LEGAL

FINDING THE SWEET SPOT AS LEGAL AND COMMERCIAL ADVISOR TO LENDERS

BY **LON M. SINGER**

An attorney who advises lenders has the ability to offer more than legal advice to help these clients. Lon Singer examines the many facets of lender relationships with counsel.

The attorney who advises asset-based lenders and other lenders faces unique and ever-changing professional challenges. Foremost among these is striking the balance between providing purely legal advice and drawing on experience and market knowledge to also offer business/legal guidance. Doing so effectively can create substantially enhanced value for the lender and facilitate transactional efficiency.

Lenders and prospective borrowers always share at least one common goal — to close the deal. But in the course of the transaction, issues and obstacles inevitably arise. Achieving and maintaining a common understanding of where legal counsel fits into the equation is a matter of consequential and ongoing benefit to client and attorney alike.

THE NEW CLIENT

Establishing an optimal working relationship with a new client requires consideration of more than a few factors, but the first question to tackle is "who is our new client?"

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Is the new client an entire bank or just its ABL business unit? Is it a non-bank commercial lender? Each lender has different "standard" forms of agreements and may have distinct in-house legal teams. Perhaps the phone call retaining the firm came in from the business development officer (BDO) — but where does the BDO fit into the hierarchy of decision-making with respect to the specific transaction going forward? Where are important decisions regarding the credit going to be made during the documentation and negotiation process? What is the institutional chain of command, and to whom must counsel ultimately answer? These issues must be discussed and resolved prior to representing the client. The failure to deal with these issues up front can result in confusion or customer dissatisfaction during the negotiation.

WHAT IS THE CLIENT'S LENDING MANDATE?

A new lending platform may require comprehensive strategic and commercial advice from counsel in refining and implementing its lending mandate. This may include the development of standard forms of agreement for the client's use, assistance in the structuring of proposed transactions, and explanation of the implications of issues presented in the process of due diligence with respect to the business, organizational structure, and assets of prospective borrowers as they relate to the underwriting approach for the platform.

At the start of a new client/counsel relationship, the level of dialogue is likely to be frequent and extensive. More established market participants generally know both the relevant market standards applicable to their "space" with respect to most issues, and their own institutional "hot buttons" and other policies. Clients in this category may only wish to be consulted by counsel if and when proposed departures from precedents in their extensive loan portfolio are brought to the negotiating table.

WHAT IS THE RELEVANT MARKET?

Different clients operate in different portions of the debt market, and each segement has its own issues. Is the client lending to brick and mortar manufacturers, retailers, health care businesses, technology and/or life sciences companies, oil and gas producers and/or refiners, paper, chemicals, metals, or other specific business types, or is it industry agnostic? Understanding a client's financing platform requires a thorough appreciation of both its mission as a lender and where its business model places it in the market for debt financing. Mastering the client's lending blueprint from a prospective investor's standpoint is useful. Careful review of a client's prospectus materials for raising capital, public filings, and precedent documentation can all provide the requisite insight.

THE LONG-STANDING CLIENT

Long-standing clients and their counsel are invested in one another's success. But these relationships demand constant attention as personnel change regularly, markets are always in flux, and legal and regulatory requirements are ever-evolving. Lenders are constantly taking stock of their organizational structures, lines of reporting, and relationships among their business units. Almost daily, industry news wires announce the reconfiguration of lender groups and their leadership and objectives. Counsel may find the rules have changed overnight regarding what issues must or should be vetted and to what extent (and with whom) expectations have shifted. Best practices certainly demand a sit-down or an extensive telephone conference at this juncture. The financial crisis of a decade ago is certainly the most recent cataclysmic example of how quickly and substantially both the economic climate and the loan market can change. Lenders and counsel were suddenly forced to confront the mixed business and legal issues raised by the failure or inability of co-lenders to fund in syndicated transactions and subsequently had to revisit long-ignored boilerplate provisions and responsibilities for addressing extant crises, as well as the interpretation of long-ignored contract provisions. Ultimately, this led to refined defaulting lender language in loan documentation and the emergence of new market standards concerning the administration and implications of such provisions.

