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JUNE 2020

COVID-19 CRISIS RESPONSE

Natural Disasters, Terrorism, Trade Wars, Pandemics–and yet, Retail Persists

Surviving the Pandemic: Stress and Distress in the Hospitality Industry

Game Planning to Navigate the COVID-19 Crisis

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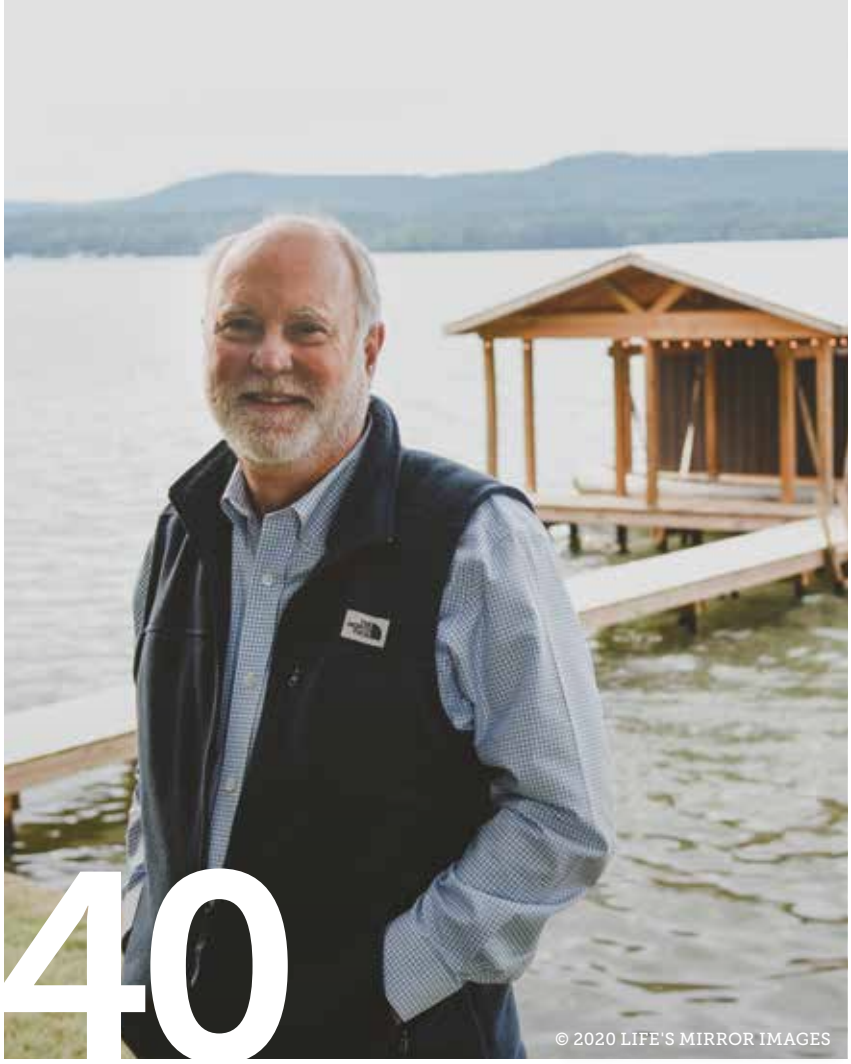

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TURNAROUND MANAGEMENT ASSOCIATION
150 North Wacker Drive, Suite 1900
Chicago, Illinois 60606
p: +1 312 578 6900 turnaround.org

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Recovering from COVID-19's Economic Devastation

BY SPENCER M. WARE, CTP, JUNE GUEST EDITOR

Spencer M. Ware is a member in AlixPartners' Turnaround & Restructuring Services group in New York. He has nearly 20 years of experience advising clients on complex financial and operational restructuring matters. He is chair of the TMA's Editorial Advisory Board and has held senior volunteer leadership positions at TMA, Haverford College, and the London School of Economics, among others. In 2018, Ware was awarded TMA's Mid-Sized Company Transaction of the Year for his work as CRO of Eastern Outfitters. He can be reached at sware@alixpartners.com or (201) 232-3970.

COVID-19 seems to know no bounds. It has indiscriminately decimated the world economy and has affected people on every corner of the earth, from prime ministers to paupers. I, too, tested positive while organizing this magazine. Thankfully, it was a mild case. However, the virus's effect on businesses large and small has been anything but mild.

As a professional who focuses on retail restructurings, it was amazing to see large retail companies falling like dominos in the two weeks leading up to publication. J. Crew, Neiman Marcus, Stage Stores, JCPenney, and Centric Brands all filled Chapter 11 within that span.

The faces of retail, restaurants, travel, hospitality, and commercial real estate are deeply scarred, if not changed forever. This is in addition to oil contracts hitting negative $40 per barrel and the auto industry bracing for the impact of car sales slipping below already untenable levels.

There is no doubt our industry will be busy. Crisis management, operational improvements, strategic reorganizations, and everything in-between will be in high demand for some time.

In this issue, we explore how businesses can respond to the economic disruption caused by the COVID-19 crisis.

Christopher R. Donoho III, John D. Beck, and Jennifer Lee of Hogan Lovells offer practical advice to help businesses avoid unnecessary economic losses or supply chain disruptions. The article explains how companies and their advisors can protect the business' interests, especially during difficult economic times.

Aaron Miller and Ziggy Schaffer of SB360 Capital write that the current crisis poses the greatest threat in generations to brick-and-mortar retail. Given retail's history, they predict some retailers will find innovative ways to respond and even thrive in the current environment, while others will succumb to the economic fallout.

In the hospitality industry, revenues have fallen off the cliff in the wake of the crisis. Richard J. Bernard and Thomas C. Scannell offer suggestions to help companies in that industry weather the COVID-19 storm. Although the experiences of hospitality and travel companies have been radically different from those of canned goods manufacturers or home delivery businesses, Matt Christensen of Business Capital offers 10 suggestion to management teams in any industry can do to help confront the current crisis.

The impact of the COVID-19 crisis on the automotive industry in the Czech Republic will be massive, say Ernst Giese and Marie Zámečníková of Giese & Partner s.r.o. They point out, however, that the industry was already troubled before the pandemic and suggest the crisis might provide the impetus for the industry to rethink its business strategy and structures to remedy its major problems.

Small businesses like restaurants are especially vulnerable to the economic fallout, say John W. Guzzardo and Nathan E. Delman of HMB Legal Counsel and John B. Pidcock of Oxford Restructuring Advisors LLP. But after a turnaround and escape from liquidation in 2018, Red South Beach's turnaround team, which in addition to Pidcock, included HMB's Aaron Hammer, who also took an ownership position in the business during the turnaround, was ready to act in the restaurant's defense against this newest threat.

Compounding pressures force boards and senior management of companies in crisis to act quickly to appease stakeholders. James D. Decker of JDecker & Company Inc. says it is critical that boards include members who have the right skills and are free of conflicts to address crises like those currently facing many companies. He suggests they consider bringing on independent directors to ensure that's the case.

Need to Move a Mountain? Look to TMA

It is no easy task to move a mountain, but one need only look to TMA to see how it's done. Thank you to all for your commitment, creativity, and fortitude in this time of crisis.

While much of the world at large has been stilled as a result of the COVID-19 crisis, the restructuring world is moving at warp speed. Our state of preparedness as professionals will now be tested, and we at TMA are at the ready.

These past few months have tested so much in so many of us. It has tested our resilience, perseverance, and will to adjust and adapt as we find ways not just to survive but to thrive. While there will be much pain and suffering to manage as the economic crisis that is upon us continues to unfold, there is little doubt that the best of us will be tested in every way.

Professional services firms have had cutbacks and layoffs, and all of us know someone affected by this challenging aspect of the new normal. While many of us are whiplashed and winded, our organization stands as a home, a place of comfort, support, and knowledge. Today we are not just TMA Ready. We are TMA Strong.

The people, power, and purpose of TMA have never been needed as urgently as they are today, and, with each passing day, the need will continue to grow more urgent and critical as we start to navigate difficult times that will need steady and sure hands to get us through.

Sometimes, however, crisis takes on a very personal tone, as it has for me. It means in the fraternal community of who we are that we all consider the personal stresses and upset this moment has caused and why we need to be unafraid to support each other as friends and colleagues most of all.

For those in our community who have been furloughed, laid off, or forced to pivot to survive, your TMA family is at the ready to help. Whether it be advice, a recommendation, an introduction, or an empathetic ear, we are here for you.

Through and through, TMA continues to rise above as it exceeds all expectations in demonstrating how vital we are in helping businesses navigate these difficult times. Demonstrating the power and reach of #BetterTogether and #Opportunity2Impact means we will stand strong, continue to grow, and remain supported by our leaders, sponsors, and members worldwide. Beyond that, our friendships have been solidified and our personal support of each other cemented in time.

It is no easy task to move a mountain, but one need only look to TMA to see how it's done. Thank you to all for your commitment, creativity, and fortitude in this time of crisis. You are revered and respected and because of that, the entire restructuring community will, first and foremost, look to us for support and guidance. That's connectivity at its finest, and the power of this forward-facing TMA is more abundant than ever.

At the Turnaround Management Association, we pivot with purpose, lead with determination, and will push through this turbulent time with a force of will that continues to define the critical importance of our worldwide organization every day.

Scott Y. Stuart, Esq.
TMA Global CEO
sstuart@turnaround.org
@TMA_CEO

There's a Reason We're Overusing Words Like 'Uncertain'

BY DEREK F. MEEK, 2020 TMA GLOBAL PRESIDENT

With the projected wave of restructuring activity already hitting and with much more on the horizon, membership is no longer an option, it is a requirement.

If there are overused words and phrases for 2020, they are understandably "new normal," "pivot," and "uncertain." If you are looking for alternatives to "uncertain," I suggest the following substitutes: unsettled, unresolved, unsure, unpredictable, and, my personal favorites, irregular, hairy, and fluctuant. Your next email that replaces "uncertain times" with "in every sense of the word, hairy times" will be a hit.

As various parts of the world dip a toe into the waters of "reopening," we are (and I can't avoid it) still *uncertain* about how best to do it. Even if the world reopened tomorrow *completely*, which it obviously won't, what does this unprecedented (also overused) time mean for governments, lenders, borrowers, equity holders, retailers, landlords, individuals, and—this page isn't long enough for me to keep going. We're all asking the same questions, but we are uncertain as to a unified answer.

What is certain, however, is that the global economy is indomitable, and it will bounce back. What is also certain is that turnaround professionals, our members, will be a material part of that recovery effort. There is a front line of dedicated professionals saving lives and interacting with individuals to treat and prevent the spread of this insidious virus, and for them we are all grateful. Immediately behind them are turnaround professionals, ensuring that jobs, livelihoods, and enterprise value are also protected and saved, as well.

Now more than at any time since its inception, your TMA is ready to equip, connect, and distinguish you as a professional dedicated to the industry and this cause. As members, I encourage each of you to take advantage of the many professional and personal benefits TMA has to offer. Now more than ever, membership in TMA is critical. With the projected wave of restructuring activity already hitting and with much more on the horizon, membership is no longer an option, it is a requirement.

I am continuously amazed at how well TMA has shifted to address the issues presented in this environment. The staff and volunteers have all adjusted quickly and seamlessly, and despite not being able to shake hands and see our members in person, it appears that the mission of TMA is running strongly and as smoothly as it always has. My heartfelt gratitude goes to those who continue to perform in the face of adversity.

Please stay safe in the coming days, weeks, and months, and I look forward to continued connectivity through TMA with each of you.

Guarding Against Insolvency Risk of Critical Vendors in the Supply Chain

BY CHRISTOPHER R. DONOHO III, PARTNER; JOHN D. BECK, COUNSEL & JENNIFER LEE, ASSOCIATE, HOGAN LOVELLS

Manufacturers may have hundreds or thousands of commercial contracts, each of which might be materially different. Understanding their rights and what they can do to protect themselves if a counterparty stops paying or delivering, or files for bankruptcy or some other form of insolvency proceeding, is a major undertaking.

Just thinking about the complexity of the problem and where to begin can be a major headache, but this type of review is absolutely critical to prevent unnecessary economic losses or supply chain disruptions, particularly in the wake of the economic shockwaves set off by the COVID-19 crisis. This article provides practical advice about how to take on such a massive task in an organized and efficient fashion to provide companies and their advisors with the tools they need to address this mission critical exercise.

Identifying Critical Vendors

The place to start is to identify critical vendors—those without which a company simply cannot operate or which are not easily replaced without major disruption. It is important to distinguish between a company's critical suppliers and its largest suppliers, those that might be the top expense of the accounts payable run and therefore be top of mind. The largest suppliers, however, are not always critical, because they may be relatively easy to replace with some notice, depending on the product.

Conversely, the accounts payable run may not even show crucial suppliers. Speaking with the operational people about which products they really need, who supplies them, and whether replacement suppliers are available is the right place to start.

If there are only a handful of critical suppliers, this is a relatively easy exercise. But it is typically not that simple, and frequently the list can include the names of 25 or more companies. Clients who are asked to undertake this exercise may produce a list with just about every supplier on it, often running to hundreds of names. So, it's a good idea to put in place a strict "top 25 only" mandate from the beginning.

If it appears that more than 25 suppliers will be named, the best thing to do is to create tiers of importance. This will help the management team focus on the most critical counterparties, but will also let the operational personnel know that suppliers they may deem critical are actually fairly far down the list or in a lower tier and that they should start planning for possible

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Even if prepayments are common in the particular industry, these are not typical times and a company may have leverage to negotiate better terms.

