

Goodwin Alerts

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COVID-19 and Financial Restructuring

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BUSINESS UNUSUAL

COVID-19 poses unprecedented global public health and humanitarian challenges. Economically, it marks the end of a growth-fueled credit cycle. It's been replaced by volatility, uncertainty and disruption. The capital markets, commerce and the consumer face strong headwinds. The duration and ultimate impact of "business unusual" is unknowable.

Cross-industry teams at Goodwin are helping clients assess and understand the ramifications of COVID-19 and navigate its potential effects, including a likely wave of restructuring activity, and increased litigation related to corporate debt contract defaults and bankruptcies.

Managing risk up front and identifying opportunities created by uncertainty is the hallmark of Goodwin's Global Financial Restructuring Group and the best strategy for crafting commercial solutions that create and preserve value from positions of strength.

Below is high level guidance for thinking about how to manage risk and identify distressed opportunities in these uncertain times:

Proactive measures must be employed. Given the increasing travel restrictions, suspensions of large public gatherings, social distancing and significant supply chain disruptions, the COVID-19 outbreak has effectively shut down large portions of the economy.

The consequences of this new reality can be particularly devastating for those companies in struggling industries, with too much debt, or the absence of revenue due to the suspension of business activities. Revenue loss or reduction in liquidity may trigger an inability to pay expenses and "keep the lights on," as well as notification obligations, potential covenant breaches (or disputes over defenses like force majeure), or an event of default. A company should take proactive measures by preparing a 13/26 week "survival" daily cash flow and operating to it, reviewing credit agreements to take advantage of all liquidity enhancing opportunities, identifying the ability to comply with covenants (or defending deviations) and engaging proactively with lenders regarding necessary amendments, waivers and forbearances to address business disruption.

Governments may provide various forms of interim relief, but that is not a substitute for decisive action. A company should also consider implementing expense management protocols that address any cash shortfalls and maximize liquidity. This could include a self-proclaimed moratorium on existing obligations, a payment priority for "survival" obligations, protections for partners who provide credit to the company, and broad ongoing disclosure of the company's actions to preserve value. When financial stress impacts a company, it may need an in-court or out-of-court restructuring to preserve value. As such, directors, officers and management should be well advised to examine all available strategies and opportunities to preserve and maximize value and implement a thorough fact-gathering diligence process.

Likewise, adversity is opportunity for lenders and asset buyers. While actions are being taken to avoid a 2007 like systemic collapse, the COVID-19 outbreak has hit the pause button on lending transactions. Such an environment presents opportunities for private lenders and asset buyers to fill the void. As the market reaction

to COVID-19 leads to declining debt and asset prices, many borrowers and their private equity sponsors may consider repurchasing debt, selling assets or refinancing with private lender capital.

For vendors and suppliers, hyper vigilant credit management is a required art and a science. Creditors providing goods and services to companies that are facing liquidity constraints or whose revenues will be reduced due to the COVID-19 disruption should carefully analyze their options and familiarize themselves with the risks and opportunities presented by distressed contract counter-parties.

First mover advantage exists. A prospective lender or buyer of distressed assets who acts early and decisively can obtain significant strategic advantages, economic premiums and leverage over competing bidders. The early participant will be able to conduct due diligence, pursue financing, apply for regulatory approvals, negotiate with stakeholders, and have superior access to management. Others will be far behind the learning curve. If a sale or new financing will be consummated through a Bankruptcy Code Section 363/364 process, lender and stalking horse bidder protections will further advantage the first mover against competition. Section 364 can provide an efficient mechanism to inject liquidity into a company that cannot be done out of court and Section 363 provides an effective sale process in a chapter 11 case to consummate a distressed acquisition free and clear of any other parties' interests in the assets and bar successor liability claims.

Locating the fulcrum security is key. Identifying the fulcrum security and whether to invest in the capital structure of a distressed company requires a deep dive into the company's industry, operations, capital structure, and debt documents. To leverage distress, investors must focus on not only potential targets, but the timing of opportunities and tactics. Whether it is purchasing debt to gain control of a distressed company or to make short term trading profits, or purchasing trade claims to help support a company and provide an entry point to influence a restructuring, successful distressed investors must understand the rights of creditors vis-à-vis each other and the debtor. Review of credit documents and intercreditor agreements will be extremely important to this task. Likewise determining and testing enterprise value is essential. To be in a position to capitalize on distressed opportunities, investors must be smarter, faster and better in finding and executing on deals at the right price and business case.

Learning on the job is not advisable. The 11 year bull market is over. The full economic toll of the coronavirus outbreak will not be clear for months. But there is mounting evidence that it will be severe. For many of those that have spent their entire careers under the decade-long economic expansion, new rules of the road and challenges must be faced. Now, more than ever, the key inquiry is what is essential to preserve enterprise value, and how the answer to that question presents an opportunity for out-sized returns. From fiduciaries duties in business distress, to credit risk mitigation tactics and supply chain contract disputes, from forbearance agreements and out-of-court workouts, to bankruptcy 101 and effects of lower prices on consummating bankruptcy sales and plans of reorganization, the economic environment calls for a deep understanding of the opportunities and pitfalls related to financial distress.

CONCLUSION

It is now increasingly foreseeable that market conditions will spur an uptick in corporate restructuring activity that will impact all sides of any business relationship. Reach out to Goodwin's [Global Financial Restructuring Group](#) to review or continue the discussion.

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Please visit Goodwin's [Coronavirus Knowledge Center](#), where lawyers from across Goodwin are issuing new guidance and insights to help clients fully understand and assess the ramifications of COVID-19 and navigate the potential effects of the outbreak on their businesses.

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