A common refrain among today's bankers is, "I have so much paperwork to do, I can't get my job done!" The "paperwork" is part of the job but is viewed by many bankers as burdensome and a distraction from their primary commercial mission. In partial response to the financial crisis, regulators have taken an increased interest in the operations and health of the banking industry generally and of particular sectors individually. Compliance departments at large institutions have exploded in size, and the federal government has published a handbook that has vexed the industry with each successive update, as has the *Interagency Guidance on Leveraged Lending*, first promulgated by the OCC, FDIC and the Federal Reserve Board of Governors in 2013.

As institutions struggle to underwrite risk while balancing yield and market share against strict compliance requirements, they and their law departments have interpreted mandates differently. Only regular dialogue with counsel can help ensure that important concerns are monitored and addressed through the proper channels. Mergers and consolidations have reduced the number of players in some segments of the loan market, while bank regulations have given rise to unregulated, alternative financing platforms and products. In each market, specialization and a strong desire to replicate dependable and successful transactional models have produced patterns of vertical and horizontal integration in the industry. On the lending side, a bank may work more regularly with a handful of sponsors leveraging the precedents from joint prior transactions to develop an efficient working environment. That positive outcome may result in similar preferences from the lenders. Managed with care, a long-standing pattern of successfully closing transactions together can produce synergies for lenders and their counsel that enhance a lender's reputation in its market and provide it with a valuable strategic advantage over its competitors.

ASSORTED ISSUES TO BE MANAGED

Pricing drives business for lenders, so they are obviously fixated on the latest interest rate trends. Counsel can serve as a resource because attorneys in the industry can have broad visibility of a wide range of transaction recently closed by their clients as both agents and as co-lenders. Additionally, counsel and client should be mindful of the interest-rate sub-issues that demand scrutiny in a dynamic market.

As the market struggles to find a uniform LIBOR successor, clients and counsel are conferring regularly, taking stock of what they see in the market in terms of both alternatives and language that preserves agent or lender flexibility to address the unavailability of LIBOR. Moreover, lenders are interested in knowing which other lenders have limited their discretion by reference to a requirement of uniform treatment of borrowers in the portfolio — or at least similarly situated borrowers.

INTEREST RATE FLOORS

As interest rates descended over the past decade, institutions faced, for the first time, the possibility of negative interests rates. Accordingly, interest rate floors were routinely adopted and became common components of both base rate and LIBOR rate definitions. Now, as rates begin their ascent, lenders are beginning to use increased floors to preserve yield expectations and are seeking insights from counsel about the use of the approach and the setting of levels.

Sensitivity to a potential "foot fault" continues to drive the energy around the event of default in credit agreements. This is another key area in which counsel and client are engaged in on-going dialogue about which defaults are going by the wayside entirely, which are subject to grace periods, and how equity or other cure rights are structured. Another common focal point is whether or not a "material adverse effect" default will be included among the events of default and how it should be constructed.

While lenders at the lower end of the middle market may have less ability to exercise flexibility in their transactions, lenders to more credit-worthy borrowers may seek guidance and input from legal counsel in addressing these issues with respect to default and fixing the proper baskets and materiality thresholds to apply to them.

Increasingly, significant energy and creativity are driving the development and negotiation of financial and liquidity matrices to circumscribe the conditions under which seller debt, affiliate debt, subordinated debt, and other third-party indebtedness may be serviced in the ordinary course as well as pre-paid. Clients and counsel will collaborate closely in the analysis of the objectives relative to earnings projections and anticipated facility utilization that are considered in this respect. Knowing what is being allowed generally in the marketplace is critical to assist clients with the essential triggers for negotiating flexibility in negative covenants. Similarly, understanding the client's familiarity with the market and the range of alternatives is an important part of adding mixed legal and business input.

Different clients have different needs and expectations. Getting to know your client and evolving the relationship on an on-going basis that accounts for changes in the client and its business and organizational structure, the finance marketplace, regulation and the economy is a key aspect of providing maximum value between counsel and client for their mutual benefit. As we move into the heart of 2019, here's wishing all of the participants in our industry healthy and robust lines of communication and equally healthy and robust credit facilities! •

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