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JB BANKING LAW NOW

THE TOP THREE MISTAKES COMMERCIAL BANKERS MAKE WHEN DOCUMENTING A LOAN

Documenting commercial loan deals almost always involves the modification of set templates to reflect the specifics of a given deal. The templates may come from prepacked form banking law document providers such as Laserpro or Bankers Systems, or they may be templates from a law firm that is documenting the deal. In any event, the vast majority of the documentation is not drafted for the specific deal.

It is generally the case that the documents themselves are a bit less important and sensetive than some bankers might think if a deal subsequently goes into liquidation. In the vast majority of circumstances, a double sided loan agreement offers just as much protection as a 50 page, attorney prepared loan agreement.

All this being true, the question often arises whether there are mistakes that a banker can make in documenting a loan deal that ***will*** have a tangible effect on a subsequent liquidation? The answer is yes, but the mistakes tend to be of specific types, and are generally not always what a banker might expect.

Mistake One – The Security Documents are Not Properly Filed or Recorded.

As simple as it might sound, this is the single biggest and most common mistake a banker can make that will have a tangible, negative effect on the recoverability of a loan if the credit goes into liquidation.

Loan documents are typically very robust, and can generally weather various types of error, but security perfection practices are not nearly as robust. Mistakes like failing to file a UCC Financing Statement, misidentifying the debtor on a Financing Statement, failing to file Financing Statements in all states in which the collateral may be located, or failing to record a mortgage in all counties where the real property is located can fundamentally destroy the bank's security position if there are subsequent lienholders.

Believe it or not, these types of errors are actually ***more common*** when dealing with attorney prepared documents, rather than bank prepared documents. This is the case because sometimes the bank assumes the attorney is going to file the Financing Statement and the attorney assumes the bank is going to file the Financing Statement and it does not end up getting filed.

So, at the end of the day, check and then double check that the security interests are properly perfected, because the failure to do this is the biggest mistake a banker can make.

Mistake Two – A Key Guarantor is Missing From the Deal.

Very often in commercial loan deals, the actual borrower is a newly created entity that does not have assets outside of the property that is being acquired or built through the loan. The parties with the independent financial resources are very often the guarantors behind the deal – be it a parent company or the individuals behind the deal. In either case, it is very important to have these key parties execute guarantees.

Identifying all proper guarantors may seem simple, but often times it is not. In circumstances where there is a complicated scheme of related entities, it might be tricky to figure out everyone who needs to execute guarantees.

Additionally, it very well may be the case that there is a wealthy individual behind a deal, but most of his/her assets are held by a trust. In this case, the bank actually needs the trust to guarantee the loan, as well as the individual.

Bottom line, the failure to obtain guarantees from all appropriate guarantors can put the bank in a precarious position from a regulatory standpoint and it can materially harm the bank's recovery prospects should the loan go into liquidation.

Mistake Three – The Collateral is Encumbered by the Incorrect Parties.

The final common mistake is for a banker to fail to get all appropriate parties to execute necessary security documents for a loan.

As stated above, it is very common for a borrower to be a newly formed corporate entity that has no assets outside what is being acquired through the loan deal. However, it is possible that the new business operation will involve property actually owned by a related parent company.

A bank may think they have all bases covered if they obtain an all assets security interest from the borrowers and then a simple guaranty from the parent company, but they might be wrong. In such a scenario, there is still a security gap if it is the parent company who owns the applicable assets, and particularly if they have pledged a lien on such assets to another creditor.

In this case, a bank can get a judgment against the borrower, and it can get a judgment against the guarantor, but it may have no rights to repossess key business assets, because it did not get the guarantor to execute a corresponding security agreement. While such a failure ***may*** be remedied through post judgment collections, such a process is very cumbersome and might ultimately end up being futile if there are other creditors that have a properly perfected security interest in the guarantor's business assets.

Additionally, problems can arise in this area when a party properly pledges an interest in property, but the bank does not get all co-owners of that property to pledge an interest as well. In this case, the bank would only have a security interest in the borrower's fractional interest in the collateral. This could create a real mess because the value of the collateral would be less than the what the bank is expecting, and the bank may have to go through complex legal proceedings to even liquidate that partial interest.

As with the other major errors, this is a simple mistake to make, but it could have dire cosequences for the bank.

Conclusion

The major mistakes a banker can make in documenting a loan deal fall into two main categories: (1) collateral perfection mistakes; and (2) including the wrong parties on the loan and security documents. In either case, mistakes are avoided by slowing down, asking questions and consulting an attorney when particularly messy situations arise.

-Matthew Bialick, Esq.

Outside Insights

A Forum for Thoughts and Articles from Sources Outside of the Johnson | Bialick Law Firm

Does Your Bank Know What to Do After a Cyber Attack?

An Article by Dan Hanson, Senior Vice President at Marsh & McLennan

Many banks have made it a priority to install protections against cyber criminals, including stronger firewalls, two-stage authentication, employee training and more.

And yet, many of these same banks have no plan for responding to a cyber breach incident. It may be they feel safe once they have protections in place or, more likely, they simply have not made it a priority to develop a response plan. Either way, these companies are missing an essential part of an overall cyber-protection program.

A RESPONSE PLAN BEGINS WITH COMMUNICATION

That starts by establishing **who should be involved**. Your cyber incident response team should be comprised of key decision-makers and leaders of key functional areas who will be involved in responding to the cyber-attack. The team should include representatives from IT, legal, compliance and communications.

