MUTINY ON THE AGENT

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In recent years there has been an influx of new players stepping into the roles of agent and lead in small and large syndicated transactions and in participated loans. Not all of them have been fully up to the task of leading a multi-lender transaction. The purpose of this article is to help the reader avoid being injured in a multi-lender transaction and to provide for a better parachute should the transaction require a change in leadership.

Imagine you and your loved ones are planning a vacation. You find a tour company that has just the itinerary that you are looking for and, better yet, they will transport you in a luxury coach with all of the amenities. You don't know anyone who has traveled with this company, but you have seen the company's advertisements and through their advertising, they appear to have a good reputation. You all board the bus and sit back, having a wonderful time. Then suddenly, as the bus is speeding along in excess of the speed limit, you become concerned that the bus driver does not know what he is doing. You reach your first destination safely, but you are fearful that you, your loved ones and the rest of the passengers are at risk. What do you do? You may not even know how to reach an appropriate person at the tour company. Do you refuse to get back on the bus?

Now imagine that you have been invited to participate in a multi-lender transaction – a club deal, syndication or participation. During due diligence you have minimal contact, if any, with the borrower but, instead, have relied on the financial information provided to you by the agent. The facility closes and you continue to fund the revolver and review the information only provided to you by the agent.

Imagine further that, from time to time in your review of information provided by the agent, you recognize some irregularities and point them out to the agent. The agent assures you that "everything is okay" and you continue on. This continues and at some point you realize that your agent, like the bus driver, does not know what he is doing.

In recent years we have seen an influx of new players stepping into the roles of agent and lead in small and large syndicated transactions and in participated loans. Not all of them have been fully up to the task of leading a multi-lender transaction. In certain situations where the documentation so provided, the agent might have been removed. In other situations, the "club" had to live with the agent.

The purpose of this article is to sensitize the reader in the hopes of helping the reader avoid being injured in a multi-lender transaction and to provide for a better parachute should the transaction require a change in leadership.

Let us start with reviewing some typical clauses from syndicated loan agreements:

- 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.
- 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.

Multi-lender documents typically contain broad exculpatory provisions protecting the agent or lead. For example, agreements typically say that the 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.
- 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.
- 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.
- 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.

In addition, the documents require each member of the club to acknowledge that it has not relied on the agent in making its loan and that it has received full disclosure. Typically, absent of default, club members are not entitled to reimbursement for their legal expenses or other costs, although it is not uncommon for club members to request and obtain a modest budget for review of loan documents.

Consider the present market where there are more lenders chasing deals than there are deals, coupled with the pressure to employ funds. Too often club members sign onto deals relying too much on the agent although they have represented in writing that they have not so relied.

Imagine This Situation

During the course of a collateral audit conducted by an outside auditing firm,

the auditor provides the agent with information indicating that there are significant indicia of fraud but the agent fails to disclose that to the co-lenders. Over the course of several days, the auditor wrote to the agent's account officer:

> *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.*
>
> *It appears we are looking at significant ineligibles due to "issues" and your general concern.*
>
> *[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.*
>
> *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.*
>
> *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.*

The agent did not reveal any of this information to the *club members*. However, some three months later when the audit was released to the agent, the agent was then obligated to share the audit report with its co-lenders. You can imagine what happened next. The agent had no duty to provide any of this information to the co-lenders and did not provide – admittedly at its own peril because, shortly following the time when the audit report was delivered to the co-lenders, the fraud was discovered.

Now Consider the Following Scenario

Borrower is in default. Lead and participants disagree on a strategy – the lead believing that it should force a bankruptcy and the participants believing that additional funding should be provided as part of a forbearance agreement and in return for some additional collateral. The lead and participants spend considerable time negotiating a term sheet for such additional funding that the lead takes to a "closed door" meeting between the lead and the borrower. However, the lead never presents the term sheet from the lending group and, instead, merely declines to make additional advances by virtue of the existing defaults. A review of the loan documents does not provide any requirement that the lead comply with instructions from the participants unless expressly obligated to do so under the loan document.

What recourse do the participants have in situations like these? Typically none. Generally, co-lenders and participants are without recourse to recover damages caused by an agent or lead not acting as a prudent secured lender, unless it is acting with gross negligence or willful misconduct which, at best, is a difficult standard to meet.

It is important to keep in mind that only the agent has the right to enforce remedies. Co-lenders lack standing to act on their own behalf once they have appointed the agent to act on their behalf.

In order to minimize the risk of being trapped in a runaway bus, it is suggested that when negotiating multi-lender transactions as a co-lender or participant:

- Seek to maximize what documents the agent/lead must provide.
- Be sure the documents provide terms upon which the agent may be replaced. (Unfortunately, this issue is more challenging in a participation, where the lead is the only party in contract with the borrower)
- Seek to minimize the exculpatory provisions.
- Monitor the loan as if you were the agent or lead.
- But, most of all, know your lead/agent!

Finally, in situations when you are the lead or the agent, keep in mind the Golden Rule: *Treat your co-lenders and participants as you would like to be treated.* TSL

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