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Navigating Restructuring Considerations and Managing Distress Amid COVID-19

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Editor's Note: *To stay up to date on the COVID-19 pandemic, be sure to bookmark ABI's Coronavirus Resources for Bankruptcy Professionals website (abi.org/covid19).*

COVID-19 brought the world's economy to a near halt in the first quarter of 2020 through widespread furloughs, store closures and stay-at-home orders, and most companies were understandably unprepared for such an unanticipated event. Although the 2008 financial crisis might provide some level of background and guidance for businesses navigating the months ahead, the current economic fallout carries certain factors that were not present in 2008. Chief among those factors is that the current economic fallout was caused by a highly contagious virus, which has severely constrained any type of in-person contact and caused most businesses to operate remotely. Even when it is safe for all companies to return to business in the ordinary course, the post-pandemic business world might be very different from historical ordinary-course practices.

Despite the economy slowly opening up, companies across all industries are anticipating a surge in financial restructurings, foreclosures and bankruptcy filings as a result of the current pandemic and resulting economic recession. Notwithstanding, companies can take certain steps to maximize their chances of successfully weathering the storm, whether that includes new financing, a formal chapter 11 filing, an out-of-court workout or otherwise. This article examines certain steps that companies can employ while navigating uncertain waters in a post-COVID-19 world.

Board Advice/Advisors

The priority of boards and management should be the maximization and preservation of value for all stakeholders while protecting people's health and safety amid the chaos caused by COVID-19. Effectively managing this crisis requires fast and decisive actions; however, the effects of and responses to the coronavirus pandemic are changing daily, and analysts and experts have not yet reached a consensus regarding when and how companies can return to regular business operations. For this reason, companies should assemble the right team of advisors to work collaboratively with boards and management to develop, analyze and execute the most viable path to ensure the company's health and survival. Companies need to stay nimble, and having a team of dealmakers with restructuring experience will help a company minimize the risk of collapse.

In addition, directors and officers of financially troubled companies will likely have to make difficult decisions, and they must be deliberate about where they focus their attention in this rapidly evolving situation. Because companies will have to balance short-term measures taken to address new issues with long-term strategic priorities, directors and officers should maintain thorough records of a diligent and well-informed decision-making process. Among other things, companies' management teams should engage in regular communications with the board to assess and address issues as they arise.

But while increased regular board meetings might be the right option for some companies, they might not be practical for others that have management teams experiencing extreme pressure in han-

dling the day-to-day issues caused by COVID-19. A company might also opt to develop a strategic crisis-management plan to guide its response, and provide its board with reports of major issues management is addressing, weekly financial information, etc. In any event, management and boards should carefully monitor operations and liquidity to ensure that they are complying with applicable fiduciary duties and taking the rights steps to preserve value for stakeholders.

Directors and officers will be presented with decisions and opportunities to take or abstain from taking certain actions, such as approving certain payments, strategic alternatives, new business strategies or other transactions. The failure to take a particular action could be challenged (with the benefit of hindsight) as a breach of fiduciary duties should the company subsequently falter or stakeholders perceive that the company's decisions harmed them. As a general matter, directors and officers will have fulfilled these duties if they act in an informed manner, with requisite care and in the best interests of the company and its stakeholders as a whole, and exercise disinterested and independent judgment. If directors and officers satisfy the duties of care and loyalty, they are afforded the protection of the "business judgment rule," which is highly deferential to and protective of directors and officers.

The financial success of a company often depends on the company's leadership. Accordingly, directors, officers and advisors should work collaboratively to find the solution and process that best fits a particular situation and mitigates risk.

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Financing/Liquidity Management

Although the long-term economic effects of COVID-19 are unknown, few companies will be spared from having to address some type of liquidity shortfall. Accordingly, many companies should explore traditional and nontraditional financing sources for relief. Financing might come from a company's current capital structure (*e.g.*, through a drawdown on a revolving credit facility or a refinancing), third-party lenders, non-traditional sources (*e.g.*, private credit), or government relief or stimulus packages (if available and if the company qualifies). In addition, because the pandemic caused many business operations to slow down significantly — if not altogether — companies should monitor their financial and other covenants in their debt documents to make sure that they are not at risk of entering an event of default on their debt.

Companies should work with their advisors to analyze their liquidity runway and financial forecasts in order to determine whether the company will need (1) to negotiate a forbearance regarding interest/principal payments with its current lenders; (2) to negotiate an amendment to its current debt documents to replace or waive anticipated or current events of default; and (3) additional financing (and if so, how much and on what timeline is it needed, and what are the available sources).

Traditional lenders might be apprehensive in extending credit or negotiating an amendment or forbearance, at least on what was historically market terms, until there is more certainty with regard to the length and effect of the current pandemic. For example, since the onset of COVID-19, the authors have seen an uptick in borrowers drawing down on their revolving credit facilities, not only because borrowers are looking to bolster their liquidity, but also because borrowers worry that current market conditions may result in events of default materializing under their credit agreements that would prevent them from borrowing in the future. While lenders and borrowers worked cooperatively for the most part during the early weeks of the economic crisis, lenders will likely take more conservative positions with borrowers as the market gains clarity with respect to industry winners and losers.

