

## Chapter 14

### **Perspectives: Secured Creditors**

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- § 14:1 Focus on business solutions
- § 14:2 Credit agreement
- § 14:3 Focus on actions, not individuals; Lender liability
- § 14:4 Notice of default and conditional forbearance
- § 14:5 Role of management and third-party advisors
- § 14:6 Change of management by lender action
- § 14:7 Peaceful surrender of collateral
- § 14:8 Independent managers

#### **Scope**

The classic path to recovery of a loan is to escalate from default to a lawsuit for recovery. This chapter explores alternatives to this classic path, focusing on practical solutions to distressed loan workouts and out-of-court remedies that lenders should consider when their loans become underperforming or nonperforming.<sup>1</sup> The scenarios used in this chapter assume institutional or commercial lenders whose loans are either in the first priority position or high enough in the secured-creditor ranking to leverage their collateral position to participate in a financial restructuring. Some of the strategic alternatives explored in this chapter depend upon the provisions of the credit agreement containing specific remedies. The alternative paths discussed may nonetheless offer some suggestions no matter what the specifics are of each credit agreement.

The concepts discussed in this chapter are familiar to experienced workout lenders and appeal to the common sense of all, once the parties widen their perspective from a razor sharp focus on

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<sup>1</sup>While underperforming or nonperforming loans can be defined in many ways, the crux of the issues discussed in this chapter assume that the borrower is not meeting the business plan and financial projections on which the loan was underwritten. This results in a default under the terms of the original credit agreement. Defaults may range from technical defaults to payment default. A technical default typically means a failure to satisfy a financial covenant or ratio.

tactics to a higher level view that provides a consistent reminder that the objective is to develop a solution for an unexpected situation.

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### § 14:1 Focus on business solutions

When a senior lender becomes insecure about the potential for recovering the full amount of its loan, the lender usually will assign the loan to a workout department. This is a positive step since workout lenders typically have the experience to ably craft solutions that materially improve the lender's chance for recovery. Furthermore, workout lenders have no prior connection with the borrower and can review the situation from a fresh, objective perspective. Once loan recovery is questionable, the lender's focus often shifts to tactics—what specific moves can the lender make to increase the chances of recovering the loan. The lender also often turns to its legal counsel for guidance. Counsel should review the specific credit agreement and prepare a list of defaults and remedies provided for in the agreement. Before focusing on legal solutions, however, the parties should attempt to fashion business solutions. Maintaining a focus on practical business solutions is a primary method for maintaining goodwill between lender and borrower. Experience shows that when the parties are able to orbit around business solutions, there is less opportunity for the parties to digress into unproductive tangents, like who is to blame for the situation. When the parties get stuck in the blame-game ditch, relationships become toxic, positions become entrenched, and precious time is wasted.

After initial review of distressed loans, lenders should turn their focus to the borrower's business and keep potential business solutions at the forefront of the recovery strategy. After all, it is the business model's failure that is leading to