

Recession Training 101



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Recession Training 101: Today's Agenda

- Introduction
- Trends in 2024
- What to Remember for a Troubled Credit
- Remedies- What Action Can I Take?
- Do's and Don'ts – Minimizing Risk

I. Introduction

Our seminar on Defensive Banking 101 explores how to document a loan so as to maximize lender's recovery. Today's seminar on Recession Training 101 will focus on what to do as loans become troubled assets and how lenders can minimize risk.

- **Hackett Feinberg PC** is a Boston based law firm of 30+ lawyers focusing on commercial lending and creditors rights; corporate deals and commercial real estate transactions, affordable housing and low income tax credit deals, employment law and counseling, estate planning.
- **Brian F. Plunkett, Esq.** is one of the firm's co-Managing partners. Brian is primarily a transaction and secured remedies attorney. Brian has been through 2 major recessions and the dot.com bubble before this one.
- **Shaun W. Briere, Esq.** is an equity partner in the firm's Transactional Group. Shaun's practice focuses on all areas of complex commercial finance, including leading the firm's renewable energy finance practice group.
- **Jacqueline M. Doyle, Esq.** is an associate in the firm's Litigation Group. Jackie deals with a wide variety of commercial litigation issues, with a focus in bankruptcy and creditor's rights.



Remember:

The workout starts on your desk.....



II. Trends in 2024

- Lingering Effects of SVB/First Republic failures
- Increased Emphasis on Deposits
- Higher Interest Rates
- Uncertainty Regarding CRE portfolios
- Desire by Lenders to Increase C&I Lending but Limited Credit Windows
- Increase in Workout Credits
- Increased Demand For Workout Consultants
- Loan modifications
 - Establishment of SOFR and Phaseout of BSBY
 - Covenant Amendments and Waivers



III. What to Remember for a Troubled Credit

- Review the Loan Documents
 - Check default, grace, cure and notice provisions
 - Is there a MAC clause?
 - Default rate provisions – when take effect?
 - Is there a Swap? Possible breakage issues affect restructure possibilities
 - Review Cross Default/ Cross Collateral provisions
 - Check possible perfection issues – special collateral

III. What to Remember (cont.)

- Review Intercreditor and Subordination agreements
 - Review notice requirements
 - Senior Debt Caps
 - Consent for amendments
 - Standby and blockage provisions
 - Only send notices if necessary. Consider “keeping your powder dry” as long as possible. But you may consider sending a reservation of rights letter when you do.

III. What to Remember (cont.)

- Is there a Participant?
 - Is this an Agented or Syndicated deal?
- Other Third-Party Agreements
 - Control Agreements (DACAs)
 - Landlord Waivers
 - Warehouse letters
 - Federal Assignment of Claims Act (FACA) notices
(often being held in escrow by lender)
- Keep an eye on Deposit Accounts

III. What to Remember (cont.)

- Covenant restrictions in Credit Agreement
 - Understand what a borrower is permitted or not permitted to do
- Covenant Waivers
 - Important to document
 - Include release language
 - as opposed to ROR notice
- Update lien searches, including tax lien searches as these are often early warnings of major trouble.
- Consider Litigation searches

IV. Remedies – What Action Can I Take?

- Default Notice/ Reservation of Rights
 - Don't delay. Starts "clock"
- Acceleration
 - Can I really make Demand?
 - Can I accelerate the loan based upon a non-monetary default?
- What else can I do?
 - Restrict Advances
 - Adjust Borrowing Base
 - Impose Default Rate
 - Restrict Distributions/ Payments to third parties



IV. Remedies (Cont.)

- What is the difference between a Forbearance and a Loan Modification?
 - Loan Modification:
 - Remains a Performing Asset
 - Waive defaults
 - Forbearance:
 - Classified as a Non-Performing asset
 - Acknowledge defaults by borrower
 - Provide time for borrower without waiving defaults
 - Both can include:
 - Release by borrower
 - Clarify provisions/ correct collateral issues
 - Require more reporting, cash flows
 - Turn-around consultant
 - Possible Forbearance or Modification Fee

V. Do's and Don'ts

Always include disclaimers in communicating with borrowers about possible solutions

When negotiating with a borrower about troubled credit, always include a disclaimer that the Lender is not bound by any terms discussed until final documentation has been agreed upon and signed.

Sample Workout Disclaimer

The Bank reserves all of its rights and remedies and waives none of the existing defaults. Nothing herein contained is to be deemed an agreement by the Bank to any waiver or modification of any terms of the loan documents or to any further forbearance. Any proposed terms and conditions contained herein are provided for discussion purposes only.

