

Recommendations for Making and Responding to Requests for Credit Accommodations

While we are all rightfully focusing our thoughts and attention on the health and well-being of ourselves and our families, we recognize that there are many business uncertainties that have arisen in connection with the worldwide spread of COVID-19 and the accompanying economic upheaval. Each day brings new developments in the COVID-19 pandemic, and while the length and severity of its adverse economic consequences remain to be seen, already there is little question that businesses will be hard hit. Many will be unable to meet their obligations under supply contracts, leases, credit agreements, and various other forms of agreements. This, in turn, will have a significant impact on the counterparties to such agreements.

In this environment, there will be many requests for credit accommodations made in the days, weeks, and even months ahead. In many cases, such requests will be granted; first, because of the broad recognition of the monumental challenges that the COVID-19 pandemic has brought suddenly upon numerous participants in the economy, but also, as a practical matter, there is an understanding that granting credit relief to an important business partner now may be necessary to its ultimate survival and ability to meet its obligations.

Requesting Credit Accommodations from Creditors

The following should be considered if you are requesting credit accommodations from your creditors:

Review your financing documents

You will want to make sure that you know and understand your loan covenants and whether you are currently or may be headed toward a default of those covenants. If you are on a borrowing base, make sure you understand whether any of your receivables are likely to become ineligible. Often, late-paying customers may become ineligible to be included in the borrowing base which, in turn, may negatively affect your borrowing availability and liquidity. Also, it may be possible that the value of your machinery and equipment will decrease in the present situation. That may also affect your borrowing availability. If adjustments to your borrowing base need to be requested, know what those adjustments are or will likely be.

Communicate early and often

Do not wait for an expected liquidity crisis to hit before approaching your lender, vendor, or landlord, for relief. Get out in front of the problem proactively and show your creditor how the COVID-19 pandemic is affecting your ability to fulfill your obligations; and how working with you through this difficult time will result in your survival and a better outcome for the creditor than it would receive were you to shut down operations and liquidate. Remember, your lenders, vendors, and landlords are also dealing with their own issues, and your communications with them will help them to plan and manage those issues more effectively.

Prepare a cash budget

Based on alternative assumptions about the length and severity of the economic slowdown caused by the pandemic, it is important to prepare a cash budget and projections for your business. The COVID-19 economic downturn has likely affected all business. An effective method for dealing with such business and liquidity shocks is to prepare (and continually update) cash projections — typically for a 13-week period. This exercise will focus you on how numerous variables will affect you and where you may be able to make helpful adjustments. Assume that the current business



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climate in many Northeastern and West Coast cities will continue at least into the summer and that such climate will spread to other areas in which you do business. Creditors, especially lenders, will want to review such projections as well as any cost-reduction measures you are planning to take in deciding whether to ride with you through the storm.

Contract Mitigation Provisions

Review contracts and credit agreements for provisions that may mitigate your liability for nonperformance, particularly force majeure clauses.

Prioritize Taxes

Prioritize remaining current on payments of federal and state withholding, employment, and sales taxes and employee wages. Corporate officers, directors, and certain employees may face personal liability if such taxes and wages remain unpaid.

Business Interruption

If you have business interruption insurance, check your policy to determine whether a global pandemic, such as COVID-19, may be covered.

Emergency Funding Resources

Check if a federal, state, or local relief program may be available to assist you. As you may already know, Cozen O'Connor has a government relations firm Cozen O'Connor Public Strategies, which offers comprehensive government solutions at the federal, state, and local level. Our Public Strategies group and our Bankruptcy, Insolvency and Restructuring practice have teamed up to offer our clients comprehensive advice to navigate through the COVID-19 crisis. As part of those services, the Public Strategies team have continued to monitor federal, state, and local programs that have recently been implemented and which may assist businesses in connection with COVID-19.

Turnaround Manager

Assess whether your business would benefit from a turnaround consultant. Often, in the face of strong headwinds (which may or may not eventually lead to a full-blown liquidity crisis), businesses may benefit from the services of a third-party turnaround or financial consultant.

Providing Credit Accommodations to Customers

With regard to counterparties to your business contracts, the following strategies will enable your company to best protect itself while reaching accommodations necessitated by the pandemic:

Customer Agreements

Any period during which credit accommodations (i.e., extended payment terms on amounts past due or presently due) are being granted to your customer/tenant/borrower (the accommodation period) should be crafted to have a defined natural expiration/termination date. The salient point to take away is to expressly provide that no notice is required from you in order for the accommodation period to end. The accommodation simply expires/ends automatically on a date certain, at which point all unpaid deferred amounts and any additional past due amounts shall be immediately payable. Therefore, in the event of a bankruptcy by the customer/tenant/borrower, you will not need to seek relief from the automatic stay under the Bankruptcy Code to end the accommodation period.

Similarly any agreement you make to provide credit accommodations (the accommodation agreement) should clearly state that if the customer/tenant/borrower defaults in making any accommodation payment or advance payment (see below), the accommodation agreement automatically terminates, without any requirement that you give notice to the customer of the default. There can be a grace period allowed, but in no event should there be a notice requirement.

Endeavor to structure any accommodation agreement so as to maximize your insulation from potential claw-back liability should the customer later go into bankruptcy. Following are some

methods which may assist in obtaining some degree of insulation:

Payment in Advance

Payment obligations on past due or presently due amounts (accommodation amounts) would be subject to a repayment plan over the course of the accommodation period as set forth in the accommodation agreement. The normal payments under the contract or lease on a go forward basis should be structured to be paid in advance (advance payment). For example, a customer or tenant must pay rent/fees and other charges to you in advance for the month of April on or before March 30. Your accounting records should be maintained so as to make clear that such payment received on or before March 30 is being paid in advance and applied to pay for the month of April.

Method of Payment

To the extent practicable, you should require that payments be made by wire/ACH transfer or cashier's check. If payment is by business check, you should negotiate the check as quickly as possible.

Accommodation Fee

Charge an upfront and nonrefundable fee for entering into an accommodation agreement with a customer behind on its payments. The agreement should be clear that this payment is a fee in consideration for your agreement to extend payment terms on outstanding obligations, rather than full or partial payment of the outstanding amounts owed.

Guaranty

Endeavor to obtain third party guaranty for payments being made by the customer. If payments are eventually clawed back, you would be able to look to the guarantor to replace them.

Security

To the extent available, try to obtain a security interest on additional collateral to secure payment of any deferred or other amounts payable under an accommodation agreement. For example, obtain a lien on accounts receivable or inventory to secure repayment. Although not ideal to the extent the collateral is subject to prior security interests, it may provide some protection to you as senior debt is paid down. Bear in mind that security interests will require recording of financing statements to perfect them and monitoring of same.

Letter of Credit

Although not likely available to troubled customers in most instances, request the customer post a letter of credit. Since a third-party bank issues the letter of credit and makes the payments thereunder, payments made under a letter of credit are not typically subject to claw-back in avoidance actions once a bankruptcy is filed.

Cozen O'Connor has equipped our attorneys and staff to affectively work remotely and Cozen O'Connor's Bankruptcy, Insolvency & Restructuring Group stands ready to assist you. If you are in need of assistance, please contact either of the co-chairs of the Bankruptcy, Insolvency & Restructuring Group, John T. Carroll and Mark E. Felger.