BUFFALO Law Journal

VOL. 87 _ NO. 41 _ OCTOBER 12, 2015 _ EST. 1929

Institutional knowledge key to lending success

Many of us are familiar with the recent cautionary tale of a certain financial institution and its disappearing blanket lien. The bank, as agent for a bank group that had made a very large term loan, and its counsel accidentally filed a termination statement on the term loan UCC-1 at the time of the payment by the same borrower of a secured financing by a different syndicate agented by the same bank.

On appeal of the creditors' committee in the chapter 11 case of the borrower, the appellate court held that, under the Uniform Commercial Code applied to the facts of the case, the agent had authorized the termination of the term loan blanket lien, and the term loan lenders went from being happily secured creditors in the bankruptcy to very unhappily unsecured creditors.

GUEST COLUMN

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This outcome could have easily been avoided with a history lesson.

Businesses may obtain financing from multiple and separate sources, whether institutional lenders, the public, private equity and venture capital investors, and nontraditional lenders. Institutional lenders, in particular, will enter into a relationship with business borrowers with hopes of those relationships becoming long term and the lenders providing all or most of their customers' capital financing needs.

In a climate where financial institutions, and law firms, are growing, consolidating or shrinking; where finance professionals are more transient than ever; and where businesses are accessing more and newer capital sources, one of the keys to a successful partnership between a lender and its borrower — to avoiding the kinds of errors that doomed the bank — is a focus on maintaining institutional knowledge.

That is, a lender, its customer and their respective law firms must prioritize their own continuing familiarity with the transactions between the parties, as well as other major transactions or relationships of the customer (such as subordinated debt or equity financing).

That seems straightforward and obvious, but any new deal between a lender and its corporate borrower might involve new bankers, new attorneys within a law firm or an entirely new law firm, or new financial executives at the company. We have all been there, chasing down an unreleased UCC-1 from a loan that was paid off three years ago when none of the bankers or lawyers who worked on the discharged loan are still around.

The parties to a financial transaction rely on the institutional familiarity of their law firms with the existing transactions among the parties to ensure the new financing is consistent. These transactions are often heavily negotiated and not simply papered with off-the-shelf agreements.

It is not just about releasing the correct UCC-1s. It is about consistency of covenants, collateral descriptions, reporting requirements, defaults and even the parties. It is about all of the proper filings being made, confirmed and renewed if need be. It is about preparing amendments, restatements and waivers that are comprehensive, accurate and legally sufficient.

It is about creating a full and accurate record of the transaction so that others can rely on that record when the next financing comes in. It is about not giving counsel for the debtor or a creditors' committee a hook to challenge the lender's liens or other rights if the company's business goes south. It is about avoiding avoidable surprises.

The senior lawyers involved in the lending relationship must have a strong working familiarity with the parties' transactions and must build their firms' institutional knowledge of those deals, so that if they are not available their firms can do the next financing efficiently, confidently and professionally.

If the junior lawyers on a financing are new to the client, the senior lawyers must closely supervise their work product but must also make them, and make them feel, part of the client team for the next transaction. For that matter, junior lawyers should join the effort and take proprietorship of the client; the more they know about the client's business, the more valuable they will be to the client and the firm.

If the firm is new to the client (whether the borrower or the bank), the transactional attorneys must invest the time to deeply familiarize themselves with the existing transactions, as well as identify any other company transactions that might affect the new financing. It might mean putting aside pride of authorship and not using your new and better form of mortgage when the bank already has a mortgage loan to the borrower.

The opening story illustrates, to the harshest extent, what can happen if law firms fail to successfully prioritize their institutional knowledge of client matters. In the first instance, the preparation of the loan releases (including the UCC-3s), documentation ordinarily prepared by bank counsel, was delegated to company counsel.

The releases were prepared by junior associate attorneys and paralegals at the company's law firm who had little to no familiarity with the ongoing lending relationship. And no one at the bank's firm familiar with the lending relationship — no attorney vested in the representation — took responsibility to see that the lien releases were correct.

At the end of the day, the client is entitled to know that its lawyer whose name is on the door will be responsible to see that the correct UCC-1 is terminated.

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