


# The Secured Lender

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## *Introducing*

**Non-Lawyer Professionals  
To Troubled Borrowers**



A background image of red curtains, partially drawn, with a red tie-back. The curtains are a deep red color and have a textured, slightly wrinkled appearance. The lighting is dramatic, with some areas in shadow and others highlighted.

**How should you recommend turnaround consultants and other non-lawyer professionals for your troubled borrower? Can common pitfalls in bankruptcy be avoided? Will the right consultant set the tone for maximizing results? What qualities are important to recovery? Read on for the answers.**

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When a borrower defaults on a loan agreement, the lender's decision to remedy will depend on many factors. The lender will likely need additional accurate information about the borrower's operations, valuation of collateral and prospects for operational or financial restructuring. The lender may obtain this additional information, as well other assistance, by asking the borrower to retain various professionals to assist the borrower in its efforts. Such professionals tapped to guide borrowers in these situations may include financial advisors (a chief restructuring officer or turnaround consultant, for example), investment bankers, inventory and machinery and equipment appraisers, brokers and the like.

Having the right professionals assist a distressed borrower often sets the tone for a workout. Because each troubled borrower has unique challenges, whether third-party help is needed and the kind of professional needed, may vary. Circumstances may dictate that these professionals come to the table with specialized expertise to maximize the effectiveness of their contributions. (The accompanying checklist may help determine whom to introduce to the borrower.) If the professionals are not well suited to the borrower's challenges, or if they are inclined to run up fees by chasing inconsequential issues, the workout is unlikely to be successful.

#### **What Is a Successful Workout?**

Bankruptcy judges and others typically define successful workouts as those that maximize the realization of the borrower's assets and business and minimize costs and time to accomplish the goal. This definition of success dovetails with the lender's goal of maximizing realization on its collateral as fast as possible, preferably with its entire loan, interest and fees repaid. However, if the borrower,

unsecured creditors or other constituencies are inclined to fight, delay the inevitable or simply make the process more expensive for the lenders, by the typical definition, the courts will deem the reorganization or workout “unsuccessful.” An unsuccessful case necessarily means less money for secured and unsecured creditors — and some constituencies end up out of the money entirely. Thus, to maximize the chance of a successful workout or restructuring, it is critical that debtor retain the appropriate professional.

Lender mandates to retain particular professionals can lead to allegations of overreaching and lender liability. However, if a lender takes an extreme hands-off attitude concerning selection, engagement agreements, compensation arrangements or other potential issues with regard to hiring workout professionals, the borrower may end up with the wrong advisors and, therefore, with a poor outcome.

Typically, the lender’s suggestions regarding retaining professionals comes in the context of a forbearance agreement. In such agreement, the lender requires that, as a condition of continuing to advance funds or forbearing from exercising remedies, the borrower retains certain types of professionals whom the lender finds acceptable. This is a reasonable request. Although the borrower is certainly free to hire any professional it wishes; however, it cannot expect the lender to advance funds or forbear from exercising remedies if the lender finds a particular professional unacceptable. Therefore, it is in the borrower’s best interest to select a professional in whom the lender can have confidence.

#### **Considerations in Recommending a Professional**

In recommending acceptable professionals to the borrower, the lender will consider experience and qualifications. Though industry expertise is often important to the borrower, the lender may be far more concerned about other aspects of the case, such as whether it should be a turnaround, sale or wind-down, and whether bankruptcy is likely. However, the lender may wish to consider the value of industry expertise when it comes to

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getting the borrower’s buy-in or knowing industry players.

#### **The Importance of Professional Certifications**

Although not necessary, certifications document a level of commitment to one’s practice and the achievement of certain standards of experience, education and training. As such, they may be important to the lender. Frequently the borrower’s financial advisor will be a Certified Turnaround Professional (CTP), and an unsecured-creditors committee might have a Certified Insolvency and Restructuring Advisor (CIRA). Certainly qualified financial advisors with similar experience and credentials exist, even if they are not certified. However, certifications may justify the retention of professionals for otherwise skeptical lender syndicates, bankruptcy judges, U.S. Trustees, unsecured-creditors committees and other constituencies.