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replacements for those vendors. It should be an iterative process, as the default response to preparing such a list is generally to be overly inclusive. Normal assumptions need to be tested. It is not whether a supplier would be *inconvenient* to replace; it is whether a supplier can be *readily* replaced.

Analyzing Insolvency Risk

If not properly analyzed and prepared for, the insolvency of one or more critical vendors can significantly disrupt a company's supply chain. This analysis is not quick or easy, and ideally will involve both business and legal restructuring professionals from the outset. Key contracts with vendors should be analyzed, and where distress may be an issue, they should be negotiated or renegotiated.

To assess and prepare for insolvency risk of critical vendors, a company should:

- Maintain open communications with its vendors/customers, first and foremost, to obtain whatever insight it can into their current financial situations and business plans. Usually, if something doesn't feel right, it isn't.

- Review contracts with critical vendors and carefully analyze provisions that may be triggered by the inability to perform: events of default, force majeure clauses, termination rights, insurance procurement clauses, access/inspection rights, minimum requirements provisions, direct access to Tier 2 and Tier 3 vendors, and title/risk of loss to finished goods, specialized tooling, and raw materials. This includes ensuring that there is a binding contract, not simply invoices and orders and acceptances, all of which refer to the company's or supplier's "standard" terms and conditions, which are irreconcilable, with no overriding agreement to resolve this "battle of the forms."

- Examine its intellectual property (IP) licenses (and any related escrow agreements) to determine its rights with respect to IP, including springing license rights, termination rights, anti-assignment clauses, escrow release triggers, and other provisions that may be exercised prior to bankruptcy.

- Determine the law applicable to contracts with key vendors and how those contracts will be treated in the jurisdiction in which the vendor would most likely file insolvency proceedings. This will help in understanding the differences not only between insolvency laws that may apply due to different states' underlying substantive law, but also the very dramatic differences between various international insolvency regimes where a critical vendor may be headquartered or have significant operations.

- Ascertain whether there are viable alternatives for sourcing key supplies or services and whether termination of the existing contract is an option. There may be an opportunity to renegotiate contracts (or enter into new ones with replacement suppliers) on more favorable terms prior to the commencement of a bankruptcy case. The company should keep in mind that in the event of a bankruptcy filing by a counterparty, the automatic stay will prevent the company from terminating the contract. Provisions purporting to grant rights or new protections upon a bankruptcy filing are likely unenforceable.

Contracting to Mitigate Insolvency Risk

Contracts are not negotiated in a vacuum. There are business and economic realities that constrain the ability to satisfy legal "wish lists" of aggressive contractual provisions that are sometimes distantly removed from practical reality. Interests must be weighed and tough decisions made about what is necessary protection in a company's particular circumstances and what it can live without.

With this in mind, what follows is designed as a menu of options, not a list of requirements, to better minimize the insolvency risk of a company's contract counterparties.

The timing of payments is key. Obtaining favorable payment terms that do not require advance payments for purchase orders greatly reduces credit risk. Even if prepayments are common in the particular industry, these are not typical times and a company may have leverage to negotiate better terms.

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Whatever the strategy, the important thing is that a company start developing it now. Distressed situations are cruelest to those who do not have a plan.

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If prepayments are unavoidable, a company may require the supplier to segregate the advance payment and take a lien on the segregated cash. This avoids ambiguity as to whether an advance payment is a deposit or earned on payment, and prevents the supplier from using the company's cash to finance other projects.

Because the U.S. Bankruptcy Code generally prohibits terminating contracts once the party files for bankruptcy, contracts should impose increased protections and/or unilateral termination rights (with little to no notice period) at the first occurrence of concrete, easily observable indications of financial instability. Other possible protections include shortening the term of contracts so that they do not bind a company for extended periods of time in the event of a counterparty bankruptcy. These measures can increase a company's negotiating position and options prior to the supplier entering into bankruptcy or other insolvency proceeding.

Contracts should provide clear title to finished goods and right of entry to the supplier's premises to inspect or recover customized or special-built tooling, finished or unfinished goods, or raw materials. Court approval will likely be necessary to exercise such provisions in bankruptcy, but they provide a solid basis upon which to argue that the goods are not property of the debtor's estate.

To provide time to find a potential replacement supplier, contracts may include a minimum requirements provision that provides for the production of extra parts that can be stored. Conditions should be stipulated under which a company can demand repossession of its specialized tooling, which should be characterized as the company's property in the supply agreement. This facilitates a company's ability to shift production from one supplier to another, if necessary, without having to reproduce the tooling.

It can be beneficial to secure alternative arrangements that enable a company to deal directly with Tier 2 or Tier 3 suppliers in the event of a Tier 1 supplier insolvency. In some instances, this may enable a company to work around such an insolvency situation and continue the supply chain with minimal interruption.

Other options to consider include:

- Drafting narrow force majeure clauses under which the supplier's obligations can be suspended restricts the events and circumstances under which a company's supply chain may be interrupted.

- Establishing a bankruptcy-remote joint venture with the supplier in which a company has a consent right to approve a bankruptcy filing of the joint venture entity isolates risk of bankruptcy and interruption in the supply chain and may allow the company to bring the manufacturing process in-house if a joint venture partner is insolvent.

- Including an insurance procurement provision to transfer risk from the parties to an insurance company minimizes a company's financial exposure given a disruption in the supply chain.

- Require letters of credit or surety bonds from reputable third parties.

- Obtaining one or more guaranties of performance or payment from affiliates of the supplier that are more creditworthy and/or have more unencumbered assets allows potential recovery from a deeper pocket with a different risk profile.

- Obtain the supplier's acknowledgement that any breach of its obligations under the supply agreement will cause the company to suffer irreparable harm and leave it with no adequate remedy at law, that the company will be entitled to injunctive relief in such circumstances, and that the supplier will be barred from taking subsequent litigation in a contrary position.

- Negotiating stipulations and affidavits of fact regarding specific contractual rights in advance may help a company obtain relief from the automatic stay and convince the Bankruptcy Court to

Christopher R. Donoho III is a partner and global head of Hogan Lovells' Business Restructuring and Insolvency practice. He represents creditors, debtors, and private equity clients in financially troubled situations, advising on refinancings, divestitures, and Chapter 11 bankruptcy reorganizations.

John D. Beck is a counsel with Hogan Lovells' Business Restructuring and Insolvency practice and is based in New York and Houston. He has a wide array of both in- and out-of-court experience representing debtors and creditors in financial restructurings.

Jennifer Lee is an associate with Hogan Lovells' Business Restructuring and Insolvency practice based in New York. She holds a law degree from the University of Virginia School of Law and a bachelor's degree from the University of Florida.

enforce certain provisions once the supplier is in bankruptcy.

Whatever the strategy, the important thing is that a company start developing it now. Distressed situations are cruelest to those who do not have a plan. Given the severity and global reach of the current pandemic, it is likely inevitable that at least one supplier in a company's supply chain will be forced to file insolvency proceedings in the next year. The key is to have both a business and legal plan in place now to minimize the damage from any insolvency and maintain a seamless supply chain. J


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Natural Disasters, Terrorism, Trade Wars, Pandemics—and yet, Retail Persists

BY AARON MILLER & SIEGFRIED SCHAFFER, EXECUTIVE VICE PRESIDENTS, SB360

First came subprime mortgages, the ensuing financial crisis, and the Great Recession. Then predictions came of a retail apocalypse caused by the Amazon effect. Despite years of grim headlines predicting the demise of traditional brick-and-mortar stores, retailers have continued to find ways to adapt, evolve, and even thrive. But the shock brought on by the spread of COVID-19 poses the greatest threat to storefront retail seen in generations.

There will be no easy path forward for retailers as life as they've known it has fundamentally changed, at least for the foreseeable future. Surely lessons and strategies learned from the Great Recession are being put to good use as retailers hunker down during this time of uncertainty. What is certain is that well-thought-out strategies implemented now by management teams, working with experienced financial and operational professionals, will improve the prospects for a successful return to normal course operations.

The COVID-19 pandemic has triggered a domino effect and the acceleration of enormous changes already impacting the retail industry. With millions of confirmed COVID-19 cases around the world and hundreds of millions of people worldwide sheltering in place, the full impact of this crisis is as yet unknown. To begin to comprehend the scope of the challenge presented by coronavirus, companies, lenders, and turnaround professionals must consider some of the significant dominos that continue to fall on American retailers.

Supply Chain, Inventory Management

One of the first dominos knocked over in the chain reaction caused by COVID-19 was the disruption of supply chains. The coronavirus outbreak tested the world's dependence on Chinese manufacturing and production as that nation moved to close factories and seal off many regions of the country. Retailers that relied heavily or solely on Chinese factories found themselves caught in a logistical nightmare.

The ongoing trade war between the United States and China had already prompted several companies to diversify their supply chains beyond China. Beginning months before the COVID-19 outbreak, many retailers and other companies began looking for supply chains outside of China to minimize the financial impact of expected new tariffs on Chinese exports to the United States. Where possible and economically viable, new vendors were tapped in Asia, Africa, and South America. However, even for those retailers that had successfully diversified their manufacturing base, resupply networks have been challenged as air cargo capacity dropped precipitously with the reduction in passenger flights and the prioritizing of essential cargo by sea as the pandemic took hold.

The COVID-19 pandemic will undoubtedly cause professionals to once again rethink how best to respond to large-scale supply chain disruptions. In the coming months and years, the retail industry will see changes in the way inventory is procured as supply chains evolve to become more resilient. The relationship between retailers and vendors will forever change as the industry once again reassess long held assumptions with respect to geographic vendor diversification, just-in-time replenishment, and who bears the risk of unsold merchandise when stores are shut down for extended periods of time.

Venturing beyond normal course plans, planograms, on-order files, and 13-week cash flows, retailers and their professionals must be prepared with crisis management tools enabling them to effectively respond to disruptions in sales and the supply chain caused by ever more frequent natural disasters, terrorism, trade wars, and pandemics.

Not all retailers have been impacted equally by the COVID-19 crisis. Nonessential retailers face a decrease in sales activity as stores remain closed and consumers temporarily shift their spending habits away from discretionary items. Those retailers that have invested heavily in e-commerce platforms have been able to mitigate some of the pandemic's impact. But even retailers with stores open for the sale of essential goods have been impacted, with empty shelves as a result of panic buying and a slower than normal replenishment cadence.

As reopen dates are reconsidered and in most cases delayed beyond initial estimates, retailers must look

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Challenges concerning inventory, personnel, and employee safety precautions loom large as authorities begin to permit the reopening of retail locations and distribution and fulfillment centers.

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at ways to recalibrate their inventory to meet customer demand. For many retailers, the shutdown came at a time when they were clearing unsold winter merchandise, bringing out early spring pack away inventory from last year, and taking in new spring receipts. By working with an inventory management professional, retailers can implement creative ways to generate liquidity while they sell out-of-season merchandise and make room for current and next season merchandise.

Brick-and-Mortar, Personnel

As the pandemic ripples through the industry, supply chain and merchandise issues aren't the only problems. Retailers nationwide have been forced to close stores or place restrictions on customer traffic in response to social distancing guidelines. In most states, governors have mandated stay-at-home orders and the closure of all nonessential retail.

For retailers that are heavily reliant on brick-and-mortar sales, have little or no e-commerce presence, and are deemed nonessential, such guidelines may prove catastrophic. With no date set for reopening stores in most of the country, it is vital that these retailers work with their advisors to project cash flow and identify the most efficient use of current liquidity. Equally important is the ability to work with traditional or alternative lenders that have the creativity and flexibility to allow retail borrowers access to additional liquidity.

Many unique challenges lie ahead for retailers that have not furloughed employees, are operating e-commerce platforms and fulfillment centers, and/or are hiring back staff in response to government-funded initiatives. Protecting the health and safety of store, warehouse, and e-commerce associates is of the utmost importance as the nation tries to slow the spread of the virus. Retailers should maintain updated contact information for all employees to cultivate healthy work environments and support those affected by the virus.

It is also important to understand the potential legal issues that may arise during this time and seek legal advice as needed. Measures should be taken to institute new policies and procedures aimed at maintaining safe and virus-free workplaces.

Congress on March 27, 2020, passed the Coronavirus Aid, Relief and Economic Security (CARES) Act to help counteract the pandemic's economic impact on individuals and businesses. The law includes many provisions to aid smaller retailers as well as millions of retail industry employees. CARES provisions included one-time checks for individuals and families, an extension of unemployment insurance benefits, loans, tax measures, and access to additional liquidity that will allow for the retention of employees during this period of economic uncertainty. These government provisions are a lifeline for smaller retailers and employees who need an economic bridge from the current dislocation in

the marketplace to a more normalized trading and work environment.

Challenges concerning inventory, personnel, and employee safety precautions loom large as authorities begin to permit the reopening of retail locations and distribution and fulfillment centers. China's attempt to recover from its own COVID-19 related retail shutdown presents an interesting example for countries dealing with the subsequent spread of the virus. Some stores in China have understandably offered deep discounts or other promotional incentives to encourage customer spending. Early evidence shows store traffic in China is slowly returning to pre-virus levels as infection rates slow and consumers regain the confidence to venture out from their homes.

While the pandemic caught most off-guard, analysts are closely watching those retailers that are reacting creatively and strategically to recapture and potentially grow market share.