With companies of all sizes and from all industries looking to address the external disruption caused by COVID-19 and the general turmoil in the debt markets it caused, traditional financing sources are not as readily available. Advisors can assist companies with analyzing potential nontraditional lending sources, including private credit and government-funding sources, to determine what other options might be available. Private-debt firms are in a position to lend,[1] and they may see an opportunity to step up and lend where other financing sources have pulled back. In addition, as governments continue to respond to the COVID-19 pandemic, so do the available relief packages and eligibility requirements. Companies should work with their advisors to evaluate all available options to address short-term liquidity concerns and mitigate risks while managing long-term exposure.

Taking measures to improve liquidity positions and stay solvent will require a tailored approach that likely involves taking several proactive measures. For example, on April 16, 2020, Nordstrom Inc. announced that it was taking "precautionary measures to strengthen its financial position for the long term" in response to the uncertainty related to the pandemic. These actions included entering into an amendment with its asset-based loan (ABL) lenders and raising $600 million through issuing secured notes.[2] The ABL amendment, among other things, provides that Nordstrom's obligations are unsecured except during a defined "collateral period" (based on the company's leverage ratio or unsecured debt rating), during which time the obligations are secured primarily by the company's inventory. The newly issued notes, which mature on May 15, 2025, are secured by Nordstrom's

1 As of March 2020, private-debt funds held approximately $271 billion in capital, according to data from Preqin. *See* Laura Kreutzer & Laura Cooper, "Private Credit Weighs Risks and Opportunities in Market Turmoil," *Wall St. J.* (March 17, 2020), *available at* wsj.com/articles/private-credit-weighs-risks-and-opportunities-in-market-turmoil-11584442800 (last visited June 15, 2020).

2 Nordstrom Inc. Current Report (Form 8-K) (April 16, 2020).

ownership interest in a separate entity that holds its real estate interests. Nordstrom also drew down $800 million on its ABL facility, suspended quarterly cash dividends and share repurchases, and reduced operating expenses and capital expenditures by $500 million.

Negotiations with Creditors and Other Parties

In addition to lenders, companies should consider their relationships with (and obligations to) other parties. Given reduced operations, companies might be unable to satisfy obligations to third parties, or might no longer need the goods or services for which they originally contracted. Companies should consider what relationships they want to prioritize and preserve in the long term, and how their adapted operations going forward could affect those relationships. Companies should look for cost-saving opportunities by reviewing their options to shed unnecessary contracts or negotiate better pricing or terms. In doing so, companies should also determine what leverage they have — either contractually or by virtue of the economic climate — to maximize value and minimize losses.

Businesses might also experience issues with their own vendors, suppliers and customers who might also be experiencing financial distress and wanting to terminate agreements or relationships as a result. An unexpected halt or reduction in business operations, and thus a slowdown of revenue, can result in parties wanting to get out of contracts (*e.g.*, vendors unable to supply goods or customers looking to terminate agreements).

Companies should work with their advisors to determine how to preserve material relationships, what leverage exists to enforce contracts and the practicality of such enforcement, and how to identify new supply chains, service providers or customers. Given the current global economic strain, many landlords, vendors and customers might be willing to make concessions that they might not otherwise have considered. Companies should be prepared to use any and all tools at their disposal while seeking to maximize the value of the company for all stakeholders.

Contingency Planning

Given the difficult environment in which companies are operating, the uncertainty regarding when the economy and operations will normalize, and what this "new normal" might look like, companies should work with their advisors to develop and review potential options to help the company stabilize (if necessary) and not succumb to the economic pressures felt worldwide.

The authors have noticed that many of their clients have successfully implemented a "carrot and stick" approach while developing go-forward options, which have included altering business plans (*e.g.*, to better fit current economic activity or address supply chain/logistical changes), negotiating with lenders, potential lenders or other parties, analyzing other ways to cut costs, or preparing for a formal in-court restructuring.

Companies should be cognizant of what options might be temporarily unavailable or not feasible, given the current situation. For example, companies have not been able to use liquidation sales, a common cost-saving and loss-mitigating action, during the pandemic. The inability to hold sales and auctions resulted in Art Van Furniture LLC converting its chapter 11 cases to chapter 7, citing "no viable path forward in chapter 11" after social-distancing restrictions stunted store-closing sales.[3] Modell's Sporting Goods Inc. took a unique approach when it suspended its chapter 11 proceedings, given its inability to conduct liquidation sales, which were the "cornerstone" of its bankruptcy.[4]

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In addition, companies should be careful to avoid taking any action that would terminate a potentially desirable transaction, financing or other option. For example, as government response continues to emerge and evolve, there might be eligibility restrictions that would prevent otherwise-qualifying companies from taking advantage of much-needed liquidity or other relief. Once a company and its advisors develop various alternatives, they should review which option(s) preserve the most value for stakeholders and determine what steps need to be taken and when to preserve optionality. Starting this process early enables companies to best position themselves for future success.

Conclusion

COVID-19 presents a dynamic situation that all companies are having to address, and the effects of the worldwide economic downturn continue to evolve. To emerge from this pandemic financially healthy, companies must find ways to take affirmative steps to adapt, and they should not idly proceed with normal business operations without taking pre-emptive or reactive measures to address issues and mitigate risks. COVID-19 will likely alter industry structures, result in different consumer behaviors, lead to new work patterns and distributions, and require adapted business plans and pipelines. Engaging the right advisors to preserve optionality to address issues as they arise is critical to positioning a company to not only survive but thrive in a post-pandemic market. **abi**

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3 *In re Art Van Furniture LLC*, No. 20-10553 (CSS) (Bankr. D. Del.).
4 *In re Modell's Sporting Goods Inc.*, No. 20-14179 (VFP) (Bankr. D.N.J.).