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Form v substance: agents' liability in syndicated loans

As part of their current exodus from the syndicated lending market, lenders are outsourcing loan administration to third parties. An agent with no stake in the loan will usually have little intimate knowledge of the facility he is administering. Yet, if the loan fails, a distressed borrower is not an attractive target. An agent is. So what are the agent's main exposures? More importantly, how well do the Loan Market Association (LMA) standard terms address them? The answer is: relatively well; but a prudent agent will seek additional terms to try to enhance his contractual protection and will take several practical steps to minimise any residual risk.

WHAT ARE THE RISKS?

Chiefly, the agent's risks are: acting outside the scope of his contractual authority; exercising discretion; and breach of his fiduciary duties. All three expose him to liability from the syndicate, with the additional risk of claims from the borrower and third parties for breach of fiduciary duties. So his foremost priorities are to avoid any responsibility whatsoever for the substance of a failing loan – and to pass on his costs of dealing with the fallout.

HOW DO THE LMA TERMS PROTECT THE AGENT?

- They **limit his duties** to “solely mechanical and administrative” obligations. He is not typically obliged to review or check the documents he circulates. He is not required or relied upon by the lenders to carry out any know your client (KYC) checks. Absent “actual” knowledge, he may assume that no default has occurred.
- They **protect against lender disengagement**, by allowing him to act on the instruction of the majority lender and to exercise his discretion (unless expressly required otherwise by the facility agreement).
- They **narrow his exposure** by a disclaimer of fiduciary relationships, a broad exclusion of liability to his principal/lenders and a wide indemnity from the lenders.
- **But** – acts of gross negligence and wilful misconduct are not protected, and there is a residual risk that a court may disregard the contractual disclaimer of fiduciary relationships in certain circumstances.

WHAT TO ASK FOR (AND WHEN), TO PLUG THE GAPS IN THE LMA STANDARD WORDING

- Amend “actual knowledge” (of default) to “written notice”.
- **Exclusion of liability** for third party actions, omissions or fraud.
- **Pass on legal advice costs** to the lenders.
- **Protect against incorrect instructions/notices**. Extend the indemnity to cover losses incurred as a result of acting upon or responding to any notice, request or instructions.
- Permission to **disclose confidential information** to avoid breach of any law or fiduciary duties.

- Permission to **do anything necessary or desirable to comply with** (or to refrain from doing anything which might constitute a breach of) any law or regulation.
- Permission to engage in **other business dealings** with the borrower.
- **Appointment of the agent** by new/replacement lenders to the syndicate upon signature of a transfer document.
- **Incorporate the security trustee**. Add the security trustee to all the agent protections, waivers and disclaimers. Exclude him from any obligation to act upon the instruction of the lenders. Protect his right to act without the consent of the syndicate in legal or arbitration proceedings relating to the perfection, preservation, protection or enforcement of the security.
- **Seek enhanced protection early on**. Lenders will be more willing to agree changes at an early stage, compared to when the loan goes into default.

PRACTICAL TIPS FOR AN AGENT IF A LOAN GOES INTO DISTRESS:

- **Who has approval rights?** Check all collateral documents. Mezzanine lenders may need to be involved.
- **Avoid exercising discretion**. Seek prior majority lender approvals, even if not strictly required. Keep a paper trail.
- **Do not act outside your authority**. Take legal advice on the exact nature and scope of your contractual and fiduciary duties (and your contractual protection).
- **Create a timeline** for proposed solutions; so that your lender principals have sufficient information to seek approval from their credit committees.
- **Beware of conflicts**. Different lenders within the syndicate may have varying participation at different levels of the borrower's capital stack. Or, you may have hedged the borrower's position. If in doubt, establish separate teams of advisors to handle the conflicting exposures to the same borrower and take legal advice.
- **Streamline communications**. Assess if the borrower should meet with the lenders. Direct communications risk mixed messages and jeopardising the syndicate's majority approach.
- **Maintain a clear, syndicate-approved dialogue** with the borrower. Do not give false hope of prospects for a successful restructuring or the likelihood that the syndicate may approve specific proposals. ■

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