Leases, Landlords

Retailers are facing a daunting list of challenges as they manage the many threats to their bruised balance sheets. Many retailers began temporarily closing stores in early to mid-March while planning to reopen them at the end of the month. As cases of COVID-19 continued to increase in the United States, however, those plans had to be shelved. With most retail stores now shuttered for an uncertain period of time, landlords are among those feeling the pain. Almost all retailers, regardless of how seriously they have been impacted by the virus, have deferred rent payments.

For many landlords, the loss of rent payments negatively impacts their ability to make mortgage payments and fund operations. Various government measures to assist homeowners facing payment default penalties, eviction, or foreclosure have not trickled down to commercial markets. In the absence of such measures and facing tenant requests for temporary relief, landlords must consider the impact that any such economic concessions will have on their existing financing arrangements. Remaining flexible to short-term economic exigencies and retaining legal counsel knowledgeable of respective contractual obligations and remedies will assist both landlords and retailers in reaching necessary lease accommodations.

Aaron Miller is an executive vice president and founding principal of SB360 Capital Partners, a Schottenstein affiliate focused on helping businesses manage change, restructure assets, and turn around dwindling profitability. Miller is responsible for structuring synergistic opportunities across the broader Schottenstein platform and has provided strategic guidance for asset recovery through bankruptcies, receiverships, out-of-court restructurings, and acquisitions. He has led several recent restructuring projects, including Olympia Sports, Charlotte Russe, Fred's, Thomasville Furniture, and many others.

Siegfried Schaffer is an executive vice president of SB360 Capital Partners, a Schottenstein affiliate focused on helping businesses manage change, restructure assets, and turn around dwindling profitability. Schaffer is engaged in all aspects of structuring unique client solutions, developing target and working financial models, and providing project management expertise for client companies. Some of the well-known names he has been directly involved with from an executive level perspective include Circuit City, Borders Books, Fashion Bug, and Ace Hardware.

Going-out-of-Business Sales

During this unprecedented time, retailers that were in the process of liquidating merchandise or strategically closing stores when the pandemic struck have been constrained in their ability to conduct going-out-of-business sales due to government-mandated closures in the vast majority of states. Going-out-of-business sales that were in progress were paused pending a return to normal trading conditions.

While new bankruptcy filings have slowed, many anticipate that mounting financial pressure will most likely result in an increase in bankruptcy filings, particularly for retailers, as the crisis and its aftermath play out. Some retailers will undoubtedly use the bankruptcy process as a means to reorganize operations and restructure lease portfolios. For others, it will be the precursor to liquidation and permanent closure.

Conclusion

One of the results of this COVID-19 crisis will undoubtedly be an exponential increase in the demand for turnaround management expertise. Many retailers were already under pressure before the crisis due to the shift to online retail, new tariffs, and shifting consumer demand. With the additional hardships imposed by the spread of COVID-19, some of them will not survive. For healthier retailers, the buildup of excess and dated inventory will be a significant obstacle to recovery efforts. There will be an urgent need to right-size levels of inventory to support revised sales plans and clear shelves of out-of-season merchandise.

The retail landscape has always been in flux. If history is any indication, some retailers will adapt to confront these new challenges and emerge rejuvenated, while others will surely exit the marketplace. During these challenging times, it is important to strategize and prepare a financial, operational, and merchandising recovery plan. Management teams, lenders, consultants, and turnaround professionals need to work together to provide vital support, helping retailers weather the storm and get back on a path to normalcy.

With crisis comes opportunity. These coming months will be the catalyst for even greater innovation and change in the retail industry.

SURVIVING THE PANDEMIC:

STRESS AND DISTRESS IN THE HOSPITALITY INDUSTRY

BY RICHARD J. BERNARD, PARTNER & THOMAS C. SCANNELL, SENIOR COUNSEL, FOLEY & LARDNER LLP

The coronavirus outbreak has impacted the hospitality industry disproportionally more than other industries. For many companies, revenues have fallen off the cliff. Further, the uncertainty and likely overhang of disruption caused by pandemic in the hospitality industry will continue for the foreseeable future.

Revised projections show a worsening impact of the coronavirus on the U.S. economy, including a loss of 8 million jobs in the hospitality sector by the end of April due to declining travel. Millions more jobs in the hospitality sector could also either be lost or severely impacted by the outbreak. In late March 2020, the American Hotel and Lodging Association said 45% of all hotel jobs had been or would be eliminated in the next few weeks. Current forecasts of a 30% drop in hotel occupancy over a full year would result in the loss of nearly 4 million hotel jobs, ranging from general managers to housekeepers.

The restaurant industry faces major upheaval as a result of the pandemic, as the Centers for Disease Control and Prevention has recommended avoiding groups of more than 50, and many cities and states have ordered restaurants to offer only takeout service. Even as cities and states reopen for business, they will limit restaurant capacity.

Shares of three major cruise companies—Royal Caribbean, Carnival Corp., and Norwegian Cruise Line Holdings—dropped more than 50% in the wake of the coronavirus pandemic.

To weather the coronavirus storm, companies in the hospitality industry should consider the following.

Conserve Cash

With seriously reduced or no revenues, companies in the hospitality industry need to find ways to conserve cash. This includes analyzing essential spending; idling operations; working with vendors, landlords, and suppliers regarding credit terms; and applying

other methods. To maximize their liquidity position, hospitality companies must prioritize their use of cash.

Hospitality companies should consider the relative costs and revenues of idling operations—*i.e.*, temporarily closing locations—until business is permitted or activity normalizes. For example, many governmental entities have prohibited restaurants from providing dine-in service but permit them to fulfill takeout orders. However, restaurants need to consider the cost and benefits, and overall results to cash flow of remaining open for takeout service. Hospitality companies will continue to have some cash burn to idle operations, but the net cash burn at idle may be less than that incurred in maintaining skeletal staffs to provide takeout service.

Good relations with its trade creditors might enable a company to establish a standstill on "old" payables until hospitality companies can restart or normalize operations. In the event hospitality companies require some goods or services on a limited or one-off basis, arrangements may be made for c.o.d. or to source those needs with an alternative vendor.

Hospitality companies may have similar negotiations with landlords, and they should also review leases and contracts for applicability of force majeure provisions or other legal rights/excuses regarding performance. Until these landlord and contract issues are resolved, hospitality companies must consider deferring rent and contract payments at this time, especially where they are not receiving benefits or services provided under such leases and contracts.

Lack of liquidity reduces the runway and range of options for financially stressed or distressed hospitality companies. With the indeterminate length of disruption resulting from the coronavirus, cash provides additional

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time, which may be necessary for survival until the industry normalizes and opportunities return as this crisis runs its course. Although the federal government has passed stimulus and bailout laws and allocated funds that may assist hospitality companies, it remains unclear if and when companies will receive such funds. However, these stimulus dollars are not expected to make companies whole for their losses due to the crisis.

Communicate with Lenders

Hospitality companies should open a dialogue with their lenders. If there is availability on lines of credit, discussions should include draw-downs to bolster liquidity. In addition, discussions may include forbearances, interest payment deferrals, amendments, extensions, restructurings, standstills, and borrowing availability increases or additional loans.

If the lender indicates willingness to support the continuation of the business in these uncertain times, the hospitality company needs to be transparent and candid, and provide information and analyses of the various possible scenarios to establish credibility with the lender.

The going concern value of a hospitality business usually exceeds liquidation value, especially under current circumstances. Hotels, timeshares, casinos, movie theaters, and restaurants are considered unique operating businesses within special purpose real estate. The operating business comprises the largest component of the asset's value.

The growing levels of stress and distress may make lenders more receptive to alternative options to maintain going concern value until the businesses normalize. Lenders have incentive to work with hospitality companies to help preserve these businesses.

Update Cash Flow Forecasts

Forecasts need to reflect the current economic environment, projected out to account for reasonable upside, as well as downside, scenarios regarding the impact of the pandemic on operations—even including a potential second outbreak of COVID-19. These forecasts may be shared with lenders and other stakeholders, depending on circumstances.

Understandably, the current economic landscape may make forecasting difficult, as the severity and duration of disruption in the hospitality industry remains uncertain. Further, depending on the business and its location(s), normalization of business operations may take additional time. Accordingly, for many businesses in the hospitality industry, ramp-up may extend over a period of time, and they may face further disruption from changing consumer preferences or a second virus outbreak. Cash flow forecasts, however, must account for these uncertainties.

Hospitality companies should review their fixed and variable costs carefully and determine what costs are needed to run the business at current levels or at idle. Capital investment plans likely need to be revised and delayed. Companies need to assess their deferred expenses and make assumptions regarding the cost to ramp back up operations.

The 13-week cash flow model, which provides insight into sources, uses, and cash positions over the ensuing 90 days, can highlight some of the critical decisions needed. The 13-week cash flow model should be updated weekly and provide comparisons of actual against budgeted items, making available detailed information in advance of the typical monthly financial close process.

In going through this deep-dive process, hospitality companies may evaluate their core businesses, capital structure, supply chains, rent obligations, vendors, etc., and assess whether substantive changes are necessary or advisable.

Dialogue with Stakeholders

Companies should open communications with vendors, landlords, bondholders, equity holders, and other interested parties to assure them that they recognize the challenges presented by the coronavirus and have plans to address them.

In times of crises, communication with stakeholders remains vital. The stakeholders have their own concerns regarding the ultimate impact of coronavirus on their businesses and investments. Open discussions regarding the issues and challenges presented by this crisis establish goodwill and demonstrate a company's intention to work with its stakeholders. These discussions do not need to express definitive solutions to the challenges, but are intended to reassure stakeholders that the company

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recognizes the scope and severity of the issues and is contemplating various responses, depending how facts and circumstances firm up.

Review Labor Issues

Labor constitutes a significant operating expense for most hospitality companies. Companies need to focus on whether to furlough or terminate employees, recognizing the costs and benefits of each option. By the time this article is published, many companies in the hospitality industry will likely have assessed these costs and benefits and made decisions; however, companies may need to reassess their decisions from time to time.

Meet Reporting Requirements

Companies in the hospitality industry that are publicly traded should review and make accurate required disclosures, in the event that business operations are impacted such that a reporting requirement is triggered under the Securities and Exchange Commission's "'34 Act." All hospitality companies that are parties to credit agreements and other financing arrangements should review existing material adverse change (MAC) clauses and potential impacts on the borrower's financial covenant compliance.

Investigate Government Assistance

Depending on their business, companies should keep apprised of the potential for government assistance. The CARES Act, signed into law on March 27, 2020, is a $2 trillion stimulus package intended to counter some of the economic devastation caused by the coronavirus. The law makes certain government loans available for the cost of rent and employees, which are forgiven when funds are expended on the required purpose. The timing and scope as to when and how much may ultimately be available remains unclear.

Specifically, the CARES Act:

- Creates a $350 billion loan program to businesses that employ no more than 500 employees, allowing companies to borrow money to cover certain costs, such as payroll, healthcare benefits, rent, and utilities, among others
- Provides loan forgiveness programs through incentivizing business to retain and rehire employees
- Expands eligibility for Small Business Administration (SBA) loans, raising the maximum amount for these loans to 2.5 times the average monthly payroll costs, or up to $10 million, with interest rates not to exceed 4%, and waiving certain credit and personal guaranty requirements
- Adds relief for businesses in the accommodation and food services industries, certain franchise businesses, and small businesses that receive financing through the Small Business Investment Company Act
- Funds small-business education programs regarding COVID-19 and available federal resources
- Enables the U.S. Department of Commerce to give grants to minority business centers and chambers of commerce to educate, train, and provide access to federal resources

- Extends Emergency Economic Injury Disaster Loans (EIDL) eligibility to individuals operating sole proprietorships, independent contractors, etc., with no more than 500 employees
- Empowers the SBA to approve EIDLs solely on the basis of an applicant's credit score or by use of alternative methods to gauge the applicant's ability to repay
  - Applicants may request an advance of up to $10,000 within three days after the administrator receives the application, which may be used for any allowable purposes under Section 7(b)(2) of the Small Business Act and is not subject to repayment, even if the loan request is ultimately denied.
- Stipulates that, for loans under Section 7(a) of the Small Business Act, Title V of the Small Business Investment Act, and for loans made by an intermediary using Section 7(m) loans or grants, the administrator shall pay the principal, interest, and fees owed for loans in regular servicing status for any such loans, whether on deferment or not, that were made before the enactment of the act for the following six-month period, and for any such loans that were made between the date of enactment of the act and six months from such date
- Appropriates $17 billion to waive limits on the maximum loan maturities for loans given deferral
- Extends maturity during the year following enactment
- Stretches lender site visit requirement timelines as necessary due to COVID-19 to (i) 60 days of a non-default adverse event and (ii) 90 days of a default
- Provides tax relief to certain eligible employers
  - Eligible employers receive a credit against applicable employment taxes for each calendar quarter in an amount equal to 50% of the qualified wages with respect to each employee. The amount of qualified wages taken into account for each eligible employer, however, will not exceed $10,000 per calendar quarter and the credit will not exceed the applicable employment taxes owed for such calendar quarter.
  - Most employers may defer payment of Social Security tax.
- Modifies net operating losses (NOL), providing a temporary repeal of taxable income limitation, including: (i) in the case of a taxable year beginning before January 1, 2021, the aggregate of the NOL carryovers to such year, plus the NOL carrybacks to such year, and (ii) in the case of a taxable year beginning after December 31, 2020, the sum of the aggregate amount of NOLs arising in taxable years beginning before January 1, 2018, and the lesser of the

aggregate amount of net operating losses arising in taxable years beginning after December 31, 2017, or 80% of the excess of taxable income[1]

- Modifies limitation of losses for taxpayers other than corporations

- Modifies capital gains and losses, providing that deductions for losses from sales or exchanges of capital assets will not be taken into account and providing that the amount of gains from sales or exchanges of capital assets taken into account will not exceed the lesser of (1) the capital gain net income determined by taking into account only gains and losses attributable to a trade or business, or (2) the capital gain net income

- Accelerates the ability of companies to recover alternative minimum tax (AMT) credits that were repealed under the Tax Cuts and Jobs Act, permitting companies to claim a refund now and obtain additional cash flow during the COVID-19 emergency

- Increases the amount of interest expense businesses are allowed to deduct on their tax returns by increasing the 30% limitation to 50% of taxable income for 2019 and 2020

- Enables businesses, especially in the hospitality industry, to immediately write off costs associated with improving facilities instead of depreciating those improvements over the 39-year life of the building

- Provides a temporary exception from excise tax for businesses that distill spirits for use in hand sanitizer

It is important for hospitality businesses to be aware of the resources available, including those in a second CARES Act, to help mitigate the effect of the coronavirus on their businesses.

