Agents and Co-Lenders in Syndicated Facilities: Structuring Agreements to Balance Differing Rights and Obligations

Navigating Rights of Agents, Information Sharing, Exculpatory Clauses, Defaulting Lenders & More

THURSDAY, MARCH 20, 2014

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today’s faculty features:

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The Syndicate's View of the Agent: Dos and Don'ts; Rights and Maybe Wrongs

A View of Secured Loan Transaction Syndicates from the Viewpoint of the Relationship Between the Syndicate Participants and the Agent

March 20, 2014
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Multi-Lender Transactions

- Co-lending arrangements
- Participations
Multi-Lender Transactions

- Co-lending arrangement
  - Each lender extends credit to the borrower(s) under one loan facility, with an agent acting on behalf of the co-lenders
  - Typically, an agent holds the collateral for the loan and an agent for the co-lenders (often the same) administers the loan for the co-lenders.
  - Advances may be made directly by the co-lenders or through the agent.
  - The co-lenders are in privity with the borrower(s)
Multi-Lender Transactions

• Participation
  – A lender makes a loan to the borrower(s) and then sells “undivided interests” in the loan to participants.
  – The participants have no interest in the collateral other than receiving their *pro-rata* share should the lender liquidate.
  – Advances are made by the lender and the participants “settle up”
  – There is no privity between the participants and the borrower(s)
Multi-Lender Transactions

- Typically occur because the loan facility is too large for the originating lender.
- Often an “easy” way to employ funds without the effort of lending directly.
- Tendency to rely on the judgment of the lead.
- Potential for the lead to disregard the club members.
STATUTORY RESPONSIBILITIES

• Anti-Money Laundering
• Know Your Client
• FACTA
• OFAC
• Securities Law Compliance
DRAFTING CONSIDERATIONS

- LSTA
- Evolving Market Standards
- Public / Private Deal
- Large Syndicate
- Small Syndicate
- Club Deal
- Voting Mechanics
What Do We Usually See?
(What's the market?)

- No duty to disclose
- No liability for failure to disclose
- Required only to give information received
- Copies of field exams (maybe)
- Default - only if they have knowledge
- Fixed list of the items to be voted on
- The agent holds and enforces rights and security
What writings must the lender provide?

• Agent shall not, except as expressly set forth herein, have any duty to disclose, and shall not be liable for the failure to disclose any information relating to the Borrower or any of its Affiliates.

• Bank will furnish copies of the Loan Agreement, any financial information received and any other material certificates, documents, or instruments received by Bank but shall not be required to obtain or furnish other information not referred to above.

• Lender shall provide a copy of all financial statements, statements of income and expenses copy of the monthly balance sheets a monthly report prepared by lender depicting trends of each Borrower’s business and copies of Lender’s field examination reports.
What writings must the lender provide?

• Agent agrees to notify Lenders promptly of any Borrower default of which Agent has knowledge.

• If Bank has actual notice of, or receives written notice of default, Bank shall promptly forward such notice to each Participant.

• Agent shall use commercially reasonable efforts to provide each Lender with information in Agent’s possession and copies of financial statements upon receipt of such Lender’s written request provided, however, nothing shall impose liability upon Agent for its failure to provide any Lender any of the foregoing even after a request thereof.
Exculpatory Terms and Indemnities
(Is the Circle Complete?)

• No fiduciary obligation
• Only gross negligence or wilful misconduct
• No deemed knowledge
• Not responsible for any representations, warranties or information delivered
• No duty to enquire
• No lender relies upon the agent for credit assessment or approval
• No lender relies on the agent for know your customer due diligence
• Only acts on instructions and if explicit
• Only acts on instructions and if explicit and with indemnity
• Indemnified for all actions but gross negligence or wilful misconduct from the borrower
• Indemnified for all actions but gross negligence or wilful misconduct from both the borrower and the lenders
Exculpatory Language
Agent shall NOT:

• Be subject to any fiduciary duties

• Be liable for any action taken or not taken by it in the absence of its own gross negligence or willful misconduct

• Be deemed to have knowledge or notice of any Default unless Agent has received notice of such default
Exculpatory Language
Agent shall NOT:

• Be responsible for any recitals, statements, representations or warranties

• Be responsible for or have a duty to ascertain or inquire into any statement, warranty or representation made in connection to the validity, enforceability, effectiveness or genuineness of this Agreement or any document
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• What Can Happen?
• Should The Agent Be Responsible
• Is it?
• What Should Be The Rights of the Syndicate
What Can Happen!

