

While every forbearance agreement is different, they will all have the following key points:

- a recognition of the existing facilities and amount of debt owing: the parties set out what is owing, and confirm certain set off rights; a confirmation that all existing security agreements and guarantees secure all existing obligations;
- a listing of all known events of default, and a declaration that no other defaults exist;
- the duration, or term, of the forbearance, and any early termination event (such as an additional event of default);
- the accommodations required to ride out COVID-19 challenges or other business issues; and
- the benefits being offered to the lender in exchange for time and continued access to credit. Examples include additional security or more control.

The last two points are the heart of the agreement: they are the restructuring plan. They set out the financial accommodation the lenders are willing to extend, what the business is to do with that accommodation (reduce expenditures on a temporary/permanent basis, abide by a revised budget, consider strategic alternatives, exit unprofitable markets, etc.), revise pricing and establish forbearance fees, set milestones for the implementation of the plan, and enhanced financial reporting and/or third party monitoring. While some borrowers chafe at the additional administrative costs and out of pocket costs associated with such reporting and monitoring, it is only reasonable that special situations require special visibility for the lender.

We cannot overemphasize the importance of clear, timely and transparent communications between lenders and borrowers in distressed situations; a successful restructuring is a joint effort. While the occurrence of an event of default can be addressed if managed properly, and anticipated or actual default should lead to a frank discussion with your lenders to find an acceptable solution. Delaying the conversation, or obfuscating the issues, only compounds the problem.

Some final thoughts: Directors are personally liable for certain debts of the borrower. These include amounts owing for unpaid salaries and vacation pay, as well as remittances for source deductions and GST/HST/QST. Deferring payment of those amounts in the hope of repaying them later may not work out without a plan and the cooperation of your lender, and risk only increasing the personal risk for the directors. As a number of those debts enjoy priority over the lenders' security, lenders will in any event typically require that proof of their timely payment be a component of the additional reporting they request.

For information relating to the various federal and provincial governmental programs made available to support Canadian businesses, click here: [COVID-19 – Government Relief Efforts to Date](#).

by Michael J. Hanlon, Waël Rostom, Adam Maerov, Tushara Weerasooriya and Vicki Tickle

**A Cautionary Note**

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

© McMillan LLP 2020