Evaluate Insurance

Companies should review insurance policies to determine possible coverage and comply with all applicable notice requirements.

Although the most obvious source, most business interruption and extra expense insurance usually requires some sort of physical injury or damage to other business property as a trigger to coverage. Such coverage typically is designed to apply where a physical event (*e.g.,* a building fire) shuts down operations for a period of time. It is unclear whether a claim premised on the physical illness of people necessary for business operations and government-ordered closures would be accepted. This issue should be examined on a policy by policy basis.

While somewhat uncommon, so-called "civil authority" coverage can be found in certain business insurance policies. These clauses were designed to insure against losses arising out of loss of income and extra expenses incurred in the event civil authorities prevent access to the business due to civil unrest or other emergencies. Coverage varies wildly depending on specific language used, but insured businesses should examine their coverage carefully to see if such protection is included.

While not as common as other insurance coverage, event cancellation insurance coverage in some form is often carried by businesses in the travel and entertainment industries, in particular. These policies are all written on nonstandardized, manuscript policy forms and should be carefully reviewed for potential losses associated with a canceled or postponed event. While many of the policies may contain some form of pandemic-related exclusions, depending on the exact facts and circumstances there may or may not be coverage for any particular losses.

In addition to seeking first-party coverage for business interruption and/or extra expenses, businesses may need to seek coverage from insurers for third-party claims for (i) negligence and injury related to the coronavirus or (ii) directors' and officers' liability for mismanagement of the business during the crisis.

Conclusion

In summary, the hospitality industry must take steps now to mitigate and address the impact of the coronavirus on businesses in the sector. These steps include a number of tools and analyses commonly employed by restructuring professionals, which can and should be used by companies in the hospitality industry to survive the current crisis.

[1] Speak with your tax professional regarding the specifics on any potential tax issues facing your business.

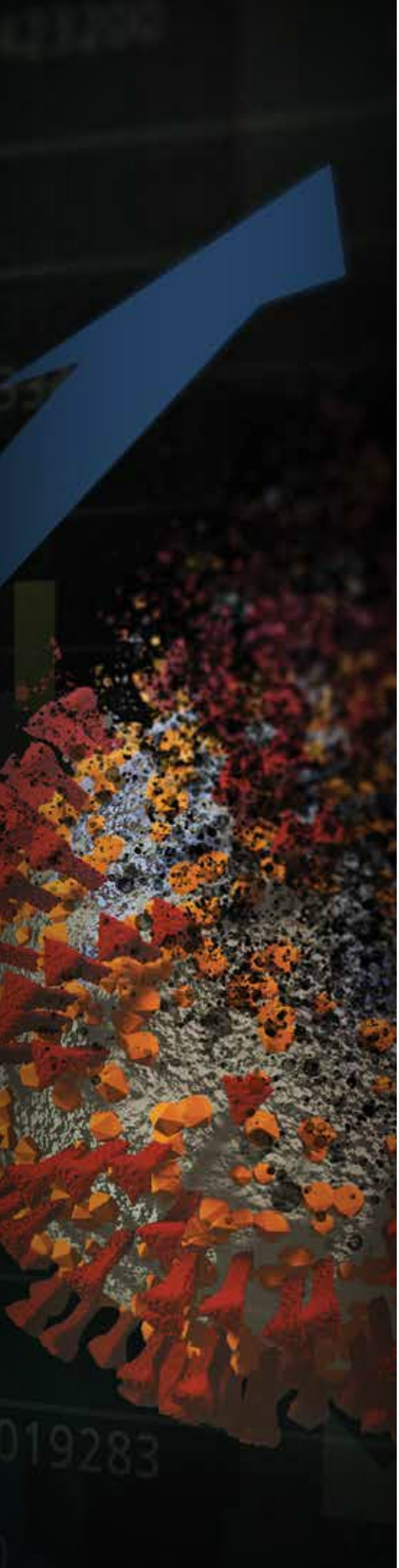
Richard J. Bernard is a partner with Foley & Lardner LLP in New York. A member of the firm's Bankruptcy & Business Reorganizations Practice, he concentrates his practice on corporate and financial restructuring, business solutions, bankruptcy litigation, secured transactions, corporate governance, mergers/acquisitions, and debtors'/creditors' rights. His experience spans numerous industries, including energy, mining, aviation, retail, manufacturing, telecommunications, financial services, heavy industry, real estate, and hospitality.

Thomas C. Scannell is a senior counsel with Foley & Lardner LLP in Dallas. A member of the firm's Financial Restructuring and Reorganization Practice, he primarily focuses on the restructuring of companies in and out of bankruptcy, debtors' and creditors' rights, and debtor-in-possession financers. Scannell also counsels clients on out-of-court workouts, turnarounds, and the acquisition and sale of distressed assets.

GAME PLANNING

TO NAVIGATE THE COVID-19 CRISIS

BY MATT CHRISTENSEN, SENIOR VICE PRESIDENT, BUSINESS CAPITAL



The economic impact of the COVID-19 crisis has placed everyone in uncharted waters. Conversations with senior management have shifted from acquisitions, turnarounds, and hypergrowth scenarios to the consequences of shelter-in-place orders and their impact on businesses. Obviously, the impact varies radically by industry. The experiences of hospitality and travel companies, for example, have been radically different from those of canned goods manufacturers or home delivery businesses.

Even with the diversity of experiences among companies, however, there are some common actions that management teams in any industry should seriously consider to deal with this crisis.

1 Establish a COVID-19 Impact Team. Amid all of the uncertainty and surprises, companies should create a crisis-focused triage team where issues, many of which a business may have never encountered before, can be prioritized and addressed. People within the company should be identified whose job responsibility during this pandemic will be expanded to include being a member of the COVID-19 Impact Team.

Serious consideration must be given to how to staff this team. Human resources should be represented, as should finance. The company's CEO should probably also be involved. A company should announce the formation of the team and let everyone know that issues arising from the crisis should be directed to the group. This alone will provide relief to other company personnel.

The team should be open to accepting information from all employees across the company, from the most senior members of the business to the most junior. This team will need to detect and address issues related to everything from employee health to the loss of a major customer or supplier. This team is management's radar, triage unit, and SWAT team, all in one. Decisions must be made quickly, but the team must take into consideration the implications of its actions on the entire organization and not just on the constituency immediately impacted.

2 Develop a Cash Strategy Adapted to a "New Normal." Previous recessions have developed gradually and with far less immediate impact than the current crisis. "Cash is king" has never been truer. Fresh rules are being written in real time on managing cash.

Unprecedented developments amid the current crisis are shaping how institutions are working with each other. Eligible borrowing base criteria are being rewritten, both formally and informally, as are loan agreements. Tenants and landlords across the country are having unusual conversations.

It's time to dump annual budgets—for now—and become extremely short-term oriented and cash-minded. Companies should familiarize (or refamiliarize) themselves with the rolling 13-week forecast. Exacerbating the issue of managing cash is the fact that returns and bad debt will probably increase, and a business should also expect an increase in slow payers. If possible, a company should create a cash reserve, as there are certain to be additional surprises as the crisis continues.

A company should consider stopping all auto payments for the time being. It should confirm its expectations with critical suppliers and renegotiate supplier terms if possible. Terms of other customer and supplier agreements may have to be modified in unprecedented ways, at least for an interim period. Also, a company shouldn't assume customers' creditworthiness because of past experience.

3 Consider Consulting Turnaround Professionals. Much of the nation will have to take a crash course in turnaround strategies to deal with the economic upheaval. For the past 10 years, the United States has had the economic winds at its back. The same management team—or for that matter, the same mindset—that resulted in superb results three months ago may be completely ill-suited for today's environment.

This is a good time for owners to seek out, and listen to, turnaround professionals. Cost minimalization,

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layoffs, furloughs, and shortened work weeks will be normal phenomena in these abnormal times. The playbooks of most companies will have to be rewritten and their tactics overhauled. Learning on the job is a suboptimal solution. Turnaround professionals are experienced in dealing with distressed situations and implementing necessary actions for survival.

4 Make Securing Capital a Science. For many companies, obtaining money in this environment has been like navigating a house of mirrors. Fundamental realities have created this environment. Banks are prioritizing Payroll Protection Program (PPP) loans (some more successfully than others), answering clients' calls, negotiating relief packages, and following crisis-inspired directives from senior management. Nonregulated entities are typically in a far better situation, but they may be facing substantial portfolio, and even funding, issues.

5 Have a Double-Dip Strategy. There is a great deal of political pressure being exerted to open the U.S. economy sooner rather than later and thereby run the risk of enduring a second COVID-19 wave. The possibility of a double-dip economic shutdown is very real. Unfortunately, a company should keep its shelter-in-place playbook handy, because it may need it again before long.

6 Maintain Rhythm, Urgency. Many view working from home as a great thing. They have their TV, refrigerator, and that great book they never had time to read. More than that, in these unsettled and perhaps loosely supervised times, they may believe, "I deserve a break!" Such thoughts are natural, easy for someone working at home to give in to, and the last thing many companies can afford.

The need for virtual and remote working capabilities is rather obvious in the wake of the current crisis, and thankfully, technology provides myriad options to accomplish this. However, the challenge for a company is to keep its team focused, motivated, and busy knocking out the tasks at hand. Meetings, project management, and timelines are now more important than ever for helping to keep people engaged. While it should remain sensitive to personal issues, a company nevertheless must maintain accountability and set routines that keep people connected.

Matt Christensen is a senior vice president, team lead, at Business Capital. He has more than 25 years of experience leading teams in regulated and nonregulated institutions, including GE Capital, Bank of America/Merrill Lynch, Opus Bank, and others, and has served in business development, relationship management, and credit underwriting capacities. At GE, he led the West Coast private equity coverage. Christensen is certified Six Sigma and the recipient of multiple awards for performance and marketing.

Reputations, personal brands, and a company's standing in the business community shaped today will make lasting impressions.

7 Look for New Possibilities. A company should look for new ways to deploy its assets. As a result of this disaster, the world has new needs. For example, a pillow manufacturer converted 100% of its production to turning out personal protective equipment (PPE). Auto parts manufacturers have converted facilities to produce ventilators. Survival of the fittest may be a test in versatility rather than endurance.

8 Buy or Merge with a Competitor. This type of aggressive move may seem counterintuitive in this period of uncertainty, but there are sources of capital that have been waiting for times just like these to put cash to work. Companies that have a sustainable platform but have hit a COVID-19 "air-pocket," oddly enough, may discover unique opportunities for growth. Weaker competitors may be vulnerable or buried in the fire drill of the moment—all day, every day. A company that has its own house in order should be open to taking advantage of the exceptional opportunity.

9 Remember Lessons of Previous Recessions. Weaker competitors will disrupt markets and lower margins, but a company shouldn't squander a great brand in blind pursuit of lower costs. Instead, it should focus on liquidity versus profitability and drive for urgency on all working capital assets.

10 Understand What's at Stake. These ideas on short-term thinking apply, for the most part, to cash flow. Hard decisions will have to be made, but reputations are built or broken in extraordinary times like these. This pandemic will pass relatively quickly. Hard decisions should be made for the right reasons. Reputations, personal brands, and a company's standing in the business community shaped today will make lasting impressions.

A company should manage as best it can to survive the current crisis and use the challenges that arise as opportunities. It's possible that the business could emerge from this crisis leaner, stronger, and better positioned for future success.

COVID-19 CRISIS ADDS TO CZECH AUTOMOTIVE INDUSTRY WOES

BY DR. IUR. ERNST GIESE, PARTNER & JUDR. MARIE ZÁMEČNÍKOVÁ, ASSOCIATE, GIESE & PARTNER S.R.O.

The COVID-19 pandemic hit the world unexpectedly and caused what is expected to be one of the biggest global economic crises in history. One of the hardest hit branches is the automotive industry, a crucial sector for many national economies, including the Czech Republic, a small country of 10.6 million where more than 1.4 million cars were produced in 2019. With a history that spans more than 120 years, auto production in this home of the well-known producer Skoda Auto accounts for more than 9% of Czech GDP, while the industry employs approximately 180,000 direct and more than 400,000 indirect employees. Each year, about 80% of the Czech Republic's auto production is exported, mostly to Germany and other western European countries, which corresponds to 21% of the nation's total exports.

Aside from Skoda Auto, other car producers in the Czech Republic are Toyota, Peugeot, and Citroën, within the joint-venture TPCA, and Hyundai. But it is not only OEMs that are important for the Czech economy and international trade. Hundreds of

suppliers, mostly small and medium-size enterprises, form an essential part of the automotive supply chain. To be more specific, more than half of the total turnover of the entire automotive industry in the Czech Republic comes from suppliers. Also, suppliers employ about 75% of all employees within the Czech automotive industry.

