

FORBEARANCE AGREEMENTS

I. INTRODUCTION

Forbearance Agreements can be valuable tools for lenders at the first sign of a troubled credit. Lenders seldom immediately shut down a credit upon the initial default, and typically provide the borrower with additional time to attempt to solve its financial problems. Accordingly, a limited forbearance gives up little on the part of the lender, yet may provide an opportunity for the lender to receive various benefits that may be very helpful in the event of a subsequent meltdown of the credit or foreclosure.

II. BENEFITS TO BE RECEIVED BY LENDER IN A TYPICAL FORBEARANCE AGREEMENT

- A. **Outstanding Balance.** Acknowledgment by borrower of the outstanding balance, in order to avoid or reconcile any disputed balance.
- B. **Current Defaults.** Acknowledgment by borrower of specific current defaults and right to accelerate under the loan agreements, in order to avoid future disputes or potential defenses relating to the defaults. ***Practice Note: Defaults should be waived only in rare instances in a forbearance agreement.***
- C. **Request to Forbear.** Acknowledgment by borrower that it has requested lender to forbear, to establish consideration for benefits to be received by lender in the forbearance agreement.
- D. **Drop Dead Date.** Establishment of a “forbearance termination date,” or “drop dead date,” by which the borrower must resolve certain issues (i.e., overadvance, refinancing, covenants, defaults, sale of business).
- E. **Amendment to Loan Documents.** Amend loan documents (i.e., new or revised covenants, decrease amount of loan commitment).
- F. **Conditions to Forbearance.** Condition of the forbearance that borrower must take certain actions, for example:
 - 1. retain a work-out consultant, who will provide regular status reports to lender;
 - 2. retain an investment banker or broker to sell the business or a division of the business, who will provide regular status reports to lender;
 - 3. liquidate excess inventory;
 - 4. add additional collateral or guarantee;
 - 5. Execute additional documents. ***Practice Note: Provides lender an opportunity to cure or clean up loan documents and lien perfection flaws.***

- G. **Valid Lien.** Acknowledgment by borrower that lender maintains a valid and properly perfected continuing first lien.
- H. **Enforceability.** Acknowledgment by borrower that loan documents are enforceable, without any defenses thereto.
- I. **Release and Waiver of Defenses.** Full release of any and all claims and potential claims of borrower against lender and full waiver of any defenses to the loan documents (i.e., lender liability claims).
- J. **Consent to Jurisdiction.** To the extent not provided in the loan documents, consent to jurisdiction in Illinois and waiver of jury demand.
- K. **Dismissal for Bad Faith Filing or Automatic Stay Waiver.** Several bankruptcy courts have dismissed the bankruptcy case of a borrower as a bad faith filing or lifted the automatic stay for “cause” if:
 - 1. borrower represents that it does not intend to file a bankruptcy proceeding;
 - 2. the lender acts to its detriment by forbearing and going forward with the credit under the forbearance agreement (i.e., advances additional funds after defaults); and
 - 3. borrower shortly thereafter commences such a bankruptcy proceeding.However, a borrower’s waiver of its right to file a bankruptcy proceeding is against public policy and, therefore, unenforceable.
- L. **Fees and Increased Interest.** Great opportunity to obtain additional fees and increased interest.

III. BENEFITS TO BE RECEIVED BY BORROWER

- A. **Limited Forbearance Only.** Forbearance should be limited and, for a short time period, subject to renewal.
- B. **Continued Advances.** Restricted continued advances under the credit facility.

IV. PREFERENCE EXPOSURE FOR CONCESSIONS?

- A. **Over-secured.** Should not be an issue if over-secured.
- B. **Under-secured.** If under-secured, the key is creation and recital of “contemporaneous consideration.”