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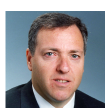
Forbearance Agreements: I Can't Help You With Your Troubles If You Won't Help With Mine



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Given the current state of the market and many prognosticators writing about impending distress and doom and gloom, I thought it would be appropriate to dust off the topic of forbearance agreements. Forbearance agreements are sometimes used when a loan has gone into default or more often when a loan has matured and the parties want to discuss a potential refinancing, workout or restructuring without the uncertainty of an impending exercise of remedies.

So let's set the stage. A loan has gone into default or matured and the borrower wants to talk about an extension, imminent refinancing with the current or another lender, a workout or restructuring of the loan or other accommodation, and both the lender and the borrower are amenable to these discussions. However, the borrower insists that the only way they will engage in discussions is if the lender forbears from exercising its remedies for a period of time. Or the borrower just needs a short extension of time to arrange for a refinancing, and the lender is amenable to same rather than its exercise of remedies currently. There are many fact patterns where a forbearance agreement may be useful or appropriate, but caution should be taken to ensure that inadvertent consequences don't happen when this "simple" short-term arrangement is implemented.

First off, if a pre-negotiation agreement has not already been implemented, then the substance of such an agreement should be incorporated into the forbearance agreement. These parameters are typically noncontroversial and should not result in much or any negotiation. The pre-negotiation terms protect all parties and have over time become quite customary and accepted practice. Since the lender is agreeing not to exercise remedies, it is appropriate for the borrower to acknowledge the outstanding debt, acknowledge the event of default and/or maturity and ratify and confirm the loan documents. In addition, it is not unusual for the borrower to provide fairly robust representations and warranties which would include – in addition to the typical representations of formation, authority, no violation, reaffirmation of the loan document representations and enforceability – that there are no defenses to the borrower's obligations, in addition to others.

Now to the meat and potatoes: the forbearance. This is an agreement by the lender to forbear and refrain from its exercise of remedies pursuant to the loan documents against the borrower, guarantor or the property. The most important provision in a forbearance agreement is a specific date – a hard-and-fast outside date whereby the forbearance will end regardless of anything else that the document contains. Typically, the forbearance provision will have various events which will accelerate any conclusion of the forbearance, and many of these can be subject to competing claims. Consequently, there MUST be a specific, enumerated outside date that, regardless of any dispute, the forbearance will end. Unfortunately, over the years I have seen some agreements which fail to adhere to this maxim and consequently end up in protracted litigation as to whether a lender can even exercise its remedies when there has clearly been a breakdown in negotiations. Some of the more typical provisions whereby the outside date of forbearance would be accelerated would include: the further breach of the loan documents; any impact on material agreements such as ground leases, franchise agreements and the like; mezzanine lenders continuing to play ball; no further breach of representations; and no bankruptcy. Some of these provisions can tend to be drafted with a reasonableness or other standard where it may not be definitive absent a court determination whether the acceleration of the end of the forbearance has occurred. Consequently, care should be given that provisions whereby a forbearance ends are explicit without the need or ability of someone (*i.e.*, the borrower) to contest or dispute the acceleration. No lender should be in a situation where it is mired in months (or longer) of litigation as to whether it can exercise its remedies. Consequently, the agreement should be explicitly clear that if the forbearance ends, then the lender is free to exercise all remedies. Again this should not be left to implication but should be explicitly spelled out. Further to the forbearance period is that the lender should require that any statute of limitations period should be tolled by the relevant forbearance period.

Relevant to any forbearance agreement is how interest and default interest will accrue and be paid, and while these terms and provisions are the subject of much negotiation, there is some sympathy to the default portion of interest accruing since the parties are agreeing to forbear and maintain the status quo. In addition to interest provisions, it is not uncommon for forbearance agreements to contain various deal specific modifications, whether deferrals of payments, inclusion or waiver of financial tests or implementation or modification of cash management provisions.

It is also typical for these agreements to contain exhaustive bankruptcy provisions and waivers and detailed provisions attempting to streamline a lender’s remedies upon an Event of Default. While seemingly onerous on their face, these provisions have become commonplace and are a reasonable accommodation for a negotiated delay and forbearance of the exercise of remedies by a lender.

Finally, in addition to extensive boilerplate provisions which should not be controversial, these documents will also contain typical ratifications and consents by any guarantors or other third-party affiliates such as a pledge by a related entity.

The foregoing is a short summary of forbearance agreements and does not purport to cover all relevant provisions. It is simply an overview of important terms. As with everything, the devil is in the details.