Pre-Pandemic Struggles

The suspension of most European car production (including the Czech-based Skoda, Hyundai, and TPCA and other German producers that are crucial to the Czech market) and the consequent closure of most suppliers' factories were unexpected and unprecedented steps, leaving the industry in chaos and fear. However, prior to the measures taken in response to COVID-19, the industry had already begun to struggle, exhibiting significant signs that the good days might, in fact, be over.

At the end of 2019, the first news regarding stagnation or even

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The unsettled U.S. trade war and proposed tariffs on automobiles caused additional uncertainty within the whole industry.

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decreasing numbers came from Germany. The industry also needed to deal with old sins, such as Volkswagen's Dieselgate fiasco, and face new challenges, especially with respect to environmental issues and e-mobility. One of the biggest challenges has been the new European emission standards that became effective in January 2020 and required an enormous investment into the development and testing of new technology. Last but not least, the unsettled U.S. trade war and proposed tariffs on automobiles caused additional uncertainty within the whole industry.

Besides these global issues, there were further specific local troubles of Czech manufactures and suppliers that became even more significant after

the COVID-19-related restrictions hit. Although the Czech Republic has been a member of the European Union since 2004 and is a strong export country, it has yet to adopt the EU currency, the euro, relying instead on its own Czech crown (floating between 25 CZK to 27 CZK for 1 EUR). Therefore, Czech producers must constantly deal with the risk of a volatile currency market.

Moreover, the Czech Republic has the lowest unemployment rate amongst all European Union members, reaching only 2%. This means that Czech production is heavily dependent on cross-border workers, mostly from Poland, Slovakia, Ukraine, and other eastern European countries.

Also, the Czech Republic used to be called the "assembly shop" of Europe, since most Czech-based manufacturing facilities are simple production plants, whereas any research and development mostly occur in foreign mother or sister companies. After all, the owner structure and the fact that foreign holdings often use the Czech Republic as a cheap place for their production also leads to significant capital outflow leaving the country without further major necessary investments.

All of these issues became even more problematic with the arrival of the pandemic. The value of the Czech crown dropped; its national borders were closed, preventing cross-border workers from entering the Czech Republic; and with the lack of sufficient capital, many suppliers are already facing the threat of insolvency.

Management Miscues

However, even before COVID-19 made its devastating entrance on the scene, there were other circumstances that caused tension and instability in the Czech automotive market. In conjunction with those listed earlier, these circumstances have mostly originated in (mis) management and the lack of strategic and long-term planning.

Above all, many Czech suppliers produce only a limited range of products focused on a limited number of customers. Suppliers with only one big customer, most often one of the VW brands, are no exception. Given the growing economy during the past decade, this has not been much of a problem so far. However, the lack of customer and product diversity turns highly problematic during times of crisis.

Furthermore, in many Czech companies and facilities, telltale signs of mismanagement or insufficient control mechanisms in place have led to three distinct solutions. First of all, there are still plenty of traditional long-term facilities that often originated as traditional state facilities which came into private hands after the Velvet Revolution in 1989. These are typically limited liability companies with a limited number of shareholders, often only a sole shareholder who is also the executive manager of the company.

However, with the growing economy and increasing exports, over time these companies often developed into bigger entities with hundreds of employees and significant turnover. Despite this growth, the original owners and managers continue to lead their business as if it were still the small family firm it once was.

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At the other end of the spectrum, two types of problems can occur in companies with foreign shareholders, which is, as stated earlier, often the case in the Czech Republic. On one hand, some foreign shareholders tend to have no faith at all in local management. This is especially true of German companies. Instead, German mother companies often appoint German managers as CEOs of Czech companies even though those managers are not physically present in the Czech Republic. This slows communication within the company significantly and also complicates day-to-day decision making. This arrangement of power sometimes sparks a certain amount of resentment among Czech employees of the company.

On the other hand, there is another extreme form of management in which a foreign investor shuns almost all control of its Czech affiliate, preferring instead to leave the Czech management with a free hand. As long as the business runs well, this might be satisfactory for both parties. However, difficult economic times may bring to the surface management issues that can quickly shatter the mutual trust that both sides had previously enjoyed.

COVID-19: Villain or Change Agent?

It is indisputable that the impact of the COVID-19 pandemic on the automotive industry will be massive and recovery will take a long time. However, keeping in mind the issues and struggles that already troubled it, the industry would have required a certain amount of recovery and restructuring measures even without the additional problems created by the coronavirus. The rising number of insolvency and restructuring proceedings of suppliers opened in Germany in 2019 was the first hint that the industry was slowly leaving the prosperous times and discovering that certain changes were necessary.

In this respect, the COVID-19 pandemic might actually provide a good chance for the industry to rethink its previous business strategy and structures, however impudent that sounds. National governments have already started to implement various support and rescue measures. For instance, in many countries (Germany and the Czech Republic included), the obligation to file an insolvency petition without undue delay has been suspended.

Also, the industry has already begun to call for a postponement of the deadlines regarding the European emissions standards set for 2020 and 2021. In an open letter to the president of the European Commission, Ursula von der Leyen, the presidents of the main European automotive manufacturers' and suppliers' associations (ACEA, CLEPA, ETRMA, and CECRA), stated that "some adjustment would need to be made to the timing of these laws."

However, it would be a huge mistake to rely solely on state or European support and expect massive support from local government or international governmental organizations. In the end, it will be the manufacturers and suppliers that will have to deal with the consequences of this worldwide crisis on their own. Therefore, now is the time for them to examine the flaws of their businesses and determine how to correct them.

Business owners and managers should focus on more product and customer diversity and broaden the range of their own suppliers so that the outage of suppliers in one country does not endanger their own production. The implementation of preventive measures and control mechanisms regarding their own as well as their business partners' insolvency is more important than ever. Also, extensive investment into research and development will be necessary.

As the state or the EU cannot compensate for lost profits and turnover forever, certain legislative measures and governmental actions would be more than welcome. The national government must help entrepreneurs receive enough distress financing, either by providing state securities for commercial credits or simplifying the investment rules. Finally, the insolvency and restructuring laws should be reviewed and amended accordingly so that entrepreneurs may use the given restructuring tools to save their businesses as much as possible.

In this respect, the EU has already enacted the Restructuring Directive, which is similar to Chapter 11 of the U.S. Bankruptcy Code. However, many member states, including the Czech Republic, have not yet implemented this directive. So instead of focusing on one-time-only solutions and individual measures taken in connection with the COVID-19 pandemic, it is also time to take action and implement some general and long-lasting rules to support and rescue all businesses, not only the automotive industry. J

[1] Statistics of the Czech Association of the Automotive Industry (AutoSAP), available here: autosap.cz/wp-content/uploads/2020/01/vyroba-a-odbyt_1-12_2019_final.pdf

[2] Czech Invest, czechinvest.org/en/Key-sectors/Automotive, and Czech Association of the Automotive Industry.

[3] Based on data from 2018, available on the website of the Czech Ministry of Industry and Trade: mpo.cz/cz/panorama-interaktivni-tabulka.html

[4] See detailed statistics published by the German Association of Automobile Industry (Verband der Automobilindustrie): vda.de/de

[5] Data of the European Commission for February 2020: ec.europa.eu/eurostat/statistics-explained/index.php/Unemployment_statistics

[6] The open letter available on: acea.be/uploads/news_documents/COVID19_auto_sector_letter_Von_der_Leyen.pdf

[7] The Directive (EU) 2019/1023.

Ernst Giese is the founder and managing partner of Giese & Partner, s.r.o., a leading law firm in both the Czech and Slovak Republics, focusing on corporate, banking, and industry law. For the last two decades, he has acted as legal counsel for leading international banks and was involved in major M&A transactions. Also, he has gained excellent expertise in numerous cross-border restructuring and insolvency cases, especially in the automotive, construction, and energy industries.

Marie Zámečníková is an attorney-at-law at Giese & Partner, s.r.o., with major international experience. She mostly advises German-based and other international clients willing to extend or restructure their business in the Czech Republic as well as insolvency trustees or creditors within various cross-border European insolvency and restructuring proceedings. In addition, Zámečníková frequently lectures and writes on cross-border and international legal and business issues and better lawmaking.


RED
Peter Vaudin
Executive Chef

GLOBAL PANDEMIC IS SURPRISE ADDITION TO RESTAURANT'S TURNAROUND MENU

BY JOHN W. GUZZARDO, PARTNER & NATHAN E. DELMAN, ASSOCIATE, HMB LEGAL COUNSEL, AND JOHN B. PIDCOCK, OXFORD RESTRUCTURING ADVISORS LLP

By the spring of 2020, Red, the Steakhouse, in Miami Beach was thriving, poised to capitalize on its success and further expand its brand. With a prime location in the city's fashionable South of Fifth (SoFi) neighborhood, the restaurant boasted a 198-seat main dining room; a 16-person, glass-enclosed VIP room; two additional private dining rooms; and an 800-bottle wine cellar, and was a hot spot for professional athletes and other celebrities.

In early March 2020, however, South Florida was quickly becoming a different kind of hot spot—one for cases of COVID-19. By March 16, the City of Miami Beach ordered the closure of all restaurants, putting the survival of Red South Beach and other area restaurants at risk.

Prior to the pandemic, Red South Beach was profitable and growing. December 2019 marked the restaurant's largest gross monthly sales in its history—exceeding $700,000—followed by two record months in January and February 2020. But, without question, small businesses like Red are the most vulnerable to the global macroeconomic impact of COVID-19. Even without the forced shuttering of establishments, a large percentage of the customer base would remain wary of the disease's spread and simply stay away. Some predict that one in five restaurants in the United States could permanently close as a result of the lost revenue crushing the entire industry.[1]

Luckily for Red South Beach, because of a more typical turnaround and escape from liquidation in 2018, the restaurant's experienced turnaround professional team was already marshalled and ready to act in defense to this new threat. Aaron Hammer, chair of the Horwood, Marcus & Berk law firm's Bankruptcy Group and a longtime turnaround professional, and John Pidcock of Oxford Restructuring Advisors LLP were still on board from the restaurants' 2018 disassociation from its previous partners and significant financial restructuring to the business itself. As such, Red South Beach responded to the COVID-19 crisis by quickly taking a number of actions designed not only to survive but to emerge financially stronger once the crisis is over.

First, the team recognized that open lines of communication with its lenders were critical to the restaurant's survival. The extension of credit is the oxygen of all hospitality enterprises during this pandemic. Not only was Red South Beach able to defer payments, but the turnaround professionals' close relationship with the restaurant's senior lender secured the company's participation in the federal government's Paycheck Protection Program. With the assistance of its turnaround team, the restaurant further sought an Economic Injury Disaster Loan from the federal government and a Small Business Emergency Bridge Loan from the State of Florida to ensure it would have the most working capital possible coming out of the crisis.

Second, the team cut as many near-term costs as reasonably foreseeable without surrendering Red South Beach's ability to reemerge as a dining destination once governmental restrictions are eased. Out of the gate, Red South Beach furloughed its hourly employees, while salaried employees worked on-site to provide takeout and delivery service to the local community. All of the restaurant's employees retained healthcare benefits during the crisis, and some hourly workers helped with delivery and takeout services as needed. Management did its best to keep Red's workforce as engaged as possible and provide critical support for them while not wasting precious liquidity necessary to restart the business in its entirety after the crisis.

Third, the team understood that Red South Beach could quickly adapt operations to stay engaged in the community—the lifeblood of a small service-industry enterprise. To start, within days of closing its dining room, the restaurant and its turnaround team launched an online delivery portal and devoted substantial additional online market revenue to boost website traffic. It also worked in conjunction with Meals for Heroes Miami to deliver 200 free meals per day to healthcare workers and other first responders on the front line of the COVID-19 crisis.

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Finally, the restaurant launched the online Red Butcher Shop to sell its prized cuts of meat and fresh seafood to locals. The concept's initial success resulted in a long-term plan to launch a national mail-order business by June 2020 to sell certified angus beef and seafood directly to consumers around the United States.

While these are trying times for the hospitality industry as a whole, Red South Beach is no stranger to threats to its survival. A mere 18 months ago, the restaurant was brought back from the brink of oblivion. The business survived that crisis and with the structures and relationships established by its turnaround professionals during that time, Red South Beach found itself more flexible and better able to adapt when the world changed so dramatically in the spring of 2020.

A Recipe for Trouble

Red South Beach began as an offshoot of Red, the Steakhouse, in Beachwood, Ohio. Red Restaurant Group (RRG) opened Red Beachwood in 2004 and, by 2017, had six contemporary steakhouses plus the American bistro Moxie, the Restaurant, in its portfolio. RRG had plans to launch three additional restaurants by 2022 and projected $43 million in consolidated revenue.

Peter Vauthy, who had worked for RRG since 1999, opened Red South Beach in 2009 and was immediately successful. Revenue peaked at $7.2 million in 2012.[2] Six years later, from the outside, all appeared well with the Red South Beach business. But back in the Midwest, RRG struggled for survival.

Two prototype restaurants developed by the group closed in June 2017. In February 2018, RRG sold Red Cleveland to an investor group, YLT Red LLC. Red Cleveland kept its original name and ultimately acquired the Red "brand," but all other financial ties were severed. The transaction was intended to shore up RRG's treasury and fuel further expansion, but those efforts fell flat. By August 2018, RRG shuttered its newest locations in Indianapolis and Pittsburgh.

