AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
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Feature

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Free Agency in Restructuring?

Best Practices for Administrative Agents of Distressed Loans

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It is inevitable that more syndicated commercial loans will become distressed and require restructuring, whether in or out of bankruptcy court. With many industry experts predicting an economic downturn, underperforming loans are likely to become increasingly common. A question that frequently arises for administrative agents under a credit facility with underperforming or distressed loans is whether the agent should resign its position or remain as agent.

This article describes the typical role of administrative agents, discusses added considerations when loans become distressed, and analyzes issues to be considered by agents in deciding whether to resign or remain in distressed situations. This article also suggests certain best practices for administrative agents during restructurings to maximize recoveries for lenders, while limiting any potential liability for the agent.

The Loan Process and the Role of Administrative Agents

In large lending transactions, a borrower (or its equity sponsor) might hire various banks to explore loan-structure alternatives and arrange the best possible financing terms. One or more "lead banks" are selected to arrange the loans, take responsibility for various aspects of the deal, and syndicate portions of the loans to other banks and investors in order to spread risk. One of the lead banks becomes the administrative agent and often serves as the collateral agent, executing security documents and perfecting any liens. The agent bank might retain loan exposure, typically through a revolving loan, and will sometimes serve as the agent under one or more term loan facilities, even without retaining any position in the term loans.

After closing, the agent performs administrative tasks, such as distributing interest and other payments to lenders, facilitating borrowing and funding requests, and continuing or converting interest periods. In addition, the agent normally serves as a conduit between the borrower and the lenders for information-sharing and other reporting to private- and public-side lenders. The agent also maintains lender lists, effectuates trades, and facilitates routine waivers and consents. Agents earn relatively nominal fees for these general tasks.

When Loans Become Distressed

When a borrower experiences financial distress, the agent's role will likely expand. Specifically, the agent might facilitate more significant waivers, consents, amendments and/or forbearances. In connection with such matters, the agent might need to interface with the borrower, lenders and other parties on more sensitive matters and address issues related to future borrowings, including when a default seems imminent. Issues often come up on an emergency basis and require immediate attention and action.

In extreme situations, especially when a distressed borrower has liquidity issues, the agent might be asked to facilitate additional funding. The agent may even need to consider taking enforcement action, although doing so frequently requires an explicit direction from some portion of the lenders. The agent may also need to have its counsel conduct full collateral and covenant reviews and analyze any restructuring proposals.

During Bankruptcy

In bankruptcy, an agent will continue to make any distributions and facilitate information-sharing. In addition, the agent and its counsel might need to review — and have substantive input on — various documents to be filed in bankruptcy court, including those related to the borrower's financing and proposed reorganization plan. At this point, the agent will be focused on ensuring that the following issues are raised and favorably addressed by the debtor: adequate protection, lender treatment and plan-distribution mechanics. Since schedules listing the faculty will likely not be filed at the outset of the proceedings, the agent may also want counsel to prepare a proof of claim on behalf of the lenders and participate in various hearings before the bankruptcy court.

Issues such as whether and when to convert interest periods might become more routine after bankruptcy, given the bankruptcy default. However, other administrative tasks might become more involved, including when agents are asked to assist on the syndication of debtor-in-possession (DIP) loans and in connection with more complicated plan structures that require the distribution of multiple forms of consideration to lenders.

Resignation Considerations

When the administrative agent is also a lender (typically with revolving loans or other significant financial exposure), the authors' experience is that it usually elects to continue as agent. An agent that is also a lender can potentially better protect all the lenders' interests, including its own, while still fulfilling its obligations as agent. Given the way that deals are structured in today's lending market, having additional, early access to information, such as restructuring proposals and strategies, can be invaluable.

By remaining as the agent, the bank might also be better positioned to realize related business opportunities, such as arranging and/or participating in rescue or replacement financing outside of bankruptcy, as well as DIP and exit financing should the borrower end up in bankruptcy. Such transactions generally need to be effectuated on an expedited basis, and the agent might be in the best position to take a lead role in such transactions, given the agent's real-time involvement and situational knowledge.

When the agent is not a lender and has no other significant financial exposure, the authors' experience is that the agent often considers resignation. The two reasons commonly given for resigning are an imbalance between the work required and the fees, and possible legal liability for actions that the agent might take in any default or restructuring situation.

Notwithstanding those concerns, there are situations where the agent might decide to continue in its role despite not having any immediate financial exposure. One reason might be the agent's relationship with the management team or the owners of the borrower (especially private-equity firms), where a resignation might adversely affect future business transactions with those parties. A second reason is that, depending on the circumstances, it might be advisable from a business perspective to "hang around the hoop" and seek the business opportunities previously noted, which would likely be precluded by resignation. Every agent and their legal counsel should evaluate their legal exposure before making a decision, but, as discussed below, the agency-protective language commonly present in credit agreements should make any such liability remote.

Protections for Administrative Agents

Credit agreements can materially circumscribe agents' potential liability exposure to borrowers, lenders and third parties. Specifically, in most agreements, the agent has broad discretion and owes no fiduciary or other duties to either the borrower or the lenders.

Most credit agreements also provide for exculpation and full indemnification from the borrower for any liabilities arising from any actions taken by the agent (typically with a carve-out for gross negligence or willful misconduct). If the borrower cannot fulfill its indemnification obligations, then such obligations are assumed by the lenders. In practice, most borrowers and lenders ultimately reach a consensual restructuring of the borrower's obligations, and if the agent has participated in such a process, then it should be specifically released from any potential claims by the borrower and participating lenders.

