

## Critical Checklists for Business Owners and Management to Mitigate Risk of Financial Distress During the COVID-19 Crisis

The COVID-19 pandemic has been wreaking havoc on industries and supply chains worldwide for weeks, and it appears that the situation will become worse before it gets better. National and international travel restrictions have decimated the airline, cruise line, and hospitality industries. Governmental restrictions have led to the shuttering of retail stores, restaurants, bars, theatres, casinos, and other entertainment venues. Voluntary suspensions of professional sports schedules and college tournaments have shut down the sports and related industries for the foreseeable future. Quarantine regulations in China and elsewhere have caused supply chain interruptions that will be felt for months in industries such as pharmaceuticals, health care, and auto.

What issues do businesses now face operating in the current environment? What precautions should businesses be taking to address current business conditions and risks dealing with financially distressed customers created by the COVID-19 pandemic?

The following checklists contain suggested warning signs and action items for business owners and management to help mitigate their risk of financial distress in the midst of the COVID-19 crisis. Every situation is unique, and there is no universal, one-size-fits-all solution applicable to every business in the face of this unprecedented social and economic disruption. Lowenstein's **Bankruptcy, Creditors' Rights & Financial Reorganization Department** will provide frequent updates on these and other critical issues, and our attorneys are available to help you through this difficult situation.

### Crisis Management "To Do" Checklist for Business Owners and Management Anticipating Potential Distress or Contraction

1. Consider whether to fully draw down on current bank line availability if liquidity may become a problem later.
2. Determine, anticipate, and calendar critical dates, including, but not limited to:
  - a. Loan/credit facility maturity dates
  - b. Debt service payment due dates
  - c. Material contract/lease payment due dates
  - d. Due dates of material pending deliveries of goods and services to and from customers
3. Prepare financial projections and cash flow projections on low, likely, and high cases.
4. Review credit agreements and anticipate potential breaches of financial covenants.
5. Remaining current on payments of federal and state withholding, employment, and sales taxes (plus employee wages, in certain jurisdictions) is critical in the face of financial distress. Certain corporate officers, directors, and employees face potential personal liability if such taxes and wages remain unpaid (particularly for "trust fund" taxes that are withheld from employees' pay or collected from customers), even if the company files for bankruptcy protection.
6. What costs and expenses can be eliminated, reduced, or suspended pending recovery from the current situation?
  - a. Evaluate and model the long-term impact of potential short-term cost reduction measures.

- b. Review nonessential contracts for force majeure provisions, and consult with legal counsel regarding the potential applicability of such provisions.
7. Evaluate whether all employee travel should be curtailed.
  - a. Nonessential travel vs. essential business travel
  - b. What essential travel could be replaced by videoconference or teleconference?
8. Visitor policies
  - a. If possible, prohibit all nonessential visitors at your facilities.
  - b. If possible, vendor activity on site should be limited to deliveries of essential goods and services
9. To the extent possible, evaluate firmwide ability of employees to operate remotely, including, but not limited to, all administrative staff. Check licenses for software, teleconferencing, and so forth to ensure sufficient access to key technology, and assess whether short-term improvements are available.
10. Review insurance policies for business interruption coverage. **Be mindful of any upcoming renewals, payment dates, and notice periods.** Consult with coverage counsel regarding potential new exclusions in renewal policies, and consider other means of managing risks that insurers will no longer cover.
11. For material supply contracts where your business is the seller of goods or services to customers at serious risk, evaluate potential use of any relevant contractual provisions and, for sales of goods, Uniform Commercial Code remedies to seek adequate assurance of future performance, stop goods in transit, reclaim delivered goods, or otherwise seek to curtail credit sales to customers at heightened risk of default.
12. For material contracts where your business is the purchaser of goods or services:
  - a. Evaluate the continued ability of your supplier to provide goods and services
  - b. Be prepared for a possible demand for adequate assurance of future performance, stoppage of goods in transit, or other efforts by the counterparty to mitigate its perceived credit risk.
  - c. **Consider proactively contacting counterparties under essential or otherwise material contracts.**
13. Consult human resources and employment counsel regarding procedures and protocols for furloughs, layoffs, or terminations. Be aware of legal obligations in terms of paid/unpaid time off, advance notice requirements of pay cuts, and ensuring continued compliance with applicable exempt/nonexempt wage and hour laws.
  - a. Evaluate potential exposure under state and federal WARN, wage and hour, and other employment laws. *Compliance with these laws, and timing of required notices and payments, is crucial if you expect to have to file for bankruptcy protection.*
14. Review outstanding purchase orders submitted to vendors, and determine if any can and should be cancelled or deferred.
15. Contact key customers to discuss whether they expect to slow down or cancel purchases.
16. Determine if extended payment terms should be requested from specified vendors
17. Anticipate requests from customers for extended payment terms, and implement a protocol for responding to such requests.
18. Anticipate inquiries and potential demands from lenders and bondholders, including, but not limited to:
  - a. Requests for updated financial projections and cost-curtailed measures
  - b. Requests/demands for additional collateral
  - c. Mobilization of bondholders and/or syndicated lenders in anticipation of default
  - d. Requests/demands for payment of default interest, professional fees, and so forth
  - e. Requests for payment of forbearance fees
  - f. **Consider proactively engaging with bondholders and lenders.**
19. Have public relations or crisis communications professionals available. Engage them early.
20. If bankruptcy protection is a likely outcome—either to restructure debt or sell the business in an orderly manner—**have a strategy in place early, with input from legal counsel, to ensure appropriate messaging to customers, suppliers, employees, and other key stakeholders to avoid panic and impairment of value.**
21. Short of filing for bankruptcy protection, relief from your lenders may be available through an out-of-court workout or restructuring:
  - a. Do not be afraid to seek relief from your lenders. Acknowledging that the COVID-19 situation could pose significant business distress, the FDIC is encouraging financial