- Field exam results indicate an issue - does the agent have a responsibility to inform the syndicate - what is the requirement for the timeliness of notification to the syndicate
- An early audit comment indicates signs of fraud - should the agent notify the syndicate, what is the timeliness of any duty to notify the syndicate
- The audit results would come too late to provide early intervention in a problem - what should the responsibility of the agent be - the agent fails to act in a prudent and timely manner- but not grossly so - what rights does the syndicate have
- The agent determines not to follow the majority will but the majority vote was not required - what can be done to compel the agent, what are the sanctions to the agent for failure in following the majority will
- There is an error in the security panel - who is responsible
- There is a failure in the know your customer identification process, what were the duties of the agent, what can be done with regard to dealing with the consequences
What Are the Challenges in Dealing With the "Imperfect" Agent Beyond the Terms of the Deal

- Generally lenders will receive none or little in the way of legal fees, and none once the initial documentation is over.
- Know your customer is often done second or third hand, and without any responsibility on the part of the agent.
- Syndicate members are frequently prohibited from having any direct contact with the borrower group.
- The indemnities and exculpatory clauses frequently go in a circle, it is hard to discover that in fact there is any duty or responsibility as indemnities frequently seem to cover almost the extent of negligence coverage.
- Standards of performance can frequently be poorly enunciated, and market standards are of little help.
What Can a Syndicate Member Do?

- Look carefully at the voting levels, understand the differentiation between unanimous requirements, a large majority and the rest of the decisions, ensure that the voting levels are checked against the percentages held to ensure that there are meaningful votes required
- Provide for a broader list of deliverables to be provided by the agent to the lenders to acquaint them with timely information
- Provide better and clearer time frames for the delivery of information
- Require periodic meetings with the auditor; field examiner; borrower group
- Undertake direct know your customer and diligence reviews, require that the initial checklist provide information directly to the lenders
- Examine and deal with the removal rights for the agent
- Ensure that there is a right to direct a vote on all matters based upon a specified percentage of the lenders
I have very little confidence in the aging by due date, as the due dates listed for invoices do not always correspond with the terms listed for the invoice.

In the verification process, some of the invoices listed on the aging with an invoice date of 10/30/08 had actual invoice dates in 2007 per the customer.
Agent responds

From: [Redacted]
Sent: Tuesday, December 23, 2008 8:02 AM
To: [Redacted]
Cc: [Redacted]
Subject: RE: [Redacted]

It appears we are looking at significant ineligibles due to "issues" with the aging and your general concern.
Yes, I am afraid that may be the case. I received my third and hopefully final version of the 11/30/08 A/R aging and rollforward last night. The total is back to the original amount, although the spread has changed. I will let you know what I find out today. It turns out that the trial balance and financial statements provided to me were also incorrect, and I have received a corrected trial balance, but have not yet received corrected financial statements.

Thanks,
[Borrower’s controller] has said that the errors thus far are due to system errors, and possible entry errors. This very well may be the case given the accounting system they are running, but it is my first instinct to become skeptical, particularly when considering their current liquidity position.

So basically I am waiting on these things from [redacted] before I can delve any deeper into the A/R issues. Let me know if you have any questions.

Thanks, and happy holidays,
1. The 10/26/08 aging listed this invoice with an invoice date of 9/28/08. The 10/26/08 aging listed this invoice with an invoice date of 8/1/08. The 8/31/08 aging listed this invoice with an invoice date of 7/31/08. The 7/27/08 aging listed this invoice with an invoice date of 5/1/08, which matches the remittance.

2. The 10/26/08 aging listed this invoice with an invoice date of 9/25/08. The 9/28/08 aging listed this invoice with an invoice date of 8/1/08. The 8/31/08 aging listed this invoice with an invoice date of 7/31/08. The 7/27/08 aging listed this invoice with an invoice date of 6/18/08. The 6/29/08 aging listed this invoice with an invoice date of 4/22/08 which matches the remittance.

3. ETC...
Hi

I left voice messages for each of you, and as you know, I would like me to come into the office on Monday to try and wrap up the exam. In addition, I would like to sit with DecDee or another employee and obtain the EDI information for a few of the larger vendors, such as Home Depot and Target for verification purposes. I realize you were concerned with the prospect of additional phone verifications, but the EDI method will be less invasive, but will allow us to verify a large amount of receivables without contacting any additional customers directly. This is a process, however, that I must be present for, in order for the receivables to be considered independently verified. The remaining outstanding items are as follows:

1. Invoice numbers for Fowler Brothers acct. doc #’s 1431055, 1449581 and 1451397 so that verifications can be completed. The aging does not list invoice numbers, and I could not locate them on the A/R rollforward, as I could for some others. The customer said they cannot verify invoices without the invoice numbers and could not simply provide a list of outstanding invoices.

2. Explanations for verification exceptions. I provided a list of invoices that customers verified as having different invoice dates ($129M), said deductions were taken or partial payments made ($48M) and items for which customers had no records ($2M). He said he would look into these.