Once you have identified your incident response team, it is important to remember to include legal representation on all **critical communications**, as this will ensure that the content of those communications is protected by attorney/client privilege. Because your email could be compromised, it is recommended that initial communications be conducted by phone and team members should be careful to remember that information exchanged during calls and meetings should be kept confidential as any information that is prematurely released could cause further damage.

When you communicate is also important. The sooner, the better for the initial contacts within your organization. Communications outside of the initial list should be timely, but thoughtful as sometimes an early, but incorrect response can cause more harm than good. Be sure to consider legal and regulatory requirements as well; they vary by legal jurisdiction.

ASSESS THE EXTENT OF THE PROBLEM

Clearly, you will want to involve IT immediately. But the responsibility for accurately identifying the scope of the breach or how badly it damaged your company should ***not*** fall solely on your internal IT staff. There are too many specific state and federal standards that need a significant level of due diligence to ensure that you're meeting all regulatory requirements. Oftentimes, even if your IT staff has the capability to diagnose and remedy the situation, bringing in a well vetted third-party forensic firm puts your organization in a stronger legal position.

Therefore, your response plan should contain a **short list of qualified IT forensics firms** you can trust to work with your internal IT team to assess the situation and recommend any technological and training changes the company needs to make.

CARRY OUT THE REST OF THE PLAN

Once the assessment is complete and you have a plan to repair damages, you'll need to thoughtfully **notify others** and work closely with internal and external resources.

- Notify all employees as to what happened and what is being done
- Inform your customers as determined appropriate for your organization or legally required, make any necessary amends and let them know next steps
- Use Public Relations to speak to the public at large about what happened. The better cyber liability insurance policies will provide you with a PR expert in the event of an incident.
- Work with law enforcement
- Work with governmental regulators as necessary

CYBER INSURANCE POLICIES CAN PROVIDE ADDITIONAL HELP

Advanced planning like this is important for any organization, and will be valuable in the event of any cyber incident. Employers with well-written cyber insurance policies in place, however, are likely to be better positioned to weather the fallout. Not only will they be provided with financial remuneration for their losses, but they will also gain access to multiple specialists (attorneys, public relations specialists, and more) who can help them navigate the complex issues following an incident.

Check to see if your policy includes access to these "rapid response teams" of experts who specialize in post-cyber incident mitigation. The better policies in the marketplace do.

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WHAT EVERY BANK THAT IS "NOT AN AG BANK" NEEDS TO KNOW ABOUT THE AGRICULTURAL DOWNTURN

The economic strain in the agricultural sector is undeniable. A prolonged reduction in commodities prices has left many farmers with either razor thin profit margins, or else losing money. The affect this has on Ag banks is quite clear because when a bank's customers feel strain, the bank tends to feel strain. However, it is often less clear how banks that are "not Ag banks" are affected by these economic conditions.

Banks that are “not Ag banks” are nonetheless affected by the agricultural downturn if their customers are themselves providers of agricultural goods or services to farmers. This would include businesses such as grain elevators, commodities haulers, or companies that sell seed, fertilizer or pesticides. These businesses may start experiencing a decrease in sales and will very likely start experiencing an increase in bad receivables, which will increase the likelihood that they will start violating financial covenants or even defaulting on payments.

Fortunately, however, there is something a bank can do to protect both itself and its customers – make sure that the borrower is protecting its statutory lien rights. Minnesota Statutes Sections 514.963-514.966 provide a series of super priority liens to various agricultural goods and services providers. But, these liens will only help your borrower’s bottom line if: (1) they realize they have a super priority lien; (2) they take steps to properly perfect their lien; and (3) they either properly leverage their superior lien position to spur payment or else take the proper steps to foreclose on their liens.

Step One – Education.

Make sure your borrowers know they may have agricultural liens. All Minnesota Statutes are available online if you know the applicable section number (see above). The simple act of having a conversation with your borrower and passing on basic lien information could substantially assist their collection efforts.

Step Two – Perfecting the Lien.

While state law does grant various agricultural goods and service providers super priority liens, the liens only enjoy super priority status if they are perfected by filing a UCC financing statement within the applicable (and often very tight) time frame.

Additionally, in the case of crop and livestock production input liens, in order to gain super priority status the suppliers must provide their customer’s bank with written lien notification statements.

Step Three – Spurring Payment.

Unfortunately, simply having a lien does not automatically mean that the borrower will receive full payment or that it will receive payment quickly or easily. To ensure payment on bad receivables, even when the borrower has a perfected super priority lien, the borrower will still need to either use the leverage created by the lien to spur voluntary payment, or else they will need to follow the correct procedures to foreclose on their super priority lien. However, this can be a long and cumbersome process.

If all of the above steps are followed, then the borrower will be in a markedly better position with respect to its past due receivables and it will be less likely to violate financial covenants in the applicable loan documents or be forced into a monetary default. That being said, DO NOT ASSUME that your borrower is already protecting its lien rights. The existence of these agricultural liens is often not well known and few businesses take the proper steps to protect their lien rights. By providing some education a bank can ensure that everybody wins.

-Matthew Bialick, Esq.

JB Banking Law Today for Ag Banks

JB Banking Law Now is the commercial banking companion newsletter to JB Banking Law Today, which focuses exclusively on agricultural banking issues. If you would like to view JB Banking Law Today, the most recent issue can be accessed by clicking on the below link.

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