

## Six Guidelines on Dealing with a Borrower after Default

This paper will focus primarily on measures a Lender should take, and actions it should avoid, when a Borrower defaults under its loan. The main focus will be preventing the costly and dreaded Lender liability action.

1. Acceleration – The primary basis for acceleration should be a payment default. The only times a Lender should attempt acceleration upon the occurrence of a non-monetary default are when (a) repayment is materially impaired by the default or (b) the Lender's security is materially endangered.
2. Communication with the Borrower – The Lenders must be concerned with credit and internal memoranda where the documents refer to (a) controls to be placed on the Borrower (control liability), (b) strategies to deal with the Borrower (threats and coercion), and (c) retroactive reevaluation of credit (Lender knew loan was bad and intended to ultimately take control). Remember, most internal communication, of any kind (email, calendar notation, etc.) may be discoverable in a lawsuit unless the Lender can claim and establish attorney-client privileged communication. The Lender must also be careful to document conversations with the Borrower to avoid lender liability suits arising from verbal communications. Additional suggestions to avoid this problem would be to (i) conduct meetings in person in the presence of at least 2 other officers, (ii) always have counsel present when Borrower's counsel is present, (iii) document any meeting after completion, and (iv) restrict communication to a single point of contact.
3. Avoid Appearances of Control – Control liability is established by the facts surrounding the relationship so, extreme care must be taken in the extent to which control is maintained. Areas of significant concern would be (a) payment of other creditors only with the Lender's consent, (b) prior approval of business plans, and (c) personnel decisions made by the Lender.
4. Fiduciary Contexts – The finding of a lender's fiduciary duty to a Borrower is still a stretch; however, a lender may cross the line when it (a) deals with inexperienced or dependent Borrowers, (b) offers financial advice and counseling, or (c) engages in self dealing, profiting at the expense of the Borrower.
5. Threats – There are no safe circumstances where threats are an appropriate negotiation technique in a workout context.
6. Course of Dealing – While the Lender and the Borrower often deviate from the specified terms of the loan documents during the course of the loan; the Lender must make sure that it gets the relationship back on track

through the execution of “negotiation agreements” and “forbearance agreements” prior to the instigation of a workout. These agreements, along with carefully drafted non-waiver language in the loan documents will avoid the “course of dealing” allegations often brought by a disgruntled Borrower.

While there are other considerations and issues a Lender must address pre-workout, adherence to these precautions will get the ball moving in the right direction.