Certifications may also be mean-

ingful for other nonlawyer professionals. For example, lenders might need a real estate broker to assist with the sale of surplus real estate or, in the event of an orderly wind-down, all real estate. Though many borrowers and lenders look at real estate brokers as a commodity, the reality of today’s depressed commercial and industrial real estate market and the costs to carry assets such as Other Real Estate Owned (OREO) require a second look. Rather than engage a broker who will merely post a sign and access a multiple listing service, it may be better to retain a professional with experience in distressed sales and a history of proactive marketing who can ferret out national and local buyers. This can minimize the time necessary to achieve a sale and can maximize the sales price. One designation that may help gain stakeholder support for the desired real estate team is the SIOR (from the Society of Industrial and Office Realtors).

Because so many bankruptcy issues turn on valuation, lenders need to consider retaining appraisers and investment bankers. Frequently, the appraiser assignment simply goes to the lowest bidder, whether the appraisal is for inventory, machinery and equipment, real estate or the borrower as a whole. However, the lender needs to think beyond determining asset value. For example, who will do the best job if the lender needs expert testimony in court? Would an MAI designation from the Appraisal Institute carry more weight in a real estate appraisal? Does the machinery and equipment appraiser have the contacts and the capital to conduct an orderly liquidation of the collateral, if needed? Does the investment bank the borrower wants to hire have experience in distressed sales or will it just delay progress while the lender’s collateral deteriorates?

#### **Borrower Interaction**

One lender consideration in introducing a financial advisor is how the professional will interact with the borrower. Many borrowers are reluctant to involve outside professionals. After all, personality fit can be very important to a smooth working relationship.

Ideally, the borrower will be open-minded enough to work collaboratively with the professional in the hopes of achieving a better end result and articulating the approach to all stakeholders so as to gain their support for the retention. Selecting the best professional for the particular job will greatly facilitate this collaboration.

### Compensation of Professionals

Compensating non-lawyer professionals is a concern for borrowers, the professionals and lenders. Some lenders assume payment from a distressed borrower is the professional's problem. However, if a professional cannot get paid, the consequences may jeopardize his or her ability to continue working and to provide the information and borrower assistance that is so important to the success of the engagement. That's why it's important to structure and integrate compensation and retention from the beginning of a case to the end. If the professional's services are important and necessary, then it is important to ensure the professional's continued participation.

Many parties will be concerned about costs, not only as they affect the borrower, but also as they perceive it affecting them personally. Though payment terms must be disclosed, the lingering question on the minds of many constituencies is whether the benefits of retaining the professional will outweigh the costs. The borrower, the lender, the professional and associated legal counsel must be able to articulate the expected difference in the bottom line and how the professional will help achieve that difference.

When a lender recommends that a borrower engage a professional, the lender may help address the compensation issues in numerous ways, either before or after a bankruptcy filing:

- ▶ If a pre-filing borrower is particularly tight for cash, the lender may advance sufficient funds to cover the professional's costs or retainer, provided the advance is at the borrower's request rather than at the lender's instruction.
- ▶ Moreover, if the borrower is headed

## SELECTION CHECKLIST FOR NON-LAWYER PROFESSIONALS

What is the need for a non-lawyer professional in the first place?

What are the shortcomings of management?

What is the need for a systematic approach to maximize values while minimizing expenses and/or losses?

What is the need for an independent, third-party perspective?

- ▶ Do the company's challenges call for experience with certain industries?
- ▶ Syndicates
- ▶ Hedge funds or other non-lenders
- ▶ Turnarounds
- ▶ Restructuring
- ▶ Contentious bankruptcies
- ▶ Workouts
- ▶ Orderly wind-downs, and
- ▶ Going concern combined wind-downs, §363 sales and liquidations?

### Has the professional worked with:

- ▶ Company and/or company's counsel
- ▶ Lender and the lender's counsel
- ▶ Unsecured creditors and their counsel
- ▶ Bondholders and their counsel
- ▶ Sub-debt lenders and their counsel
- ▶ Equity sponsors and their counsel
- ▶ Customers and their counsel, and
- ▶ Other company stakeholders and/or their counsel?