institutions to work with borrowers, particularly those from industry sectors that are vulnerable to the volatility of the economic climate and small businesses and independent contractors that are reliant on affected industries. The FDIC has encouraged efforts such as waiving certain late payment fees, offering payment accommodations for borrowers to defer or skip some payments, increasing credit limits for certain borrowers, and extending payment due dates, which would serve the long-term interests of communities and the financial system.

- b. If you anticipate seeking lender relief, approach your lenders sooner rather than later, and be well prepared for the negotiation. The lenders will ask for updated financial projections. Think through the bases for assuring the lenders that your situation will improve. Detail expense reductions. Demonstrate that granting relief is better for the lenders than the alternative—which may include bankruptcy. Develop a liquidation analysis which reflects that the lenders are sufficiently collateralized in the (hopefully unlikely) event of liquidation. Or, demonstrate that the alternative of liquidation is worse for the lenders than granting relief.
- c. Bankruptcy courts may become very busy in the near future. Bankruptcy courts are courts of equity. Bankruptcy judges are compassionate and prefer reorganization over liquidation. They favor preserving jobs and also enabling creditors to make back their losses on future business done with the debtor—which presumes that the debtor entity in Chapter 11 successfully reorganizes in bankruptcy. So, while bankruptcy judges will be fair and balanced, they will be sympathetic to the plight of a debtor forced unreasonably into bankruptcy by an overly aggressive, unbending lender and by circumstances beyond its control.

## **Checklist of Questions to Ask Your Customer/ Counterparty if You Are Worried About the Impact of the COVID-19 Crisis on Their Business**

1. For key customers: *What can we do to help your business during this unprecedented crisis?*
2. What communications have you had from your lenders?
3. Have your lenders reduced any advance rates, such as on inventory or receivables?
4. Have your lenders declined to advance any funds that you have requested or indicated that they intend to do so?
5. How much availability do you have remaining under your bank line? Do you intend on drawing on that line?
6. Are you presently in default to any lenders or bondholders?
  - a. If not, do you expect to be in default in the near future? When? What would be the nature of the default?
  - b. Have you engaged with the applicable lenders or bondholders to discuss a forbearance, waiver, or amendment to deal with the default or anticipated default? What is the status of those discussions?
7. Have you furloughed, laid off, or terminated any employees? Are you continuing to pay all/certain employees even if they are unable to come to work? How long can you continue to do so?
8. At what level of capacity are you operating? Do you expect to further reduce operations?
9. How long can you continue your business shut down or to operate at reduced capacity before you encounter a liquidity problem?
  - a. What measures are you taking to mitigate liquidity risk?
10. How many days' cash do you have on hand based on current market conditions?
11. Have any customers cancelled orders? Have any customers refused to accept/provide delivery of previously placed orders?
12. Has your backlog of orders shrunk? Have you seen new orders slow down/stop?
13. Have any significant customers asked for extended payment terms?
14. Among your top ten customers, do you know if any of them are shut down or operating at significantly reduced capacity? Do you know what will be the impact on your company?
15. Have any of your key vendors indicated that there may be a delay in providing the goods and services you need?
  - a. What measures are you taking to mitigate supply risk?

16. Have you had any shortages of raw materials? From the United States? Outside of the United States?
17. Are you current with all of your key vendors?
18. When is your next debt service payment due? Do you project having sufficient liquidity to make the payment? Do you expect to seek a deferral/forbearance to make all or a portion of the payment?
19. Do you have any significant debt maturities coming due? What steps are you taking to refinance, amend, or extend maturing debt facilities?
20. Have you heard from any of the bondholders with regard to them organizing as a group? Have any lenders or bondholders made any demands upon the company? What have they requested? Have any lenders or bondholders retained professionals? Have any lenders or bondholders contacted you? What demands or requests have they made?
21. Have you retained any restructuring professionals/crisis managers? Have your lenders/bondholders requested that you do so?
  - a. *For customers with publicly traded or syndicated debt, answers to some of these questions may be available on commercial sources such as Reorg and Debtwire even before the customer knows the answers!*