3. Explanation for why A/R sales exceed Product Sales. November product sales (I/S-GL#400000)=$7,855M compared with $9,252M in sales per A/R rollforward. October product sales (I/S)=$5,305M compared with $8,227M in sales per the A/R rollforward. I would expect I/S sales to be higher than A/R sales, because the company does have non-A/R sales, particularly in the outlet store. (Note: these figures are based on fiscal periods, not calendar months)

4. Explanation for the $614M Target G/L transaction where it appears that invoices were charged back to the aging.

5. Explanation for the five paid invoices from the subsequent cash test that had older invoice dates on the remittance. Further research indicated that these invoices should have had older invoice dates each month dating back to June or July, at which point the invoice date did match the remittance. It appears that the dates have been updated each month, which has kept the invoices current.

6. Explanation as to why all invoices from 90333252 through 90704170 have an invoice date of 9/25/08, but then the next open invoice begins in June and dates mostly increase from there (some other 9/25/08 invoices mixed in as well). It seems that invoice numbers and dates should both be sequential. Oldest invoice on 10/26/08 aging-6/5/08, but oldest invoice on 11/30/08 aging-5/8/08, how is this possible?

7. Answers to general questions regarding the changes in gross margin and interest expense in the interim compared with the prior year.

8. Explanation for 3.4% variance between A/R cash per rollforward and deposits into the concentration account.

Feel free to contact me with any questions.

Thanks,
After the Company continued to delay the follow-up visit........

Items remaining open as of the report date are as follows:

• Explanation as to why gross accounts receivable exceeded gross income statement sales in each month ....

• Explanation for exceptions found during phone verifications

• Explanations for the 69 day variance between the date stated on the Company bill of lading and the date per the carrier’s online tracking system...

• Explanation for variances between invoice dates stated on customer remittances and those on the ...agings...

• Explanation as to why ..invoices on the ...aging held the same invoice number but different customer names, dates and amounts

• EDI verifications
• During the period from December 22 - - when the first indicia of fraud was shared with the banker, through February 27 when the fraud was conceded by the borrower, the lenders advanced over $20 million.

• After all of the borrower’s assets had been liquidated, the lenders suffered a $20 million loss.
When the Agent (Lender) and Co-lenders (Participants) Disagree
• Borrower integrity issues arise resulting, in part, in a significant write down of AR
• Lender investigates and declares a default
• Agent notifies participants
• There appears to be significant additional collateral AND a significant equity cushion in side collateral
• Lender wants to force a bankruptcy
• Participants prefer to provide limited funding to allow the borrower to sell
• Lender and participants work and agree on a term sheet for additional funding to bridge a sale of assets by the borrower
• Lender attends meeting (without participants) with borrower and does not present the term sheet
• Instead, the lender states there will be no further funding absent a bankruptcy
• Borrower files Chapter 11
• And obtains a priming DIP loan from a new lender
KYL
True Participations
is the purchased undivided interest actually a disguised loan?
Rights of Lender vis a vis participants
(a unique story)
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Recommendations

• When negotiating multi-lender transactions as a co-lender or participant:
  – Seek to maximize what documents the agent/lender must provide
  – Seek to minimize the exculpatory provisions

• Monitor the loan as if you were the agent or lead
But most of all…

K Y L

KNOW YOUR LEAD
• Remember the Golden Rule:

• Treat your co-lenders as you would like to be treated
Thoughts for Further Consideration

• Is there a difference between the smaller syndicate and the larger syndicate, should it be more club like, should there be greater unanimity, should lender involvement be pushed

• Are things different for a professional administrative agent rather than a lead arranger, should they be, should the syndicate take that into account in assessing rights and monitoring

• Is there a role for default positions, if there is no response from the lenders should they be deemed to have taken a position, should the vote be required to be pushed and held

• Yank a bank, what should be the terms, what should be the payout, how do we recognize and punish bad behaviour – weak behaviour – self serving behaviour
BancAssets/MidFirst Close $100MM U-Haul Loan

- BancAssets announced it closed a $100 million loan across a network of 23 community financial institutions to meet part of U-Haul’s corporate debt needs.
- BancAssets partnered with MidFirst Bank, which served as the lead bank and agent. The deal, which closed October 8, 2013, represents a new channel for community financial institutions to participate in large and middle-market corporate financing deals, a market normally dominated by the world’s biggest banks.
The financial institutions that participated in the U-Haul loan deal were:

- Alliance Bank of Arizona
- Atlantic Regional FCU in Brunswick, Maine
- Bankers Trust Co.
- Blue Ridge Bank
- City National Bank of New Jersey
- Cross Keys Bank
- ESB Financial
- EVBFirst Chatham Bank
- Kennett National Bank
- Leaders Credit Union, Jackson, Tenn.
- Metropolitan Bank
- MidFirst Bank
- Mohave State Bank
- Money One Federal Credit Union, Largo, Md.
- Murphy-Wall State Bank and Trust Co.
- Sacramento Credit Union
- Southeast National Bank
- Sycamore Bank
- Texas First Bank
- The Brenham National Bank
- The Clay City Banking Co.
- The First National Bank
- Trust Co. of Broken Arrow.
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