TEN THINGS YOUR ATTORNEY WOULD LIKE COMMERCIAL LENDERS TO REMEMBER

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1. Know The Borrower

A mantra as old as lending is still a key to good credit approval and loan administration. It is also necessary for proper loan documentation. A comprehensive understanding of the customer and its business also help proper credit structure such as matching the type of credit to the collateral and repayment source(s) and putting the right financial covenants and reporting in place. It also helps determine what information is needed when in order to properly monitor the credit. Not understanding which entity owns which assets and whether the assets can be pledged as collateral can also result in delay and additional costs. "Standard" loan ratios and financial reporting requirements not tailored to the business or the collateral are not likely to help effective loan administration.

Anyone with a few grey hairs has seen that borrowers can act in very different ways when their financial situation becomes difficult. Some are candid and cooperative, some ignore or worse don't even see or agree there is a problem, the worst start looking for ways to shift the loss to the bank while hiding assets. The "character" factor is alive and well in the age of credit scoring. One of the smartest bankers I ever worked with once described that a certain prospective customer with a colorful borrowing past, could spend full time trying avoid paying the loan once made, while the banker certainly did not have that sort of time to monitor the loan.

Know the Borrower also means understanding the legal entity(ies) which are borrowing, granting collateral liens and guaranteeing the credit. Requiring complete entity documents early in the underwriting process is necessary to understand what actions are allow or require special approval by shareholders, partners, member, trustees, etc.) Ensure the bank knows who is authorized to sign loan documents and that person signs the documents. Remember that regardless of the number of layers of entity ownerships, at the end of the day only a human being can sign on behalf of an entity. You must drill down through the entity layers until you reach a natural person.

A note on Certifications of Trust. Under The New Mexico Uniform Trust Code, the bank is entitled to rely on a certification of trust and enforce the transaction against the trust, <u>only</u> if the bank does not have knowledge that representations in the certification are incorrect. If the certification allows actions which are not actually allowed (or are prohibited) by the trust document, the certification is not

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enforceable if the bank knows the certification is in conflict with the trust document.

The Uniform Trust Code provides that knowledge of the terms of the trust may not be inferred solely from the fact the lender has a copy of the trust. A fight over "what the bank knew and when did it know it" is never good and is always expensive. It is almost always fact driven, and it is hard to prove a negative. "Yes we had a copy of the trust but we never read it" take time and money to prove. The bank <u>may</u> require the trustee to furnish excerpts from the trust document showing the trustee designation and that the trustee power to act in the pending transaction. Some banks as a matter of policy prohibit having or reviewing the trust document when relying on a certification. At a minimum, you should know why you would ask for a copy of the entire trust document when a certification if being used.

"Knowledge" of an inconsistent certification could be raised if there is a challenge to the trustee's borrowing actions. This can be a greater concern where the trust is guaranteeing a loan to an entity not owned by the trust or pledging collateral to secure a loan to a borrower not owned by the trust. A challenge by a successor trustee on behalf of deceased trustee's minor children beneficiaries, arguing the loan/collateral pledge/guaranty did not benefit the trust and was not allowed by the trust, can be a very unpleasant experience.

2. When Negotiating, Document Commitments And Non-Commitments

Most banks use some form of commitment letter for certain proposed loans. Interest letters or terms sheet are also common. What is needed but is often not included in interest letters is language which clearly states the content is for negotiation and discussion only, is not a promise or commitment to make or renew a loan, and such a commitment if made will be contained in a subsequent document signed by both parties. A single sentence is rarely sufficient to contain all these qualifications. Confirmation by the customer of the non-commitment is good protection and avoids misunderstandings. Both commitments and interest letters should include language that the writing supersedes prior written and oral communications. In the case of a "terms sheet" a clear disclaimer that all terms, rates and other requirements are subject to change and any actual commitment by the bank for the proposed credit will be in a separate written commitment.

There are a number of important components to a formal commitment. Most banks to a clear job of stating the loan amount, rate, payment terms and collateral. Equally important are the "documentation" and "out" provisions which require closing and funding only with documentation require by the bank and the conditions under which the bank can refuse to close and fund (i.e inability to provide required collateral values, material adverse change, etc.) Often overlooked in a commitment is the requirement that if the bank incurs costs (appraisals, title binder, surveys, collateral valuations, etc.) and the loan does not close, the borrower is still obligated to reimburse the bank for those expenses. One way to ensure payment is a prepaid commitment fee sufficient to cover the expected costs.

