

## Restructuring in the Time of Coronavirus



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**Deborah Kovsky-Apap** | [kovskyd@pepperlaw.com](mailto:kovskyd@pepperlaw.com)

**Todd A. Feinsmith** | [feinsmitht@pepperlaw.com](mailto:feinsmitht@pepperlaw.com)

**Kay Standridge Kress** | [kressk@pepperlaw.com](mailto:kressk@pepperlaw.com)

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An increasing number of businesses — even those that have traditionally been financially and operationally sound — are now experiencing unanticipated revenue losses as a result of the coronavirus pandemic. Companies may find themselves in the unfamiliar position of being out of compliance with financial covenants with lenders, unable to meet financial obligations to vendors, in default of contractual obligations, or in need of financial or restructuring/bankruptcy assistance.

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If your company has not previously experienced financial distress, you may not be aware of the steps you should take and options you may wish to consider as you navigate the uncharted territory of this global crisis.

### **Immediate Steps**

***Understand your liquidity.*** If you do not have a 13-week cash flow projection, prepare one as soon as possible. If you already have one, review it in light of changed circumstances. Consider the impact of potential revenue reductions of 25, 50, 75 and 100 percent over the course of the next 13 weeks. **If your company projects a negative liquidity position within the next three months, the time is now to begin negotiations with lenders, vendors and contract counterparties to avoid a default or missed payroll.**

***Cash is king, so protect your working capital.*** The most critical issue for any business is preserving cash, especially since there is no way to predict how long widespread shut-downs will last or how it will affect the economy.

- Identify and implement cost reductions. Defer capital expenditures. Defer or reduce non-critical vendor payments and lease payments, if necessary. Proactive outreach to your vendors, landlords and contract counterparties is a critical part of this process.
- If business drops significantly, consider furloughing non-essential employees, or reducing pay for some or all employees. (See Pepper's COVID-19 Employment FAQs (available at: <https://www.pepperlaw.com/publications/covid-19-employment-faqs-2020-03-16/>) for guidance about employment laws regarding pay and furloughs, including the WARN Act, which may be implicated.)
- As we have noted, cash is king, and never more so than now. Draw on your existing lines of credit immediately. If you have unencumbered assets, consider using them as collateral to seek additional financing.

***Restructure your existing debt.*** For many companies, even drastic cost-cutting measures will not be enough to enable them to service secured debt during this time. If you don't have enough liquidity to do so, try to negotiate a consensual resolution with your lender with the assistance of experienced restructuring counsel. Often, the prospect of the remedies available under the Bankruptcy Code can create important negotiating leverage to gain critical out-of-court concessions from vendors, landlords, contract counterparties and lenders in distressed situations.

Out-of-court debt restructurings can take many forms, including a temporary or permanent reduction in the interest rate; extension of the maturity of the loan; PIKing interest payments that come due during the crisis; establishing a moratorium on all loan payments for a set period, with the deferred payments tacked on to the end of the loan; partial debt forgiveness; and splitting the existing debt into an A/B note structure, where the B note (often called a “hope” note) is subordinated and is only paid when and if the business recovers. Any restructuring should also take into consideration potential tax consequences. In particular, debt modification in certain circumstances may result in cancellation of debt (COD) income. Such income may be offset by operating losses, though certain restructurings can limit the utilization of such losses.

***Beware of personal liability.*** Under certain circumstances, officers and directors can be held personally liable for the non-payment of wages and certain taxes, and for making distributions to shareholders if the company is deemed insolvent. Careful consideration should be given to ensure that such obligations are paid on a priority basis to avoid personal risk to officers and directors. Likewise, business owners should be mindful of obligations that may arise under any personal guaranties that have been issued.

## **Long-Term Steps**

If a negotiated out-of-court restructuring is not possible, an in-court restructuring under Chapter 11 may be a viable option. Chapter 11 provides significant protections and the ability to effectuate a non-consensual reorganization, although it does come with costs and risks.

### ***Benefits of Chapter 11***

***Breathing room from creditors.*** All collections, lawsuits, foreclosures and similar actions are automatically stayed as soon as the bankruptcy is filed. Your secured lender may seek relief from the automatic stay in order to foreclose on its collateral, but it would have to establish “cause,” or demonstrate that the collateral is not necessary for your reorganization. Bankruptcy courts are generally disinclined to grant such motions before the debtor has been given a fair chance to reorganize.

***Rejection of burdensome contracts.*** If you are party to financially unfavorable contracts or leases, you have the ability to reject them. If any damages result from the rejection, the counterparty will have only a general unsecured claim that can be paid at a reduced rate under a plan of reorganization.

**“Free and clear” asset sale.** You can sell free and clear of all liens and encumbrances under Section 363 of the Bankruptcy Code, with the liens and encumbrances attaching to the sale proceeds. This feature of the Bankruptcy Code is often attractive to potential buyers, who can obtain assets “cleansed” of liabilities. Current equity holders may participate in a Section 363 sale, and secured creditors may be entitled to bid up to the entire face value of their secured debt.

**Exclusive right to propose a plan.** For the first 120 days of the bankruptcy case, you will have the exclusive right to propose a plan of reorganization. As long as you have at least one impaired class of creditors that accepts the plan, and the plan otherwise meets Bankruptcy Code requirements, it can be “crammed down” over the objections of non-consenting creditors — even your secured lender.

### **Costs of Chapter 11**

Businesses need cash to continue to operate (even if only in a modified, limited fashion) during the pendency of the case. This may require giving “adequate protection” to your secured lender in order to use cash collateral or obtain post-petition financing — for example, by granting replacement liens on post-petition receivables and/or making adequate protection payments to the lender.

In estimating the costs of a Chapter 11 filing, bear in mind that a creditors’ committee will likely be appointed to represent the interests of all unsecured creditors. The committee is entitled to retain its own professionals, such as attorneys and financial advisors, and those expenses are borne by the debtor.

Pepper’s Bankruptcy and Corporate Restructuring Group has deep experience with debtors’ and creditors’ rights, secured lending, out-of-court workouts and Chapter 11 restructurings. **We are available to assist you in assessing your needs and options in the face of this crisis.**

Please feel free to contact any of the partners in our group should you need assistance:

Todd Feinsmith – feinsmit@pepperlaw.com

David Fournier – fournied@pepperlaw.com

Don Detweiler – detweid@pepperlaw.com

Bob Hertzberg – hertzbergr@pepperlaw.com

Henry Jaffe – jaffeh@pepperlaw.com

Deb Kovsky – kovskyd@pepperlaw.com

Kay Kress – kressk@pepperlaw.com

Fran Lawall – lawallf@pepperlaw.com

Evelyn Meltzer – melzere@pepperlaw.com

David Stratton – strattond@pepperlaw.com