Because Red South Beach had contributed so much of its free cash toward RRG's other ventures, the cupboard was bare when it came time to pay its own bills. RRG had further leveraged Red South Beach's assets to bail out its failing new locations, and by September 2018, Red South Beach was substantially in arrears on its rent payments.

As a last-ditch effort to save the enterprise, in June 2018, the majority shareholder of RRG and Red South Beach, BJRP LLC, obtained a secured loan of more than $1 million and granted a blanket lien cross-collateralized against all of RRG's remaining locations, including Red South Beach. The years of failed expansion and runaway financial mismanagement were too much to overcome, however. A mere four months after taking out this new financing, BJRP filed for Chapter 11 in the U.S. Bankruptcy Court for the Northern District of Ohio, scheduling a $960,000 claim to its secured lender and another $770,000 combined to two other secured lenders. With BJRP now under the protections of the Bankruptcy Code, its lenders began looking southeast to their other potential sources of recovery. Red South Beach was running out of time and options.

The Right Ingredients

The turnaround team understood that, unfettered from the dead weight of Red Restaurant Group, Red South Beach—with Vauthy in the kitchen—could be profitable and successful on its own. Upon BJRP's Chapter 11 filing, Red South Beach's legal and financial turnaround professionals quickly went to work. The first task was to fully analyze the revenue and expenses of the business. Fully understanding the cash situation was critical to Red South Beach implementing a near-term structure necessary for the business as it transitioned ownership. The team focused on critical vendors to maintain operations.

The team then turned to analyzing the multitude of relationships between Red South Beach, BJRP, and its lenders and vendors. Multiple discussions ensued with all the parties, and lines of strategy were formulated by the team. Red South Beach contemplated filing its own Chapter 11 case, but the principal secured lender did not want to impair its ability to credit bid the full value of its loan in BJRP's Chapter 11 case. Absent another strategy, this position would result in effectively forcing Red South Beach to permanently go dark.

It soon became apparent, however, that Red South Beach's landlord wanted to continue the business as a going

John Guzzardo is a partner in HMB's Bankruptcy, Reorganization and Creditors' Rights Group and chair of the firm's Litigation Group. He represents debtors, creditors, trustees, and receivers in local, regional, and national proceedings in Chapters 11 and 7, with a strong emphasis on complex bankruptcy litigation matters.

Nathan Delman is an associate in HMB's Bankruptcy, Reorganization and Creditors' Rights Group. With more than a decade of experience, Delman has handled matters of all sizes, but his practice focuses on business reorganization and the protection of secured and unsecured creditors' rights in insolvency situations. He is also the firm's resident resource on personal bankruptcy.

John Pidcock is the founder of Oxford Restructuring Advisors LLP. With more than 20 years of restructuring experience, he provides crisis management services to underperforming companies and constituencies, including interim management and debtor advisory, bankruptcy preparation and management, post-merger integration, debt restructuring and refinancing, and post-confirmation creditor advisory. Pidcock was previously with Conway MacKenzie.

concern and without interruption. The landlord's costs of carrying empty space and remodeling for a new tenant in a worst-case scenario served as a great incentive for a consensual resolution.

With this motivated partner, Red South Beach and Vauthy found their lifeboat. Florida law grants landlords a statutory lien for unpaid amounts going back to a lease's start date, which in Red South Beach's case was April 2007, well before the senior lenders entered the picture. The landlord maintained a good relationship with Red South Beach's management but, to protect itself, reluctantly filed an eviction action against the restaurant in October 2018. The turnaround team recognized that if Red South Beach's operating company was properly evicted, the landlord could foreclose its statutory lien on the vast majority of the restaurant's working assets—including everything essential to continuing that business.

A new entity, Bisteca LLC, was formed as the investment vehicle in a "new" Red South Beach with Hammer as its managing partner. Bisteca brought new capital to invest and provided the landlord with an upfront lease origination fee and signed a new five-year lease on substantially improved financial terms for the restaurant. Bisteca subsequently entered into a licensing agreement with YLT in Cleveland to use the Red name and related intellectual property. The landlord then moved ahead to evict "old Red" so that Bisteca could take the wheel on a "new Red" with a substantially deleveraged capital structure.

A Rare Strategy

On a sunny mid-November morning, Vauthy and the entire Red South Beach staff waited nervously outside the premises as the Dade County Sheriff served notice and changed the locks on behalf of the landlord, formalizing and finalizing Red South Beach LLC's eviction. After a stressful (but successful) three-hour negotiation with the landlord over the final lease terms, Bisteca took possession of the space. Service continued that night without missing a beat. Through deft maneuvering and a restructuring team that envisioned and executed an entirely custom workout strategy, Red South Beach, and nearly 50 jobs of treasured staff, were saved.

The next 16 months saw unprecedented stabilization in the business. Free of the weight of the failed decisions of RRG and with most legacy debts now resolved, "new" Red South Beach could now spread its wings. Improvements were made to the space in the form of additional private dining space, among other things. By all accounts, the turnaround of Red South Beach was successful and complete. But, most importantly, the financial rehabilitation in 2018 gave the enterprise the breathing space and room it needed to maneuver when COVID-19 hit just over a year later.

Despite the current circumstances, Red South Beach and its turnaround team are confident that the restaurant will resume operations as a growing, robust, and vibrant business. In fact, Red South Beach is even planning to expand its reach with a second restaurant several blocks from its current location. The new venture will feature signature burgers and sandwiches, and a line of craft beers and handcrafted cocktails. By the time the quarantine recedes, the company hopes to have its lease in place, investment capital lined up, and a signature menu finalized.

To resuscitate this struggling business, the turnaround professionals employed a strategy that was not immediately apparent and typically used in restructuring an enterprise of this size. Though the solution may not have been on the menu, sometimes the right turnaround team can prepare the perfect recipe.

[1] See, *e.g.*, businessinsider.com/1-in-5-restaurants-could-close-due-to-coronavirus-ubs-2020-4.

[2] Roughly 20% of this revenue related to Red South Beach's rooftop operation, which was permanently shuttered by local noise ordinance in 2013.

WHEN A CRISIS STRIKES, A BOARD MUST BE UP TO THE JOB

BY JAMES D. DECKER, FOUNDER, JDECKER & COMPANY INC.

When a company is in a crisis, it needs to make sure it has a board that can meet the task. Some crises develop over time due to shifting markets, deteriorating profitability, or lack of access to capital. As is happening today, the other form of crisis can be characterized as a "Grey Rhino" event (highly probable, high-impact but otherwise neglected events).

In either case, a crisis threatens the survival of the organization and is characterized by obscure causes, effects, and a lack of an apparent solution. There will be a demand for fast-track decision making, as a crisis creates moments of truth for an organization and is often an existential threat. It is important that the C-suite and the board acknowledge that the company is in crisis, which threatens its viability, and have a plan for dealing with the challenge.

Boards often lack a complement of directors with crisis expertise for fear of sending stakeholders a worrisome message: there is something wrong. However, a crisis is the ultimate test of resilience for any institution, its board, and its top executives. Senior executives and directors have exposure to continuous external scrutiny from the media, the legal profession, regulators, and other stakeholders for months or even years during and after a crisis. These compounding pressures force boards and senior management to act quickly to appease anxious or angry stakeholders. However, uncertainty compromises the ability to respond promptly due to the lack of information regarding the cause and effects of any action.

If a board does not have directors with the right skills to address a crisis or there are conflicts of interest which may interfere with that, it becomes critical to add

independent directors who have those skills and are free of conflicts.

McKinsey identified four critical fault lines that pose a severe threat to a board's effective crisis response:

1 Overreliance by the board on the CEO or senior management. A board that is unwilling to check or challenge senior management for fear of crossing the line into operational activities is failing in its governance responsibilities. Candid, or as some may call it, "carefrontational," conversations enable directors to avoid poor judgment calls by management

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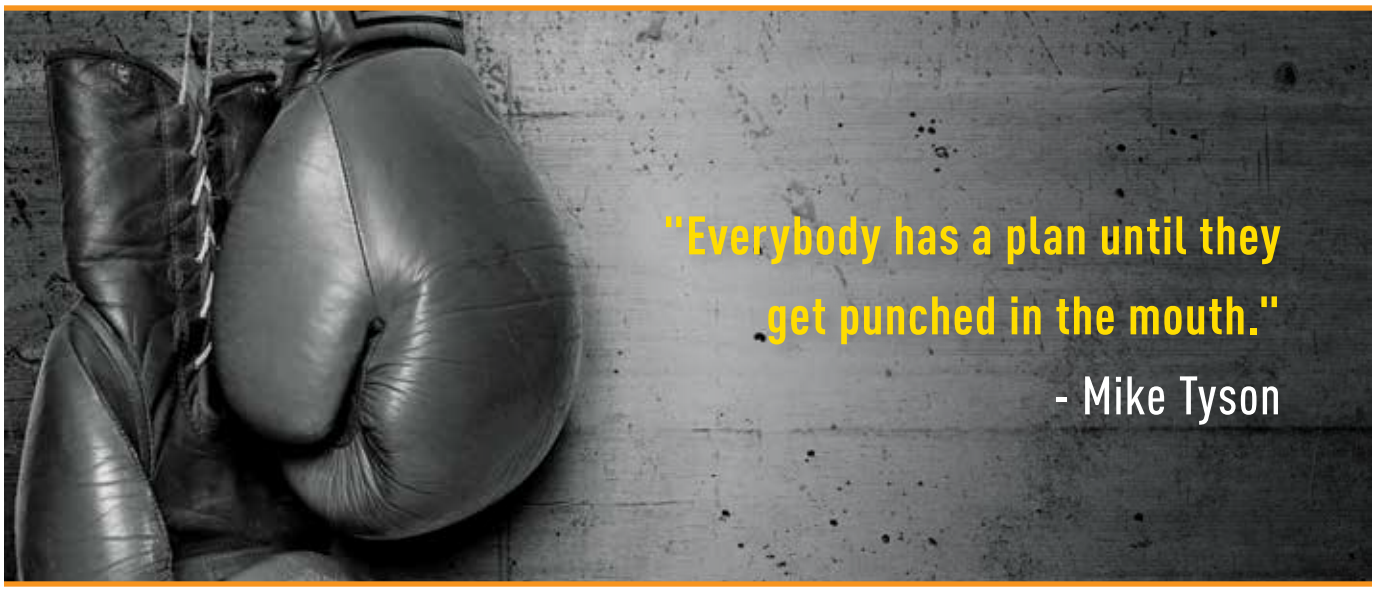

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and leave them better able to act when a crisis occurs.

2 Micromanagement by the board. An equally significant and opposite problem is micromanagement by the board. Board members seeking a direct say in the management process because of their prior executive positions can cause chaos in the organization. While there is pressure to act quickly and decisively, a board's role is one of oversight, not management. If it is apparent that the leaders are not up to the task, board members must reserve the right to step in and steer the organization. In such circumstances, boards will take on some operational responsibilities and make decisions that would otherwise fall within management's purview.

3 Complicated dynamics within the board. Crises are an accelerant to all relationships. A crisis can expose an existing board's dysfunction or lack of clear leadership. Boards tend to spend too little time addressing such issues before the onset of a crisis. Given the few times that directors meet, there may be a lack of trust and questions regarding each member's strengths and weaknesses. If the CEO, rather than one of the directors, is the leader of the board, it may worsen board dynamics.

4 Imperfect information flows between management and board. During a crisis, there is a natural conflict between the board and management. The board wants more data to meet its fiduciary duty of staying informed to make decisions and demonstrate a duty of care. Management, which is seeking to fix the problem and minimize distractions, doesn't want to commit the time and energy to meet the board's demands. Too many board demands can hamper management performance, but a failure by management to provide sufficient information to the board damages trust.

Assuming that a company's board doesn't have any of these potential fault lines, the next issue is dealing with the crisis.

Mike Tyson once said, "Everybody has a plan until they get punched in the

mouth." Crises fundamentally change the terms of engagement among boards, senior management, and creditors, forcing all groups to make difficult decisions, including whether significant changes to the senior executive team or the board are required. When leveraged companies find themselves in default, it is common for their lenders to demand as a condition to forbearance that one or more independent directors be placed on the board.

In a crisis, lenders want a board capable of making tough calls, such as:

1. Who should lead the crisis response team?

2. Should a special committee or restructuring committee of independent directors be appointed and granted decision-making authority to ensure the right balance of speed and oversight?

3. Is the senior management team up to the task, or are significant changes necessary?

4. Is the board's broader composition right? Should members who have potential economic conflicts or who can't add value leave? Are additional, independent members needed to help the company respond and recover?

5. What are the immediate shifts required within the board's composition and roles?

6. Does the board need to establish the principles to guide the organization's response and recovery?

To manage these calls and other tasks, boards need to consider the following.

The Buck Stops Here. Responsibility for proper crisis response rests squarely on the shoulders of the board and management. If heads roll, it will not only involve management but the board as well.

Directors Must Understand their Fiduciary Duties. The primary duties are the duty of care and the duty of loyalty. Legal counsel should be consulted if only to remind directors of these duties and help avoid problems down the road.

Proactivity Is Needed. The board must get out in front of the problems on its own. If the board is only reactive, it fails to exercise its proper governance function. To be proactive, board members need experience in dealing with a crisis similar to the one the organization is facing. A public relations crisis is not the same as dealing with a financial crisis. The board needs to ensure that among its members, it has turnaround and restructuring expertise.

