THREE FACTORS TO CONSIDER IN FORBEARANCE AGREEMENTS: WAIVER OF CLAIMS, ADDITIONAL COLLATERAL & ACTUAL FORBEARANCE BY THE BANK

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Tag: R. Thomas Avery

Business borrowers that find themselves in default on a promissory note or other credit facility may be asked by the lender sign a "**forbearance agreement.**" Often, these are presented by the lender as a generous concession on their part in order to give the borrower additional time to try to work its way out of the problem.

> *Although, forbearance agreements may provide breathing space to refinance or improve conditions, usually, they are used by lenders to improve their position to the detriment of the borrower.*

Forbearance agreements arise when the borrower is already in default on the loan and the lender could immediately begin to collect against collateral and file a lawsuit for any deficiency. Options for the lender may vary based on individual state laws and the type of loan. In a forbearance agreement, the bank or other lender **offers to forbear from collection efforts**, for a specified period of time, in exchange for certain things from the borrower.

All forbearance agreements **involve borrowers and/or guarantors giving up certain rights or property in exchange for additional time or other considerations**. It is of utmost importance that a borrower, or guarantor, fully understand the deal **before** signing a forbearance agreement.

Three Factors to Consider When it Comes to Forbearance Agreements

Although there are many factors to consider when it comes to forbearance agreements, three are most important.

First Factor: Waiver by the Borrower of all Claims, Defenses, and Set-Offs to the Debt

First, the borrower must understand what it is giving up in exchange for the agreement. Over the years, I have reviewed countless forbearance agreements presented by banks or other lenders to my clients. Every forbearance agreement I've seen includes a waiver by the borrower of all claims, defenses, and set-offs to the debt.

> *Forbearance agreements typically include a release and waiver of claims against the lender. If the lender breached the loan documents or was liable to the borrower for some other reason, they would require the borrower to release those claims as part of the deal.*

If the borrower signs an agreement which includes such a waiver, anything that the bank did which was improper or illegal, up to that point, cannot be used by the borrower to defend him or herself. Signing such a forbearance agreement means that if the borrower is not able to successfully work through its problems under the terms of the forbearance agreement and the bank subsequently takes actions to collect on the debt, the borrower will have no defenses to the bank's claims and no effective means to resist the bank.

The only exception would be claims that arose after the execution of the forbearance agreement. A lender that knows it did something wrong, which could constitute a defense to all or some portion of the debt, may use a forbearance agreement to remove or minimize its risk going forward. Any borrower or guarantor who is asked to sign a forbearance agreement with a waiver needs to understand exactly what rights, defenses or set-offs it is waiving by signing. The chances of successfully working through your problems during the forbearance period must be weighed against the rights that are surrendered.

Second Factor: Surrender of Additional Collateral/Cash as Part of the Forbearance Agreement

Second, lenders often require borrowers or guarantors to surrender additional collateral and/or cash as part of the forbearance agreement. **It is extremely important that the borrower and guarantors understand exactly what it is that they may be giving up for more time.** Sometimes banks include collateral in a forbearance agreement that they would not otherwise be able to obtain in collection efforts.

> *For example, if one spouse has a business which is the borrower under the loan, and personally guaranteed the loan, the bank may request a security interest in that spouse's home in exchange for the forbearance agreement. Under Missouri law, assets held jointly by a married couple are not subject to the debts of only one or the other. So, in this situation, if the business owner is married, his or her personal residence, assuming it is titled jointly, would be immune from collection efforts by the bank on the business loan.*

A borrower should think long and hard before giving that type of security to the bank in exchange for some additional time to work through its problems. It may be better to let the business go and keep the family home.

Third Factor: Requirement of Forbearance

Finally, borrowers and guarantors need to make sure that forbearance agreements offered by lenders actually require it to forbear. Often, forbearance agreements include vague clauses which allow the lender to declare the borrower in default of the forbearance agreement prior to the time specified for forbearance.

> *For example, the forbearance agreement may define "default" to include a "material adverse change" in the borrower's financial condition. What does that mean, exactly? If possible, borrowers and guarantors need to negotiate these vague clauses out of the agreement or at least make sure they are clearly defined.*

In addition, and very importantly, **forbearance agreements typically leave the underlying loan documents in place.** Many loan documents include a provision that states that the borrower is in default of the loan if the lender "feels insecure." This is extremely vague language. Unwary borrowers could sign a forbearance agreement, waive their rights, give up additional collateral and then, very shortly after signing, find that the bank is declaring them in default because it "feels insecure." This would be the worst of all results.

Conclusion

Under certain circumstances, forbearance agreement may be the right way to go for a borrower who is struggling to meet its obligations to a bank. However, it is extremely important that the particulars of the forbearance agreement be understood and the terms be negotiated with the lender. Regardless of what the loan officer may tell you, the bank or other lender is looking out for its best interest in entering into any forbearance agreement with you. It is up to you to make sure your interests, and those of your business, are protected.

About the Attorney

R. Thomas Avery has earned a national reputation in the field of lender liability. During his career, he has obtained judgments and settlements on behalf of his clients for lender liability, judgments voiding guarantees, and negotiated favorable work-outs.

Thom represents corporate entities and individuals in a wide variety of complex commercial litigation matters, including contract disputes, lender liability, construction defect claims, mechanic's liens and other commercial disputes. A veteran litigator, he is committed to counseling and leading clients through every aspect of their case, from the initial consultation through trial and appeals.