

Harmonizing Your Lender Group... Or Else, 'There Be Dragons'

BY HOWARD BROD BROWNSTEIN

"Speak, hands for me!" William Shakespeare, *Julius Caesar*, Act 3, Scene 1. (Casca first, then the other conspirators and Brutus in the act of stabbing Caesar)

Nowadays, agent lenders have to worry as much about getting stabbed in the back by participants in the lender group, as they do about the borrower's difficulties. Once upon a time, lender group meetings were genteel affairs with many of the same faces sitting around the table on deal-after-deal, all representing regulated depository institutions, all playing by the same rules handed down from Mount Fed in Washington. Seldom did agents and participants have so serious a falling out that litigation ensued. Banks were profitable, loan spreads were healthy, "God was in His Heaven." All was right with the world.

Then, one day, an equity or hedge fund got the bright idea that, rather than invest money in the equity of a company and be on the receiving end of a lender's displeasure, why not *be* the lender itself? Perhaps this fund purchased the loan as part of a package of "distressed loans" from a beleaguered, once fleet-of-foot bank in a first-of-its-kind transaction. Or perhaps this was a fund named after the mythical three-headed dog that guarded the gates of hell.

Regardless of the identity of this pioneer, as business cycles shortened up, market liquidity exploded then collapsed, and Ponzi schemes filled the headlines, one day the agent lender looked around the table, and all the faces had changed. Instead of a group of acquiescent

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participant lenders that the agent lender had brought to the dance and who played by the same regulatory rules, looking back at the agent was a host of new faces: bright, young M.B.A.s that had never been through a down cycle. Rather than having booked the loan at 100 cents on the dollar like the agent lender, following a painstaking business development process likely involving golf, alcohol and cholesterol, these newcomers had instead bought the loan at \$.42 and would be happy to sell at \$.53. Rather than being willing to hang in there for a reasonable turnaround process so that the loan might be repaid in full, the new participants *hoped* for a default, because they *wanted* to foreclose. And as for maintaining any relationship with the borrower — fuggedaboudit! Their

only meaningful relationship was with their \$.42 cost and the "carried interest" that their fund earned. During a lender group conference call, the agent lender heard the words "loan to own" muttered *sotto voce* by one of the participants to someone offline.

Obviously, the game has changed. How should agent lenders handle this shifting landscape? What are the rules she should follow? Most importantly — how should the agent lender keep from getting shot in the back by her own participants?

Typically, the issues that arise between agents and new non-bank participants are based upon positions the non-bank participants would like the lender group to take that the agent lender might question or oppose. For example, the borrower may be requesting a waiver of a technical covenant default, which would ordinarily not require more than a waiver fee, possibly a resetting of the covenant, and the umpteenth release of the lender group covering everything from the expulsion from the Garden of Eden through the Lindbergh kidnapping to yesterday's inclement weather. However, the non-bank participants may want the lender group to seize upon this peccadillo as an excuse to move towards an eventual foreclosure. What should the agent lender do?

Lawyer Up!

At the first sign of potential disparity of views among the lender group, the agent lender should make sure that the lender group's legal counsel is up to speed on all developments, and has cleared any conflicts that might have arisen with the advent of new participants. Lenders have differing policies concerning whether, in the face of portfolio problems, they will call upon the same counsel that drafted the documents or instead turn to an attorney that is more of a workout specialist.

Either way, the agent lender must recognize that, when facing a potentially disharmonious lender group, legal counsel can provide the necessary cover for taking reasonable action rather than pursuing some other agenda. Perhaps there have been previous instances of such waiver requests, and for the lender group now to be far tougher than it had been on previous occasions might not be justified. While the author

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is unaware of any legal decisions in which borrowers have successfully claimed lender liability predicated upon the alleged avariciousness of some of the lender group participants, it might make for an interesting legal theory if there had previously been a course of cooperative dealing, prior to the arrival of the non-bank participants.

Call in the Cavalry!

The borrower may have already engaged a turnaround professional, possibly at the suggestion or insistence of the lender group. The value to both borrower and lender of such an independent and objective professional is well recognized. Now that lender group disharmony has reared its head, the lender group (and especially the agent lender) would benefit from having its own advisor.

However, while firms that primarily act as financial advisors to lender groups may be on the agent lender's speed-dial, it may be preferable to consider a firm that includes turnaround and crisis managers, and regularly provides services to borrowers as well as lenders. Such a firm may be better able to harmonize differing points of view among the lender group, and instill discipline regarding the loan documentation (see below). That is, not to put too fine a point on it, the agent lender may need her own crisis manager to whip things into shape and get everyone singing from the same song page, just as the crisis manager for the borrower helps its management team eliminate disparity. This is not a case for a passive or reactive financial advisor, but rather calls for a "wartime consigliere" that can corral the errant mavericks. The turnaround professional/lender group advisor can also provide cover for the agent lender, (i.e., "Our worthy financial advisor recommends..."), against the day when the agent lender might have to defend herself against a participant's lawsuit.

The foregoing is not meant to suggest that the turnaround professional will countenance a lackadaisical attitude towards a noncompliant borrower. Rather, the advisor can be objective and independent, and focus on the donut not the hole: let's get repaid. If it really makes

economic sense for the lender group to pursue its rights and remedies *consistent with the loan agreements, read in the context of all past dealings*, the advisor will not hesitate to recommend such action. In fact, engaging a turnaround professional as the lender group's advisor sends a powerful message: "Dear Borrower, Please get real, and quickly, since the lender group has hired a manager and not just an advisor. We are not asking for the keys (yet), but do not threaten us with tossing them, because we're ready to catch them."

Live Within Your Loan Documents!

Agent lenders that are encouraged by their non-bank participants to stray beyond the four corners of their documents should be guided by the warning inscribed by Old World mapmakers at the unexplored edge of their maps: "Beyond here there be dragons!" Notwithstanding all

the e-mails, conference calls, reporting requirements, hopeful discussions, trips to the woodshed, back-channel communications and earnest supplications, the lender group is bound by its loan documents. It can decide to lend or not lend, but it has only the remedies that are spelled out in the loan documents. Frequently, non-bank participants are not so familiar with this stricture, and the turnaround professional/financial advisor can be helpful in providing this understanding for them.

And if it looks like exercising rights and remedies is really a distinct possibility, the groundwork must be laid carefully for this, in consultation with counsel and the advisor, and consistent with the documents.

This is an appropriate time for a review of the documents governing the agent lender's authority and the relationship between and among the members of the lender group. With the assistance of counsel and the advisor, the agent lender can lead the effort to eliminate any loopholes and clarify any ambiguities.

Non-bank Participants, Despair Not!

Lest any readers who are non-bank participants in troubled loans read this article as part of a conspiracy to deprive them of their \$.53, the opposite is actually the intention. As regulated lenders know well — some having learned the hard way — the borrower that has allegedly been mistreated by the lender group may not be the only enemy worth worrying about. If the borrower files a bankruptcy proceeding, and assuming the unsecured creditors will not get paid in full, they will come gunning for the lender group, which is typically the only deep pocket in the case. It is therefore doubly important for a lender group to proceed cautiously when dealing with a distressed borrower.

There are of course tremendous opportunities for non-bank lenders to buy bank debt at a discount, and realize a huge gain if the loan is repaid in full, or even a respectable gain if the situation improves somewhat, such that the debt can be resold. However, regulated lenders have had drilled into their consciousness since their first day on the job how one can and cannot treat a borrower; non-bank lenders may not have had the advantage of this experience. By buying bank debt and becoming part of lender group, it is necessary to play by the rules, or else, "there be dragons!" [abf](#)

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