Appropriate Levels of Intrusive vs. Hands-off Governance Are Required. The old governance mantra "noses in, thumbs out" no longer applies. Every board must find its new balance with management on how to increase its oversight to appropriate levels and provide expertise where needed.

Risk Committees Are Insufficient. Boards need to look at risk metrics but also must leave room to consider anecdotal data and information that percolates up through the organization. The committee must be open to all of these data sources rather than be guided only by management's statistical reports and data.

Emerging Risks Must Be Monitored. Reporting on emerging risks is essential to avoid being caught flat-footed, and thus appropriate expertise is critical. A CFO who has not experienced a financial crisis can better respond to it with input from a restructuring expert on the board.

Immediacy Is the Rule. In a crisis environment, boards and management aren't allowed the luxury of time to make decisions. Responses must be formulated quickly, even if only to say, "We don't know yet but are doing everything in our power to find out immediately. We will stay in close communication with you as we do." Direct experience is essential during a crisis, as the time element is critical. Having resources that have real-world experience can make the difference in executing plans successfully and knowing what is time-critical and what is deferrable.

A Firm Moral Center for the Organization Is Needed. The board can inspire the right kind of action and attitude throughout the organization and help the company recover from the crisis with its reputation not only intact but more robust than ever. Laying off employees and not paying suppliers raises issues. The manner with which the organization handles the crisis is critical for the firm's reputation. A botched response may result in the company being unable to attract talent in the future or to obtain credit from critical suppliers.

The board's responsibility is not to step into managements' role but to:

- Carefully question management regarding the reliability of information and its plans
- Assess and advise management on its handling of the crisis
- Provide assistive feedback to management as appropriate

A board that lacks experience in dealing with the impact of a crisis may be hard-pressed to fulfill these functions. Experience can help the board probe management effectively to discover hubris and blind spots. A board that lacks these qualities should consider adding independent directors with the appropriate skills and experience to respond to critical situations.

James D. Decker is the founder of JDecker & Company, which is focused on corporate governance, distressed transactional advisory, and litigation support. He serves on numerous boards as an independent director and often as chair of special committees and restructuring committees. Over his 30-year career in investment banking, Decker has advised more than 150 companies involved in restructurings, distressed M&A, and special situations financings, both in and out of court.

EAGLE-EYED *John R. Bise*

PRINCIPAL, BISE BUSINESS ADVISORY LLC | TMA MEMBER: 12 YEARS

Q How did you gravitate into turnaround/restructuring work?

BISE Early in my career, I was a commercial banker, and then I worked with a couple of small venture capital funds. In each of those settings, I had occasions to work with distressed firms.

At the time I was leaving my last regular job, the fund was realizing that a company we had invested in was showing signs of trouble. I was engaged to assess the state of the business more closely and to work with the CEO in establishing priorities. That engagement proved to be fascinating. They had several lines of business that I looked at comparatively, and I also looked at managerial capabilities and organizational effectiveness. I loved being able to arrest the deterioration that was happening in some areas, address some of the leadership gaps, and help them to right the ship.

That led me to pursue more of those engagements, and I picked up assignments in restructuring feasibility, some operating problems, and some litigation matters. That was almost 20 years ago, and today I'm still working with some of the people who were attorneys, lenders, or investors in some of those early engagements.

Q Particularly in this industry, you have to trust the people you're working with, and they have to trust you. Once that trust is established, it keeps a good pipeline of business open.

BISE It does. A lot of what we do involves not only looking at cold facts but also making judgements about the business, about management, and about what's feasible. You have to have the trust of the folks that you're working with, whether it's an outside investor or lender or whether it's the business itself. One of the things that is critical to me is to win the confidence of the folks who are not specifically those who have engaged me. I've had instances before in which I've been engaged or recommended by a lender, and a business might engage me guardedly. You have to win their confidence by convincing them that you're there to help, not to be a Trojan horse coming in to stage some sort of surprise attack.

Q What have been some of your favorite or most gratifying engagements along the way?

BISE In one situation, I was recommended by a worried lender to co-owners of an underperforming borrower. Financial results were deteriorating. Cash was dwindling. They were past due on loans. The owners were at odds with each other, and one of the owners was on the cusp of divorce. All around, it was a mess.

Early on, I discovered that the owners didn't know the distinct profitability or cash requirements of each of their three lines of business. As it turned out, the clients' accounting system had divisional capabilities, and the bookkeeper was actually maintaining the records in such a way that getting segmented results was not difficult. We were able to establish in fairly short order that one division was operating badly in the red without the owners even realizing it. We established a plan to exit that segment.

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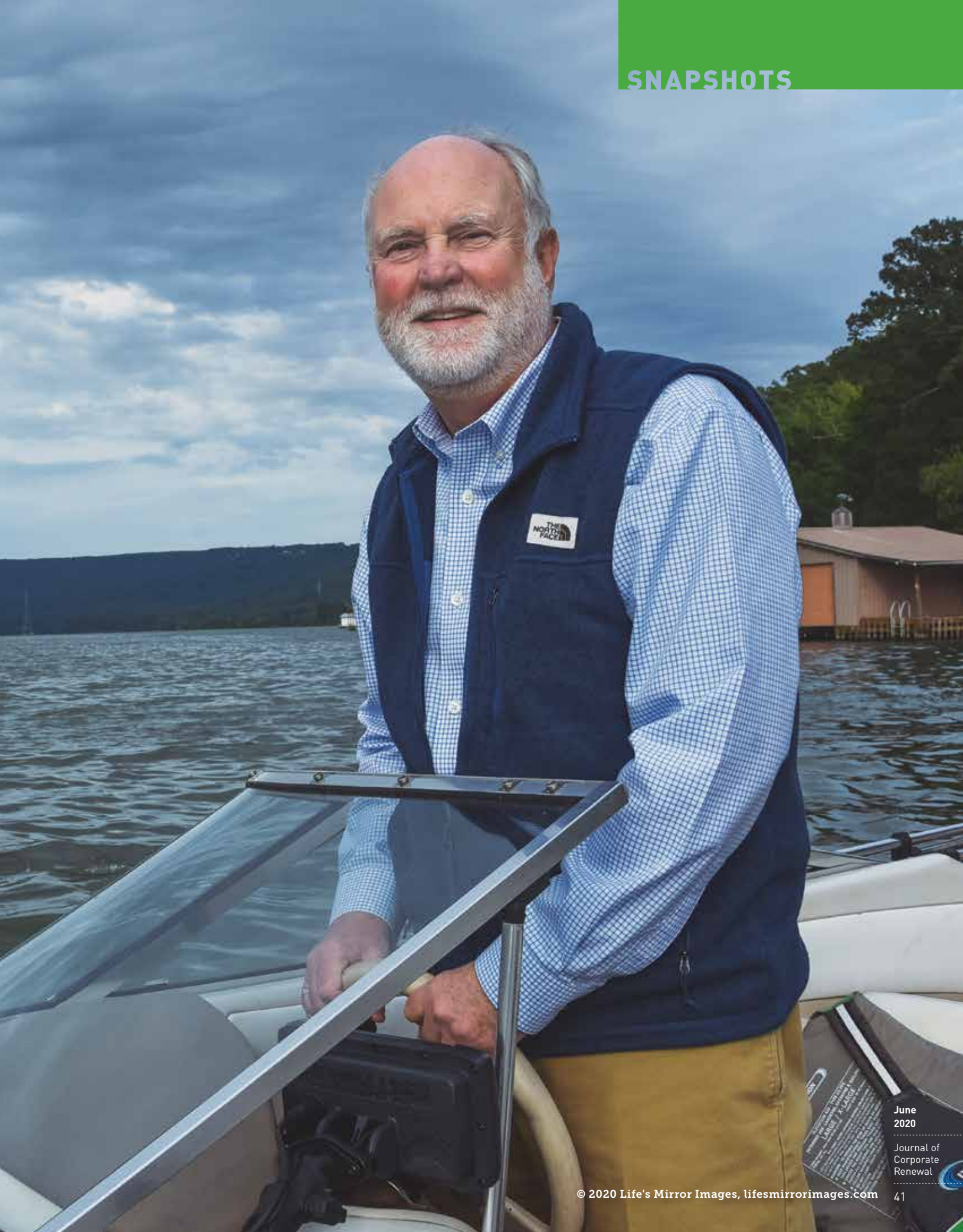

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Then I had to convince the owners that disclosing this to the bank and the fact that there would be some losses on disposal of assets was necessary. Ultimately, they agreed to do that, and we were able to secure some temporary concessions on debt service requirements and avert what certainly would have been a disaster if we hadn't taken intervening measures.

It was gratifying because it was clear that if the business went down, the owners were going to be wiped out and the lender would have suffered a big loss. That probably would have been the last straw in breaking the marriage of one of the owners. It's satisfying to be able to help in that kind of situation and at least give people a good chance to continue on a favorable footing.

Q Did they not want to give the bad news to the bank because they feared the bank's reaction?

BISE The owners of this company felt that if they disclosed to the bank that they were going to lose money in selling some unnecessary assets, it would terrify the bank. I had a pretty candid conversation with them and said, "Look, the bank is already concerned. You shouldn't be surprised by that. They're going to be pleased with the fact that you know what's causing your problems and you've got the ability to resolve this, even if you take some losses in disposing of these assets. They want you to generate cash so that you can service their debt and proceed as you'd originally planned."

Maybe it's a bunker mentality that troubled business owners get into, but they almost seem to have the attitude that if they keep their heads down and their mouths shut, nobody will discover what's happening. The reality is that, to a lender, silence from an underperforming borrower does nothing but heighten concern. A lack of candor does nothing but foster mistrust. I'd much rather go to a lender with bad news and a plan to address the situation than I would to try to keep my head down and just hope that nothing bad is going to happen.

Another situation that I enjoyed involved a debtor who had tried to exclude from her bankruptcy estate an interest in an operating concern that was one of several entities in that estate. She had placed de minimis value on her interest in this company and tried to preserve the benefit of her ownership through her spouse, whom she indicated owned a piece of it. Under Florida law, there was a stay that prevented foreclosure on the business as a whole. They were simply milking the cash out of the business by a combination of salaries and bonuses, and preventing the creditors from being able to recognize any value out of that part of the estate. I was able to provide counsel with some evidence that ultimately was helpful in getting the court to rule that the debtor had acted fraudulently. That ruling afforded creditors a pathway to recovery.

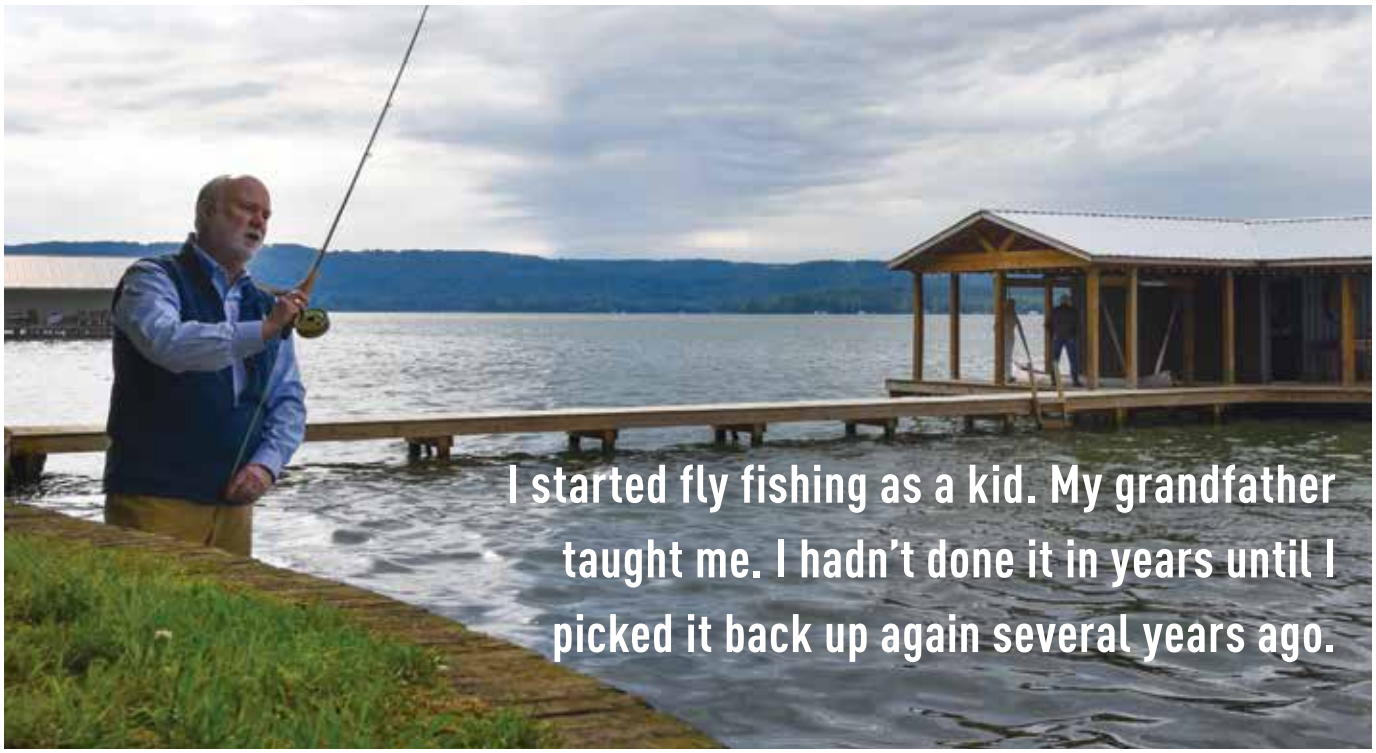
Q Judges love to get information like that.