3. All Agreements Are In The Loan Documents

Any banker who has been involved in a loan workout understands that while the loan documents may not often be looked at for a performing loan, when problems occur, the bank will look to the loan documents to protect its rights and remedies. The borrower or its attorney will also look at and likely challenge any action contrary to those rights. In a competitive banking world with an emphasis on marketing and "getting the deal done", it is a simply wrong to tell a borrower the loan documents are just "forms", just "paperwork required by the back room", or "these papers don't really matter as long as I am your banker". It is a more serious issue to make statements such as "don't worry, we really don't enforce this stuff" or "the bank would never do the stuff in here". Bank loan documents (if well done) are designed to address a broad range of potential problems and either avoid or resolve those issues in the bank's favor. The worst risk (to the bank and to a lending career) is for a lender to tell the borrower that the lender will actually apply different loan terms or standards (invariably more lenient) than the written loan documents.

The loan documents should reflect all terms, conditions, and requirements imposed by the bank to grant the loan. Failing to include to those provisions likely means the bank will not be able to enforce them against a borrower who later becomes uncooperative.

I have over the years had lenders question why a loan agreement for a large or complex credit was "so long" and ask me to make it "shorter". I usually ask the banker to identify which protections and provisions the bank will never need to enforce, so I can remove the un-needed provisions. That usually resolves the question.

4. Make Sure All Loan Documents Are Complete And Executed

The loan is ready to close and the borrower is anxious to get funded. Larger banks have documentation review systems and staff to help; in a smaller bank it may be just you (and perhaps an assistant.) In addition to ensuring the signing entity, require appropriate resolutions and authorizations to prove who has authority to sign and confirm the resolutions conform to the actual entity documents.

Mortgages and other collateral documents often describe real estate or personal property by an attached exhibit. Loan agreements and other loan documents may use schedules, exhibits or other attachments. It is surprising in a loan workout how often the bank or its counsel discovers that some document was not signed, was not notarized (where required) or an exhibit was not attached. If the exhibit does not contain a heading describing the document to which it belongs, it can be difficult to tell which is the proper exhibit. Even if attached, documents can get detached and re-arranged prior to scanning. As with most issues, prevention is easier and cheaper than resolving a later problem.

5. Enforce (Or Document Waiver Of) Covenants

Contested loan workouts are more difficult (and expensive) when the borrower claims covenants or remedies are not enforceable or were waived by the bank's failure to enforce them. Enforcing some but not all covenants without documentation, or informally "waiving" requirements can create the opportunity for an uncooperative borrower to argue waiver or unfair action by the bank.

First the bank may not realize there is a covenant non-compliance. Relying on a requirement for the borrower to self-report non-compliance is not a recipe for success in the view of most. Some covenants are mandatory (usually financial ratios and financial statements), others may be "if required by the bank". Make certain to distinguish elective requirements in the loan documents to prevent a compliance exception where a credit review notes a "required" provision was not enforced when the bank only intended the borrower to provide information on request.

Another threshold issue in drafting for covenant compliance is whether the loan documents make covenant non-compliance an automatic "default" or merely an "event of default" for which the bank can elect to declare a "default". The two are vastly different for good reason. Giving the bank to option at its sole election, to declare a default, is far more flexible for the bank in administration of the loan.

When non-compliance with a covenant is discovered, obviously the bank needs to understand the consequences. A late financial statement is not the same as a suit by another creditor to appoint a receiver and liquidate the business. As soon as the bank determines what action (or inaction) to take, written notice of the both the non-compliance and the consequence should be given in writing. If the bank requires correction, be clear what is required, by when, and the consequences if correction does not occur. If the bank waives the non-compliance, written notice of the waiver should explain whether the waiver is a one-time waiver or covenant is no longer required. In either case, the notice should report that the waiver does not apply to any other covenants. Written acknowledgement from the borrower of the problem and the promised corrections is a great idea often overlooked. Some banks require a fee as part of a non-compliance waiver.

6. Document The File (And Be NICE)

I have on rare occasion dealt with abanker who never wanted to put anything in writing under the theory it could never be used against the bank (or more probably the lender). My view is this neither realistic nor helpful to the bank. Under the adage that “no documents are needed for a performing loan” and “all documents are needed for a problem loan” – the safer approach is to document every loan as though it may become a workout. “Documents” includes emails and all other forms of written communication as well as file notes and phone call records.