Does the situation call for certification?

How much will the non-lawyer professional cost compared to value projected to be received?

How can the selection of non-lawyer professionals set the tone for this case?

for bankruptcy, the lender may have additional flexibility to structure professional compensation as part of a debtor-in-possession ("DIP") loan facility. This facility may provide separate carve-outs for the borrower's attorney and financial advisors. These carve-outs may be separate and distinct from any carve-outs for the unsecured-creditors committee and its financial advisors in order to prevent an unnecessary struggle between the borrower and the unsecured creditors committee over carve-outs and control.

- ▶ It is important for the lender, as well as the other constituencies, to

recognize and honor any security interest which the professional takes in retainers paid. Holding a security interest in the retainer, as opposed to simply holding it as property of the estate, provides further protection for the professional.

### Professionals in Bankruptcy

Sometimes, despite the best efforts of the borrower, the lender and all the professionals, an out-of-court workout is not possible. Professionals remain necessary in most bankruptcy cases to achieve a successful result. However, under the Bankruptcy Code a debtor may only retain a professional if the

professional does not hold or represent an interest adverse to the estate (11 U.S.C. § 327).

Section 101 (14) of 11 U.S.C. defines the term *disinterested person* as a person who:

- (A) is not a creditor, an equity security holder, or an insider;
- (B) is not and was not, within two years before the date of the filing of the petition, a director, officer or employee of the debtor; and
- (C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.”

The professional and the borrower, as well as the lender, should take interest in the professional’s disinterestedness. If the parties do not contemplate and structure “disinterestedness” prior to the bankruptcy filing, a key professional may be prevented from serving during the bankruptcy case, leaving the borrower without urgently needed assistance or requiring the borrower to change professionals at a critical time. While there are a number of issues which may disqualify a professional on the basis of disinterestedness, two issues arise most often: compensation and the pre-petition role of the professional in the business.

Though a number of issues exist that may disqualify a professional on the basis of disinterestedness, two issues arise most often: compensation and the professionals’ pre-petition role in the business.

#### **Compensation**

Because the professional cannot be a creditor of the debtor, it is critical to pay the professional in full prior to filing the bankruptcy case. Moreover, creditors can recover certain pre-

petition payments to the professional in a bankruptcy case, which could also lead to the professional lacking disinterestedness. A preference under 11 U.S.C. §547 is a transfer made by the borrower for antecedent debt within 90 days of filing the petition, which allows a creditor to receive more than it would have in a Chapter 7 liquidation. If a professional seeking employment with a debtor in a bankruptcy case receives an obvious preference, the court may disqualify the professional from serving. Thus, it is not only critical to pay the professional in full, it is critical to pay the professional in a timely fashion and preferably hold a retainer against which he or she bills.

#### **The Pre-Petition Role**

The second issue that frequently disqualifies professionals is their role prior to the bankruptcy. For instance, if the professional served as chief restructuring officer or held some other C-level position with the borrower, he or she will be disqualified under 11 U.S.C. § 101(14)(B) because he or she served as an officer of the debtor within two years before the filing of the petition. However, many courts have allowed debtors to retain such professionals under 11 U.S.C. § 363 as an ordinary-course-of-business transaction. Each jurisdiction typically has rules and guidelines for retaining professionals under this section. Disclosure of contacts and relationships with relevant parties, fee arrangements and the like are required under both 11 U.S.C. §327 and §363.

#### **Conclusion**

Retaining specialized, nonlawyer professionals can make or break a distressed situation, so choosing the right professional is of extreme importance. The appropriate professional

can assist the lender in identifying strategies and exercising remedies while maximizing business value for the debtor, the lender and other constituencies. On the other hand, the wrong professional, whether in skill, experience or personality, can lead to an unsuccessful turnaround. The lender should be involved in assessing the appropriateness of professionals selected by the borrower, while taking care not to retain the professional for the borrower or otherwise cross appropriate boundaries in lenders’ rights. Coordination among the lender, the borrower and the professional on the scope and direction of the engagement, compensation and other operational issues from the outset can greatly enhance the chances of a smooth turnaround and/or bankruptcy case. **TSL**

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