Considerations When Restructuring a Business

By Michael R. Blaser

The post-September 11 economic downdraft, the bursting of the technology bubble, high leverage based on anticipated growth (and easier lending policies during the last decade) and basic business cycle fundamentals lead to situations in which businesses find that they have, or will likely have, insufficient cash flow to service all obligations. Bank covenants are missed, and the lender(s) look to assert more control over the situation and minimize potential losses and reserves. In such situations bankruptcy, while a valuable tool, is usually near the bottom of the list of desirable outcomes for the business and its lenders alike. Instead, the business (and, in many cases, its lenders) will often seek to restructure the balance sheet of the business outside of the bankruptcy process.

It’s always advisable to plan ahead. Project debt covenant compliance, cash availability and operating line availability at least a year in advance. Take action based on a realistic assessment of the business and its problems as early as possible. However, by the time many clients start to think about legal options, the steps that could be taken already have been taken, and the situation is still not headed in the right direction. The following questions are just a few of the many things to consider when business conditions appear to be leading or have led to potential restructuring situation:

❖ Are the problems with the business fixable? What is the story to fix them? In many successful informal restructurings, there are one or two key things that have adversely impacted the business, such as an unfavorable contract or lease, a division or segment of the business that has not performed, etc. Is there a realistic story to tell either current lenders or new lenders as to how these problems can be fixed if the balance sheet and debt terms are restructured?

❖ Who has what collateral? What is it likely to be worth? Which lenders have what collateral? Are they properly secured? Do any creditors have (or have the right to) any statutory liens, such as mechanic’s liens, agricultural landlord’s liens, etc.? Are any debts personally guaranteed? What is the value of the collateral (and/or any personal guarantees) if the business were not a going concern? Assess the relative position of all creditors vis-à-vis the business in a potential liquidation as far in advance as possible to determine relative negotiating positions.

❖ Are owners willing to do more? When lenders first become aware of likely problems, the first reaction is to ask the business, and its owners, for more. More collateral, more personal guarantees, more burdensome financial reporting, etc. Know before the questions are asked if owners are willing to do more, and, if so, on what terms.

❖ Are you working with the right lender and/or with the right people at the lender? Is the underlying problem with the business or the lender? Oftentimes, if the business has had a checkered history with the lender, the fundamentals may not be that bad, but the lender gets “deal fatigue” and simply wants out. In addition, sometimes the lender is under pressures that the business may not be aware of (i.e., to reduce reserve requirements, to clean up the balance sheet for a sale or stock offering, etc.) and the marching orders are to get any questionable loans off the books. Have all alternate sources of financing been explored? Another issue is who at the lender you are working with. Larger lenders in particular have a “workout group” that deals with problem loans. In some situations, it may be beneficial to have the loan sent to the workout group rather than keep negotiations with a line officer that may feel “responsible” for the loan. Ask questions and determine the best steps for the business.

❖ Who needs the business? Will they help? Key vendors and customers, including landlords, are often willing to contribute to the resolution of a restructuring rather than risk the alternative.

❖ Get legal advice early. In addition to all of the obvious legal issues that confront a business facing a restructuring, owners/managers are well served by obtaining objective third party advice as early as possible on available options and a realistic assessment of those options. Having a third party involved in dealing with creditors and/or their attorneys, will usually (partially) reduce stress on owners/managers. It is common to hear that owners/managers wish they would have engaged counsel in the process earlier than they did.

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