If you operate under the assumption that every document in the loan file could end up being read by a judge in a collection suit, showing what the bank did, when, and why at each step demonstrates the business reason for actions (or inactions) by the bank. If a borrower request is declined, the request, the reasons for the decline and how the response was made to the customer can be as important as documenting requests which are granted. Especially in the case of credit weakness or continuing renewals, documenting the concerns and reasons for the bank’s actions will be needed by the workout officer or attorney. Most banks with a formal credit underwriting and approval system satisfy much of this goal. Documenting interim communications with the borrower are important as well.

Be Nice! Under the theory “a judge may look at the whole file”, a professional and courteous content and tone helps prove the bank acted in a fair and business like manner.

7. Recognize And Address Loan Problems And Weaknesses

Every lender has (or will) experience the joy of a good loan customer experiencing financial issues. Obviously the severity of the problem will govern the bank’s response. Continuing our theme of documenting what actions the bank takes and why, it is not helpful to hide a problem or concern. Recognizing and documenting the issue allows the bank to document what actions the borrower promises to make to correct the problem. Most experienced workout officers and attorneys favor written notice: 1) of the specific problem, 2) of the required cure or action by the borrower, 3) any time requirement or deadline for such action, and 4) possible actions or at least a full reservation of right of the bank in the event the borrower is unable to cure or the problems gets worse.

Assuming problems are identified at a time when the borrower is still cooperative, document that cooperation. When possible, get a written confirmation from the borrower: 1) agreeing the problem(s) exist, and 2) stating the corrective action the borrower offers or agrees it will take. If the relationship deteriorates, the bank has written proof that the borrower agreed the problem existed and how the borrower promised to fix the problems. Proving the borrower admitted the problem, was given the chance to cure, and was unable to cure goes a long way in front of a judge to show the bank's good faith conduct. This hopefully prevents fights over whether there was problem, how the problem was to be fixed, and whether the bank improperly "controlled" or "managed" the borrower's business.

8. Keep The Guarantor At The Table

Every banker who has had to enforce a guaranty to repay a loan has experienced in real life the "character" factor of credit. Guarantor "remorse" seems to occur far more often these days than in prior decades – presumably a reflection of social change I will leave to someone else to explain. Few guarantors intend to have to actually pay, at the time a loan is made and they give the guaranty. Even fewer willingly write checks to pay a problem loan. Keep the guarantor "involved" during renewals, restructuring and any workout prevents arguments about "release" of the guarantor. Having a guarantor confirm the existing guaranty as part of the borrower's loan modification prevents an argument about "release" or that the bank was no longer relying on the guaranty. Beware of any "revocation" notice from a guarantor and consult your attorney if any "I don't want to be liable any more" notice is received from a guarantor. Any renewal or restructure after such a notice may in fact release the guarantor unless an affirmation is obtained.

9. Understand And Follow Requirements For Remedies

If the time comes for the bank to discuss or take actions or remedies allowed under the loan documents – first understand, then and follow those requirements. The bank's loan documents should contain specifics for how and when the bank is entitled to take actions. Going back to #3 above, review your documents to confirm what is required and follow the loan documents. Remember that there are also overriding state and federal law requirements which must be followed (for example UCC Article 9 requirements for the notice, sale and accounting for the sale of personal property collateral, and the automatic stay under the U.S. Bankruptcy Code). Banks with dedicated loan workout staff are likely to have a better working knowledge than a line lender of how to follow all these requirements. You can be sure that any uncooperative borrower, bankruptcy trustee and unsecured creditors in a bankruptcy will scrutinize, and attack any misstep.

10. Get A Legal Review/Consultation (While You Still Can)

At the risk of being accused of self-servicing advice, consulting early and often with legal counsel. Consider having counsel prepare complex/unusual loan documents or review the bank prepared documents. Consulting with and loan document review by experienced counsel in the event of serious credit weakness can provide real value. First, consider the benefit of being able to say "we consulted with our attorney and acted on the attorney's advice. Assuming the advice is good, this may limit complaints about the bank's motives for taking adverse action against the borrower. A discussion and review of documents may identify new or corrective documents needed as part of a loan modification or restructure. Again, while the borrower is still cooperative is the time to get needed documents. Borrowers seldom agree to fix problems after receiving a demand letter or being sued.