Inclusion of such a disclaimer can avoid many later misunderstandings, possible defenses to enforcement actions and complications.



V. Do's and Don'ts (Cont.)

Releases

Whenever you accommodate a borrower and enter into a loan modification or amendment, if at all possible, the documents should include release language. If you give a borrower a break, the borrower should release the lender. A release will bar any claims premised on events occurring prior to its execution.

V. Do's and Don'ts (Cont.)

Email Communications:

- Use Discretion- Never say something in an email about a borrower you would regret being made public. Keep in mind that one day a judge or a jury may be looking at your email or hearing a statement you made. “Mother knows best” – is that email or comment something you would want your mother to see or hear?
- This applies to internal emails between co-workers as well.
- Do not forward communications with your lawyer to a borrower or third party, since this may waive the attorney-client privilege.
- Be careful of the email chain when forwarding.



V. Do's and Don'ts (Cont.)

THINK BEFORE YOU SEND!

WE ARE OFTEN IN A HURRY WHEN SENDING EMAILS AND HIT THE SEND BUTTON WITHOUT PROOF READING OR THINKING ABOUT WHAT WE WROTE. THIS IS DANGEROUS. A POOR CHOICE OF WORDS OR A POORLY DRAFTED SENTENCE CAN RESULT IN SERIOUS CONSEQUENCES.

Example:

1) You have been asking for evidence of insurance from your customer without response. Exasperated you decide to be more forceful. You write:

“If we do not promptly receive adequate evidence of insurance, we will have no choice but to force place the insurance (we buy it for the customer) and charge it back to them. As you may suspect, it is much more expensive than the customer buying the insurance directly.”

The customer never provides evidence of insurance. The lender never purchases force-placed coverage. Some months later the building burns down. The borrower's attorney calls and asks for the force-placed insurance policy information. When told force-placed insurance was never purchased, the attorney makes lender liability threats arguing that the customer never sought to buy insurance believing the building was insured through the lender.

V. Do's and Don'ts (Cont.)

2) A good customer is having cash-flow issues and asks you for help in locating a source of funds to get him/her through the cash flow difficulty. You write:

“I may be able to provide you with an option for short term financing. We have a partnership with a non-institutional lender who we sometimes refer customers to in your situation. They specialize in helping with financing when traditional bank financing is not available. This may be a viable option to get you through this period. Please let me know if you would like me to share his contact information or have him contact you directly. We can assist with providing any financials needed as long as you authorize it, to make the process easier and faster.”

Unintentional hurried emails can lead to a myriad of troubles.

V. Do's and Don'ts (Cont.)

Privacy concerns-you are walking in a mine field of legal liability.

- Never speak to a possible new lender about a borrower you are trying to get out of the bank.
- Never disclose any information about the borrower or your collateral.
- Never provide a new lender with copies of your appraisals, environmental reports, etc.

You may think you are helping your bank get out of a bad credit, but you are also potentially opening yourself and the bank up to a lawsuit by the new lender or borrower.

REMEMBER: There is no such thing as an “off the record” discussion.



V. Do's and Don'ts (Cont.)

Never Destroy Documents or “Clean Up” a File

Destroying documents or “sanitizing” a file is not defensive or wise banking.

- It is foolhardy and it is wrong.
- What you think you have deleted or “fixed” will come back to haunt you.

V. Do's and Don'ts (Cont.)

Beware of “Course of Dealings”

- Always send a non-waiver letter as to future defaults when waiving a default in one instance.
- An established course of dealing may result in a waiver of loan terms that have been repeatedly ignored.
- If possible, rehabilitate the previously unenforced covenant or other default.

V. Do's and Don'ts (Cont.)

Don't Lead Borrower Down the "Primrose Path"

- Massachusetts law imposes duties of good faith and fair dealing on parties to a contract.
- Significant lender liability decisions against lenders when lender leads borrower or potential borrower "down the primrose path" and then at the last minute seeks additional concessions.

Example 1: Bank held liable when it assured borrower it would renew revolving line of credit and then on eve of its expiration insisted on additional terms. When the borrower would not agree, bank shut off line of credit with no prior notice, as permitted by loan documents. Court imposed liability based on bad faith.