BISE I remember when the ruling came in, the attorney in the case sent me a copy and said, "You should frame this and put it on your wall."

Q What key milestones in your career do you think have made you the professional you are today?

BISE There are two things that I would point to. They were not so much events as they were realizations on my part. One was realizing the importance of simplicity. A litigated case in Bankruptcy Court early in my career involved a pretty complex analysis to work through the problems of the debtor's business. Counsel urged me to do everything I could to simplify the presentation of the analysis.

I ended up reducing a pretty complicated situation to two or three simple, illustrative graphs, and those proved to be easy to communicate and easy for the court to understand. I have continued to use that approach with success. Often, there is a lot of complexity and noise, but in the end, if you can distill that information down to a few salient



points, that's significant. That was a great lesson for me to grasp and hang on to.

The other realization I came to was an issue of perception and understanding. It goes back to the mindset of dealing with troubled individuals and realizing that renewal is not just about fixing or resolving an immediate problem. It's something that's restorative for all involved, even though it can be pretty painful.

The immediate parties will always have the perception that somebody's a winner and somebody's a loser. But the reality is that none of the situations we go into are sustainable as they exist when we're engaged. Our job is to work toward a resolution, which means getting to something that is sustainable and, in the end, serves all parties because it results in a pathway to lifting the threats that drag on the business and harm its investors, lenders, and personnel.

Make no mistake, there's going to be conflict, and it's necessary to work through those things firmly. But ultimately, renewal ends up leading to some kind of health. When you see renewal as a means of healing rather than a conflict over what could become the scraps after a big battle, that makes a big difference in my mindset and, I think, in my effectiveness. I see that realization as a milestone.

Q Did both of those realizations come to you early in your career, or was it later on?

BISE The issue of simplicity came to me fairly early in my career in terms of restructuring. I'd say the realization about understanding the perceptions of the deeper impact on individuals probably took a while longer. It's easy to go in with the mentality that this is a war and put on flak jacket and helmet and fight. But the truth is that you've got to get cooperation from people, whether it's to get information or to implement new plans. I'd say the latter of those two realizations probably took me a little longer to get to than the first one did.

Q What role has your TMA membership played in your career? You've been a TMA member now for almost 13 years.

BISE I don't recall if I was a charter member of the Alabama Chapter or I joined shortly after the formation of the chapter. TMA has really been, first of all, a good professional network, giving me colleagues that I can look to and, at times, compare notes with. It's a source of referrals and a source of shared learning and insights. I enjoy the development that I pick up both through thought-provoking programs at our chapter meetings and also information that I'm able to pick up through the *Journal*. I find all of those things to be helpful.

Q What advice would you have for someone who was new to the industry or was thinking about getting into it?

BISE One, be prepared to live with conflict. In a distressed situation, there are always going to be differing views as to what led to the problems, and the stakes are generally high for those that are involved. Frequently, folks think it's in their best interests to either withhold information or to fight about things that, frankly, are secondary to healing the business. Understand that that's something you're going to encounter frequently.

Secondly, I'd tell them to consider their willingness to be a contrarian voice because of the turf protecting that goes on and the feeling of guardianship of one's personal position or interest. You have to be prepared to learn about information or develop opinions that sometimes are going to be contrary to what your client or somebody else in the room wants to hear. You have to be willing to deliver those facts or recommendations, even if they conflict with what the client or whoever you happen to be working with at the moment hopes to hear.

You also have to be prepared to take actions that will be opposed by some party in the case. Dealing with that conflict and also being willing to be a contrarian are both significant items.

The third piece of advice I'd offer goes back to something we were speaking about a moment ago: Always be aware of the personal interests and costs to the parties in your cases. People are key. You often have to have those people to get things done. But because the impact on the people, the business, the lender, or the investor can be so substantial, it's frequently necessary to take actions that are hard and can be distasteful both in the doing of them as a professional

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but also to the people in the business. Understanding the impact of those things on them and being willing to acknowledge those difficulties can certainly help in easing tensions, getting cooperation, and making progress.

Q Let's talk a bit about what you're passionate about outside the office. You had mentioned you have a cabin. When did you acquire that?

BISE About three years ago, my wife and I bought an old cabin. I laughed and said we found a tiny, rundown cabin on a pretty lot. I think it was actually a Sears house. I didn't realize it at the time, but Sears used to sell home kits. It was an older house in fairly shabby shape, but it certainly was workable.

When we were looking at it, my wife said, "We can use this just the way it is!" Of course, an hour after the seller accepted my offer, she said, "The first thing I'd like to do ..." But little by little, relying on her talent as a designer, we rebuilt the cabin and then rebuilt the boathouse and dock and ultimately acquired a boat. It's an old Larson inboard/outboard.

The cabin is located on Lake Guntersville, which is a popular bass fishing lake near Scottsboro, Alabama. It's part of the TVA (Tennessee Valley Authority) system of hydroelectric power lakes along the Tennessee River. I would guess that where we're located, the lake is about a mile wide. It's used for commercial traffic, principally barge traffic, but there's a lot of fishing there. It's also an area that has a number of eagles.

My wife and I really enjoy getting out in the boat and exploring the lake or simply enjoying the magnificent sunsets. When we have children and grandchildren in town, we love to play on floats and pull them around. When it's just the two of us, we enjoy finding nests of eagles and using binoculars to watch the eagles from a distance. It's amazing to watch an eagle dive out of flight into the water and come up with a fish, and then watch them take it back to a nest and see little eaglet heads pop up.

Q Are they bald eagles or some other type of eagle?

BISE They're bald eagles. There's a state park that's probably 10 or 15 miles below us on the river. A couple of times a year, they host events for eagle watching. We have some neighbors with whom we sometimes do this eagle watching. They were telling us that a couple of weeks ago they went out and found nine eagles in one afternoon.

It's pretty cool to watch them. They are big birds. It's really extraordinary to imagine these birds flying and having the eyesight to see a fish beneath the surface and dive into the water and come up with a fish that weighs several pounds.

Out at the lake, I also enjoy fly fishing. It's a lake that's known for bass, but I enjoy fishing for bream with dry flies. We have a little area close to our dock that seems to be a nesting spot. I sometimes go out there at dusk, and I've had instances where in two hours I'll pull out 20 fish. Sometimes they're tiny bream, but they're still fun to catch on a fly rod. Pull them in, take them off, throw them back in, and look for another one. That's a good day.

Q How long have you been fly fishing? That's quite an art.

BISE I started fly fishing as a kid. My grandfather taught me. I hadn't done it in years until I picked it back up again several years ago. It's a lot of fun. I've mostly done dry fly fishing in still waters of lakes, but I've had occasion to do some wet fly fishing for trout in fast-moving waters as well, and that's a blast.

Q For those of us who know nothing about fly fishing, what's the difference between dry flies and wet flies?

BISE Dry flies float on top of the water, and wet flies are made to go beneath the surface. A type of dry fly is a popping bug. Generally, the body of the bug that's being mimicked by the lure is made of wood or cork, so it floats and it's fun to see the fish hit the bait. There are other dry flies that float, but typically you put a little powder on them to keep them buoyant and resist the inclination to sink.

Q What might people who only know you professionally be most surprised to learn about you?

BISE I think they would be surprised to find that I spend time away from the office doing dispute resolution in my church. I'm a Christian, and my church has a process for dispute resolution. Regrettably, disputes and arguments exist in the church, just as they do in society as a whole.

I try to help folks in the just and reasonable resolution of those quarrels, and do so within the framework of those structures.

Q These are quarrels within the church, not family dispute issues?

BISE Generally, it's not a family dispute, though it could be. Frequently, it may be a dispute between people within the church, or there may be someone in the church who is aware of someone else they feel is doing something wrong. We encourage them in that kind of situation to first approach the person and deal with it privately.

Sometimes it involves a dispute between an individual and policies of a particular church or a decision made at a particular church. They may disagree with it for any number of reasons, but ultimately, just like in a distressed business situation, you need to resolve it in a way that's reasonable and just and proper and fair to all concerned. I enjoy being part of that, even though at times it can be stressful. You can see the stresses on the involved individuals.

Q Does it put you in a position of being blamed as the messenger?

BISE Sometimes that happens. Generally in those situations, I'm not the sole person trying to help with resolution, so you do get sanity checks by working with other people.

Q How long have you been doing that?

BISE I've been doing it at various levels for quite a while. I've been doing it more intensely for the last six or eight years.

Q Maybe your turnaround/restructuring background makes you particularly well-suited for that position.

BISE There are certainly some commonalities with respect to the two—the willingness to listen and to try to understand, to try to empathize and dig beneath the emotions to the underlying facts, and then to gauge those on the basis of the necessary elements, whether it's in business or whether it's an issue within the church or another organization. J

TMA TALKS

INTERNATIONAL COMPANY TURNAROUND OF THE YEAR WINNER FOCUSES ON IMPROVING PROFITS

Welcome to TMA Talks, a regular series of podcasts. Each segment features prominent TMA members, industry experts, and other special guests. These exchanges, edited transcripts of which are printed in the *JCR*, offer insights into key markets, forward-thinking economic outlooks, insider thoughts on industry trends, and much more. TMA Talks podcasts are available on the TMA podcast channel. Subscribe to our channel wherever you find your podcasts.

ANDREW SCURRIA I'm Andrew Scurria with the *Wall Street Journal* here at The TMA Annual Conference in Cleveland, and this is TMA Talks. I'm here with Fabris Perusko, CEO of Fortenova, the former Agrokor. You're being recognized with a TMA International Company Turnaround of the Year Award as part of a team for the restructuring of Agrokor. Could you please tell me a little bit about the business?

FABRIS PERUSKO Agrokor is one of the largest companies in Southeast Europe. We are a business which is present in the retail and food production areas. We are a $5 billion-plus company in revenue and employ more than 50,000 people in Croatia, Slovenia, Bosnia, Serbia, and Montenegro, an area of 20 million people.

In 2017, the company entered into a bankruptcy procedure. We had 7.5 billion euros of debt, which was restructured during the procedure. To give you just a little bit of flavor how important the company is for the regional economy in terms of the number of employees, our bankruptcy would be like a bankruptcy of two Volkswagens in Germany.

We represent for all five countries around 1% of GDP, except in Croatia, where we represent about 2% of overall GDP and around 4% of state budget revenue. As for the size of the restructuring, I would like to highlight that this, after Parmalat, was probably one of the largest cases, especially in the food production area. Parmalat was a 14-billion-euro case. On April 1, 2019, the settlement was implemented, and we continued our life as Fortenova Group with restructured capital and debt structures.

ANDREW Can you tell me a little bit more about the terms of the restructuring that allowed the company to exit bankruptcy?

FABRIS In the first month of the bankruptcy procedure, we received financing of 1.06 billion euros of debt, out of which half was fresh cash and half was elevated old debt. This liquidity was used to continue operations. As for the rest of the debt, the secured debt was reinstated into new terms, and the rest was transferred into equity.

In the meantime, during the procedure we were working on making sure that all of our creditors were secured from the legal position. We achieved recognition of the procedure in England, Switzerland, of course in Croatia, and, at the end, based in Chapter 15 in New York, because those four legal systems were where all of our creditors had their contracts with the old Agrokor. So, bondholders were based on New York law, a majority of the international credit was done based on English law, and the local creditors were based on Croatian law.

ANDREW Can you tell me a bit about the competing geopolitical interests in this case? Some institutions, I understand, were from different countries, and how did that work out?

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FABRIS Two of the largest individual creditors were two of the largest Russian banks, Sberbank and VTB Bank. On the bondholder side were mostly Western or U.S. funds. During the procedure, as I mentioned earlier, we got a senior facility which was used for liquidity. A quarter of that facility was also owned by VTB, the second largest Russian bank, and the rest was owned by European banks or U.S. hedge funds.

ANDREW At what point did you get involved in the case, and what was your role exactly?

FABRIS At the beginning of the procedure in 2017, one month after the procedure started, I was invited by, at that time, the extraordinary commissioner to run the restructuring of one of retail companies. Then when the extraordinary commissioner resigned in February 2018, I was invited to take the role of extraordinary commissioner. Otherwise my background was in restructuring, first in McKinsey, where I was part of a restructuring practice, and later on, I worked for a couple of private equity firms in a similar space.

ANDREW Fortenova, I understand, remains a pretty highly leveraged company operating in a challenging environment. What can you say about its strategy going forward to remain viable and generate operating profits, especially as we think about potentially a global recession on the horizon?

FABRIS We exited the extraordinary administration with 6.2 debt to EBITDA leverage. Three weeks ago, we finalized refinancing of 1.2 billion euros debt with new terms. The financing was done with HBS as a main creditor. Right now, the whole focus of management is to improve profitability in our three major verticals.

In retail, we are focusing on improving profitability mostly through operational improvements. The company grew through acquisitions, but post-merger integration was never done properly, so we are focused on that. In our food vertical, where we are making almost 1.2 billion euros of revenue, we are focused on improving revenue and on operational improvements to improve our profitability. And in agriculture, where we are making almost 400 million euros of revenue, we are focused on improving the return on invested capital. Previously, the company spent significant capital in different investments in agriculture, but unfortunately, returns were not done properly. Now with a new capital structure, I hope this will be possible to achieve.

Tell us what you want to hear on upcoming TMA Talks. Send your thoughts, ideas, and comments to TMA Global CEO Scott Y. Stuart at sstuart@turnaround.org.

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