Protecting Lender Rights Before a Borrower Files Chapter 11

Oct 15, 2026

Categories:

Banking On It Publications

Authors:

Jared M. Tully

This is the second article in a three-part series examining the litigation risks lenders face as commercial loan defaults rise and lessons from recent cases that can help lenders strengthen their recovery position. Brought to you by the team behind our Banking On It blog.

Borrowers rarely enter Chapter 11 unexpectedly. Typically, the warning signs are visible for months or even years before the petition is filed. Covenant defaults accumulate. Financial reporting becomes sporadic or unreliable. Vendor relationships fray. Liquidity tightens. Management turns over. For the attentive lender, these signals present not just a credit concern but a strategic opportunity.

The most important bankruptcy planning often occurs before the bankruptcy is filed. That was a central tenet in part one of this series, which addressed the top litigation risks confronting special asset officers in today's lending environment. The reason comes down to timing. Lenders have a limited window between the first signs of distress and the moment the borrower's counsel files a Chapter 11 petition, and what the lender does during that window will shape its position for the entire duration of the case. The lender that uses this period to review its documentation, build its litigation record, and develop a coherent strategy will be in a fundamentally different position than the lender that simply reacts to the filing.

Recognizing Early Distress Signals

Effective prepetition planning begins with early recognition of distress. The most obvious signal is a covenant default, such as a missed financial ratio, a breach of a borrowing base certificate requirement, or a failure to deliver audited financials on time. But there are softer signals that experienced special assets professionals learn to watch for: increasing requests for waivers or amendments, delays in responding to information requests, key management departures, and vendor complaints about slow

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

FBT Gibbons

payment.

Liquidity concerns are especially telling. When a borrower begins drawing down on revolving credit facilities at an accelerating pace, or when it begins seeking alternative sources of financing, a future bankruptcy filing often becomes increasingly likely. The borrower may not yet be insolvent, but it is moving in that direction, and the lender's window for prepetition action is closing.

Early recognition is critical because the actions a lender can take before a bankruptcy filing are far broader than those available after filing. Before filing, the lender can exercise remedies, sweep accounts, terminate commitments, demand additional collateral, and engage directly with the borrower to restructure the credit relationship. After filing, the automatic stay precludes virtually all of these options. Early recognition of distress and decisive action is a meaningful strategic advantage.

Reviewing the Loan Package

The first step in prepetition planning is a comprehensive review of the loan documentation. This sounds simple and basic, but beginning with a thorough understanding of the loan documents to guide your planning is essential.

The review should encompass every material document: the credit agreement, all amendments and waivers, security agreements, guaranties, intercreditor agreements, and UCC financing statements. The critical questions are straightforward but essential:

- Is the collateral properly perfected?
- Are all UCC filings current, including continuation statements?
- Have any guaranties been inadvertently released or impaired by subsequent amendments?
- Are all defaults properly documented in writing?
- Have any remedies been waived by course of conduct or by the terms of a forbearance agreement?

This is also the time to confirm that the lender's security interest extends to all assets the lender believes it covers. Collateral

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

descriptions that were adequate at origination may not capture assets acquired since closing. Intellectual property, deposit accounts, and equity interests in subsidiaries are commonly overlooked categories that can represent significant value in a bankruptcy.

Building the Litigation Record

Prepetition conduct drives future bankruptcy disputes. The record a lender creates through its pre-filing communications, enforcement efforts, and documentation practices will be scrutinized in virtually every contested matter in the bankruptcy case.

Written communications should be precise, consistent, and drafted with the understanding that they will likely be read by a bankruptcy judge and certainly be read at a deposition. Default notices should be clear and unambiguous, citing specific provisions of the loan agreement. Forbearance agreements should be carefully documented with explicit reservations of rights. Amendment documentation should be clean, complete, and consistent with the lender's stated positions.

Enforcement efforts should also be documented contemporaneously. If the lender exercises remedies such as sweeping accounts, applying proceeds, or terminating commitments, those actions should be supported by written records demonstrating that they were taken in accordance with the loan documents and in good faith. A well-documented enforcement record is the best evidence against allegations of bad faith, inequitable conduct, or violations of the automatic stay.

Preparing for Chapter 11 Litigation

Once a lender has determined that a bankruptcy filing is likely, it should begin preparing for the specific litigation arenas that define Chapter 11 cases. The most immediate is typically the cash collateral fight. From the first day of the case, the debtor will seek to use the lender's cash collateral to fund operations, and the lender must be prepared to articulate its adequate protection requirements,

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

including replacement liens, adequate protection payments, and financial reporting obligations.

Preference actions are another foreseeable risk. Payments received by the lender within 90 days of the filing, or within one year for insider transfers, are subject to avoidance unless the lender can establish an applicable defense. The ordinary course of business defense, the contemporaneous exchange defense, and the new value defense all require evidence that is best gathered before the filing, not after a preference demand is received.

Valuation disputes are a recurring feature of Chapter 11 cases, affecting everything from adequate protection to plan confirmation. Lenders should begin developing their valuation positions prepetition, engaging appraisers and financial advisors who can provide credible, defensible valuations of the collateral. Fraudulent transfer litigation, while less common, can also be anticipated in cases involving leveraged acquisitions, dividend recapitalizations, or intercompany transfers that may have occurred while the borrower was insolvent.

Special Considerations for Syndicated and Participation Loans

Prepetition planning becomes significantly more complex when the loan involves multiple stakeholders. In syndicated credit facilities, intercreditor agreements and participation agreements create a web of rights and obligations that must be carefully navigated. Voting rights, consent requirements, and the administrative agent's authority to act on behalf of the syndicate all need to be clarified before a filing occurs.

The most common source of dysfunction in syndicated loan workouts is a failure to coordinate strategy among the lenders before the filing. Different lenders may have different risk tolerances, different recovery expectations, and different views on whether to support a restructuring or push for liquidation. These differences need to be understood and addressed prepetition, when the lenders still have the ability to negotiate among themselves without the constraints of the bankruptcy process.

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

Administrative agents should confirm their authority to take enforcement actions, retain counsel, and make litigation decisions on behalf of the syndicate. Participation agreements should be reviewed to ensure that participants' rights and obligations are clearly defined. Syndicates that enter bankruptcy with a unified strategy and clear authority structures will certainly achieve better outcomes than those that are still debating their approach on the first day of the case.

Key Takeaway

A bankruptcy filing should not mark the beginning of a lender's strategy. Rather, it should be the next phase of a strategy that began much earlier. The most important bankruptcy planning often occurs before the bankruptcy is filed, during the period when the lender still has the full range of prepetition tools and remedies at its disposal.

Lenders who use that prepetition window to review their documentation, build their litigation record, prepare for specific Chapter 11 disputes, and coordinate with co-lenders will enter the bankruptcy proceeding from a position of strength. Those who wait for the filing to begin their planning will spend the early weeks of the case scrambling to catch up.

The next article in this series will examine some of the major crypto bankruptcies and the lessons they hold for lenders regarding collateral ownership and litigation-driven recovery strategies that apply well beyond digital assets. In the meantime, if you have questions or would like further guidance on prepetition planning, please reach out to the author or any member of FBT Gibbons' Regional & Community Banks team.

Banking On It

Delivering timely and practical commentary on the legal and regulatory challenges impacting financial institutions, our ***Banking On It*** blog covers a wide range of topics, from consumer finance and loan originations to workouts and regulatory enforcement trends. Our goal is to keep you informed and prepared for what's

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

ahead.

Visit Blog

© 2026 FBT Gibbons LLP. May be considered attorney advertising in some jurisdictions.

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

FBT Gibbons