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# Borrower in Default? Déjà Vu 2008 Financial Crisis

## Lessons Lenders Learned to Minimize Risk

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Lenders should recall the lessons learned from the last serious economic downturn that gave rise to financial services litigation – the 2008 Financial Crisis- and buckle up for a new wave of litigation as the COVID-19 downturn and associated financial disruption speeds upon us. Unfortunately, many companies will not survive the financial disruption, so there will be fallout and inevitable litigation.

With borrowers in default, a flood of workouts and litigation are on the horizon. Here are some measures Lenders should consider when dealing with distressed borrowers to minimize risk and maximize recovery.

First, know thyself – and thy borrower. When dealing with a borrower in serious financial distress, default or when restructuring a loan, it is critical that the Lender know the terms of its loan documents and contractual rights. Our client alert *Borrower in Financial Distress? Lenders Prepare Now to Enforce Your Rights* discusses housekeeping Lenders should do now to prepare to enforce their creditors' rights when and if it becomes necessary. To be effective with a borrower in this situation, a Lender needs to know its borrower and understand the borrower's business and industry.

Second, think preventatively. When engaging with a borrower to amend, modify or restructure a loan, there are preventative measures a Lender can take to mitigate litigation liability while at the same time prepare to enforce its rights if litigation arises. Below are some measures to consider.

- Document all payment and covenant defaults
- Document all actions amending, modifying or restructuring the loan (including waivers, consents, modifications)
  - Remember undocumented actions can create a course of conduct and be used against the lender – even if the intent was to help the borrower. This comes under the heading of no good deed goes unpunished.
- Use of a Pre-Negotiation Agreement allows a lender to:
  - Recap and document the loan status (including amount due, defaults, amendments and the like) and possibly cure gaps or deficiencies in loan documents.
  - Categorize the negotiations as settlement and compromise discussions under Federal Rule of Evidence 408 or a similar state rules.
  - Confirm there are **no** agreements or waivers by conduct or negotiation.
  - Confirm no oral agreements and that all agreements must be in writing.
- Act in accordance with lender's contractual rights and use extreme caution when taking action that exercises control over your borrower's business.
  - If the borrower fails, any control action taken by lender may be blamed for the loss or failure.
  - If lender has monitoring rights, take care to monitor anyone placed on site with the customer – lender will be responsible for their actions. E.g., auditor who gives or offers advice on borrower's business operations.
- Treat every conversation with the borrower as if it is being taped – it may be!
  - Be professional, courteous, objective and accurate in all communications.
- Treat every email as if it will be shown in court to a jury – it may be!
  - Do not forward internal emails to the borrower.
  - Do not create internal emails criticizing colleagues or management.
  - Treat all emails as professional and formal communication.
- If you have a document retention policy – follow it. Lender is better off not having a document retention policy, than having a policy it does not follow.
- Forbearance Agreements provide an opportunity for lender to cure and protect.
  - Like the Pre-Negotiation Agreement, use a Forbearance Agreement to confirm loan amount due, defaults, and cure gaps or deficiencies in loan documents.
  - Lender is making concessions, so get a release – at least to that point in time.
- If you anticipate litigation, contact in-house or external counsel immediately to establish a privilege to protect the litigation analysis and strategy.

Although not comprehensive, the forgoing measures should provide a refresher and some general guidance for dealing with borrowers in the financial disruption caused by COVID-19.

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