V. Do's and Don'ts (Cont.)

- **Example 2:** Where a borrower was assured of a favorable interest rate by a lender to induce him to bring his business to that bank and then on the eve of the closing when the borrower had no ability to finance his acquisition elsewhere the borrower was told the rate would be much higher and he could take it or leave it, the court imposed significant liability on the lender. Again, even though there was no written commitment the court imposed liability for misrepresentation and unfair and deceptive conduct.
- **Conclusion:** Never pull out the rug from under a borrower at the last minute. If the relationship with an existing borrower breaks down prior to renewal of a loan or if you are inclined to shut off a line of credit unless there is a true emergency, allow a reasonable time for the borrower to find alternate financing. Don't leverage the threat to not advance promised funds to get better terms.

V. Do's and Don'ts (Cont.)

Control/Instrumentality Liability

Lender may require that a borrower retain a workout consultant and may suggest multiple candidates to borrower, but:

Never force a borrower to use a particular consultant or control the consultant's actions.

Lender should never specifically direct who a borrower should pay and who it should not pay or regularly approve or reject particular checks- this risks liability to the borrower and other creditors.

But it is okay to insist that the Bank be paid.



V. Do's and Don'ts (Cont.)

Lender Should Speak with One Voice

- The more voices the greater the chance of mixed messages, confusion and lawsuits.
- Lender needs a point person, but meetings may require witnesses.
- If you have a lawyer, then all discussions should be through counsel.

V. Do's and Don'ts (Cont.)

Helpful “Maxims”:

- Often your first loss is your best loss
- Try to avoid financing your own workout
- Trust but verify!

V. Do's and Don'ts (Cont.)

Do's	Don'ts
<ul style="list-style-type: none"> Keep to both the letter and spirit of the agreements 	<ul style="list-style-type: none"> Act precipitously; avoid surprises, sudden changes in direction or taking action with no or unreasonable notice
<ul style="list-style-type: none"> Be consistent; if you need to change your position, give reasonable notice you intend to change course 	<ul style="list-style-type: none"> Insist on unreasonable milestones
<ul style="list-style-type: none"> Give as much notice as possible, unless prejudicial to the bank 	<ul style="list-style-type: none"> Try to run or control your borrower's business; do not choose which bills your borrower pays, do not choose management or require the retention of specific professionals
<ul style="list-style-type: none"> Be fair, ensure that your actions appear fair to a reasonable person 	<ul style="list-style-type: none"> Lie or mislead (borrower or third parties)
<ul style="list-style-type: none"> Treat borrower's information confidentially 	<ul style="list-style-type: none"> Show personal bias
<ul style="list-style-type: none"> Be truthful, forthright, and courteous 	<ul style="list-style-type: none"> Be vindictive, arrogant
<ul style="list-style-type: none"> Keep bank management informed, involved 	<ul style="list-style-type: none"> Share your personal opinions; stick to the facts
<ul style="list-style-type: none"> Be careful of what you write; keep well written contemporaneous notes and memos for file 	<ul style="list-style-type: none"> Threaten, especially false threats (like those intended to merely get the borrower's attention)
<ul style="list-style-type: none"> Keep all remarks and notes professional in tone and content 	<ul style="list-style-type: none"> Try to placate the borrower; avoid statements like "don't worry, we'll work with you" may be used against you to establish an agreement with the borrower

V. Do's and Don'ts (Cont.)

Do's	Don'ts
<ul style="list-style-type: none"> Keep all agreements in writing, approved by bank/counsel, signed by senior management 	<ul style="list-style-type: none"> Oral agreements
<ul style="list-style-type: none"> Have witness on important calls/at important meetings 	<ul style="list-style-type: none"> Rely on solutions utilizing other people's money; be wary of solutions
<ul style="list-style-type: none"> Make it clear that there is no authority to waive, alter or amend. All negotiations and discussions are non-binding for discussion purposes only and subject to internal bank senior management approval 	<ul style="list-style-type: none"> Cc anyone other than counsel on any communication in order to maintain attorney-privilege
<ul style="list-style-type: none"> Always reserve the bank's rights and remedies in all communication 	<ul style="list-style-type: none"> Sign borrower prepared agreements; be wary of borrower prepared documents, have them reviewed internally and/or by counsel
<ul style="list-style-type: none"> Report suspected criminal violations 	<ul style="list-style-type: none"> Conceal borrower's wrong doing
<ul style="list-style-type: none"> Trust, but verify; borrowers are not your friends and desperate people can do desperate things 	<ul style="list-style-type: none"> Personal attacks or attempts at humor
<ul style="list-style-type: none"> Remember, always act in good faith; defined generally as "honesty in fact" and is an obligation of every contract 	

Any questions?

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