In more complex situations, the lenders might organize themselves, and sometimes an agent can even consider encouraging the lenders to organize, with the agent either leading the group or deferring the leadership role to other lenders. When a group of lenders holds a majority of the total lender claims, those lenders can direct the agent, removing some of the burdens of decision-making and further mitigating liability. For any action that might be considered controversial (*e.g.*, acceleration, enforcement or commencing litigation), agents are usually only required to act at the written direction of required lenders (and even then, agents might retain some discretion).

Option to Resign

Although the agent typically cannot be forced to resign, it almost always has the option to do so. In situations where an agent bank acts as an agent for more than one loan that might have competing interests in any restructuring transaction, it might be advisable for the agent to resign one of those roles. Where an agent has no exposure and is particularly concerned about liability issues, resignation might be the best alternative.

When agents resign, certain actions are usually recommended. Resigning agents should give sufficient notice to facilitate the appointment of a replacement agent, assist with finding a replacement agent and negotiate a resignation agreement. Resigning agents should also ensure that they maintain their contractual indemnity and expense-reimbursement rights. Although it is generally possible to resign at any time, including in bankruptcy, if practicable it is best to complete the resignation process before the borrower becomes significantly distressed.

Best Practices for Administrative Agents with Respect to Distressed Loans

When agents remain in place and participate in restructuring distressed loans, the following best practices can help protect them from potential negative ramifications.

Hire Professionals

Agents should consider hiring certain professionals when a loan becomes distressed. First, agents should retain counsel to (1) assist in the matters previously discussed, (2) assist in formulating strategies and restructuring alternatives, (3) analyze any restructuring proposals, and (4) negotiate and draft any amendments or similar agreements. In many situations, it might be helpful to utilize lawyers with restructuring expertise at the same law firm that worked on the original lending transaction, given such firm's extensive knowledge of the deal structure and its background, but agents may also consider engaging a new firm if specific circumstances make that option more appropriate.

Similarly, agents might want to retain a financial advisor to assist in developing and evaluating potential alternative capital structures. Such advisors can also provide advice on remediating any operational challenges. These professionals can also help raise capital, if needed.

When lenders have organized and hired their own professionals, it might be most efficient for agents to share the lender group's financial advisor (or for the group to share the agent's advisor). Either way, relying on the advice of professionals can provide additional protection for agents.

Coordination and Communication

Agents should seek to increase coordination among different areas of their institution, including the workout and risk-management groups, while also bolstering communication among the borrower, the lenders and any other relevant parties. Agents should also maintain regular contact with the borrower and lenders to ensure that they can help facilitate any proposed transactions, which often have accelerated timelines. Agents should also make sure that the lines of communication are open among all parties' professionals.

Document and Collateral Review

Agents might already be familiar with the relevant loan and security documents, but, once distress is apparent, they should have their counsel undertake a new, more detailed review of all relevant materials and leverage institutional knowledge. Among other things, the agent's team should be fully up to speed on the background of the transaction, amendment thresholds, financial and other covenants, and the terms of any intercreditor agreements. This effort should ensure that the agent is best prepared to be a constructive partner in a restructuring, including identifying provisions that could be tightened or otherwise improved, as well as proposing viable restructuring alternatives.

Agents should also have their counsel carefully identify all collateral granted under the security agreements — either confirming that everything is properly perfected or identifying (and correcting) any defects. This process should also identify any assets excluded from the collateral package. Amendments and forbearance agreements should be utilized to fix any issues with collateral and to expand the collateral package. Depending on the situation, counsel might also be able to identify unencumbered assets that could be used to raise new money, including as part of a DIP loan.

Seek Explicit Direction from Required Lenders for Any Controversial Actions

As previously discussed, credit agreements typically provide the agent with exculpation and indemnity for any liability not resulting from its gross negligence or willful misconduct. Thus, when agents are directed by required lenders to take any action, loan documents typically provide that they are *per se* exculpated for that action. Such provisions not only give agents added protection from any direct claims, they also help shield them from criticism from the other lenders and the borrower. For example, explicit direction helps protect the reputation of the agent and deflect the legal exposure if there is any dissent among the lender group or concerns over the borrower's or other lenders' reactions to any proposed course of action.

Be Proactive and Ready to Take Action

Agents should as be as well informed as possible with regard to the borrower's financial situation and should press the borrower for all of the information that is necessary to assess the borrower's short- and long-term prospects and liquidity needs, and any potential restructuring transactions. When the time comes, agents need to be ready to act.

When circumstances dictate, agents should first consider incremental actions, such as charging default interest and/or exercising cash dominion, if permitted. If all else fails, agents and their advisors should be prepared, especially if so directed, to accelerate the loans or take other remedial enforcement action, which might include foreclosing on collateral or commencing a lawsuit.

In bankruptcy, agents might also want to be proactive with respect to potential time-consuming tasks. These could include assisting with any diligence and related "know your customer" issues for any new lenders and also determining effective distribution mechanics and logistics well in advance of plan consummation.

Conclusion

On its face, serving as an agent on distressed loans might sound challenging, and resignation might seem appealing. However, most loan agreements provide an agent with explicit protections that minimize any legal exposure.

Continued engagement in a responsible and well-advised manner should enable an agent to protect its and other lenders' investments. Moreover, persevering agents are often able to take advantage of beneficial business opportunities. Agents should consider all potential ramifications — positive and negative — before determining whether it is prudent to resign or continue in a given situation. abi

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