Lenders Are from Mars, Borrowers Are from Venus

Anthony & Partners Helps Financial Institutions Addressing Problem Loans; Offers Valuable Insights in the Context of a Distressed Economy

In a nationwide economic downturn that has lasted more than three years, hitting Florida more dramatically than many other states, John Anthony and his teammates have been kept busy responding to the demands of financial institutions grappling with unprecedented levels of non-performing assets (NPAs).
In a recent interview, Anthony and his teammates at Tampa-based Anthony & Partners fielded questions relating to their practice, the philosophy of "special asset officers," and the differing perspectives of banks and debtors in problem loan contexts.

What is a "special asset," and what sort of bank officer is typically given responsibility for dealing with a defaulting commercial borrower?

Based upon unfavorable trends in our economy, compression and competition in the banking industry, and extremely aggressive governmental regulation, financial institutions are necessarily quick to classify a loan as "non-performing" if there is a material event of default that reasonably calls into question the ability of the bank to be fully repaid as promised. Examples of defaults that warrant transfer of a loan to "special assets" may include (a) installment defaults, (b) insufficient financial reporting, (c) lapse of collateral insurance, (d) dissipation of collateral, (e) property tax delinquency, or (f) defaults with the same or other financial institutions, the IRS, or judgment creditors.

The financial institution is generally more than happy to take reasonable measures necessary to resolve a credit and restore it to mutual profitability, but the actual outcome depends upon how the debtor and creditor together respond to the situation. A financial institution has every motivation to keep NPAs low, and keep its income-producing assets high. The special assets department is composed of officers with specialized experience in addressing non-performing loans in a manner that is calculated to reduce risk of non-payment, avoid write-off of debt, and minimize the time and money expended to achieve these goals.

What do you see as the respective viewpoints of a financial institution and a defaulting borrower in a typical default scenario?

A borrower experiencing business reversals has a natural desire to conceal or minimize the bad news. This tendency can stem from an optimistic perspective that the problem will be solved, a misunderstanding of the severity of a reversal, or simple fear of the lender's adverse response. The lender, upon finding out facts that should have been fully reported by a troubled borrower, is typically concerned about the competence and/or good faith of the borrower hiding or misunderstanding problems impacting the rating of their loan.

While it is clear that many loans cannot be satisfactorily restructured in a commercially reasonable manner, many opportunities can be lost by the failure to meaningfully understand both sides of the lending relationship. For so long as a borrower is prepared to act in good faith, provide competent data for monitoring and grading

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the lending relationship, and commit an appropriate amount of its resources to service debt, a lender will generally accommodate to the fullest extent that prudent banking norms and regulatory guidelines permit.

What are the typical options available to a lender evaluating options for an NPA, and what considerations militate in favor of one or the other strategy?

Whenever the disposition of the borrower, the sufficiency of the collateral, the availability of cash flow, and other favorable factors predominate, loan restructure is preferable. A workout may be as simple as a forbearance agreement calculated to relieve ongoing capital requirements. More complex packages are tailored to maximize opportunities or overcome business or legal obstacles.

When a borrower's business, financial, and legal problems involve multiple creditors with conflicting goals, chapter 11 can afford the parties a platform to reliably restructure bank debt, discharge or reduce trade debt, downsize or otherwise modify business operations, and emerge successfully with the going concern intact. If the lender and borrower demonstrate good faith, without attempting to defy norms of commercial lending, chapter 11 can work.

When there is a shortage of collateral, income, or good faith, the lender may have no alternative but to sue. An excellent litigated result is generally worse than a good business result. However, a judgment is always preferable to inaction in the eyes of bank management and bank regulators.

What is lender liability, and how does lender liability litigation impact resolution of problem loans?

Some borrowers perceive that a lender will not talk to them about loan restructure unless they make threats. It may relieve tension in the short term for the businessperson to blame the lender, but this is almost always counterproductive. Rather than facing business and financial realities, forgery allegations, holder in due course arguments, spongy bad

Frank Lafalce and Stephenie Biernacki Anthony

faith claims, and other theories come advanced. From the perspective of a special assets officer, whose chief goal is to restructure debt whenever practicable, spurious allegations are perceived to be indicative of bad faith. Dockets have been congested due to reduced judicial budgets and increased foreclosure filings, and bogus lender liability claims and defenses are often clearly calculated to delay the inevitable. That does not provide special assets officers with optimism for the borrower. I have never seen a valid bad faith claim asserted against financial institutions, but I have seen many deals not get done because a borrower insists on counterproductive threats.

From your experience over the years, do you have any thoughts on how the system of addressing problem loans might be improved?

Florida is one of the few states in the southeastern United States that requires judicial foreclosure. This is great for lawyers on both sides, but it is bad for financial institutions, and very bad for small business. If the risk and uncertainty associated with foreclosure were removed, lenders and their borrowers would share a realistic perspective of the alternatives available in workout contexts. Judicial foreclosure wastes money and time, and creates unnecessary uncertainty. Until Florida joins the majority of states that have non-judicial foreclosure, judges and lawyers on both sides should focus on producing results that are fast, economical, and fair to everyone. We lawyers take an oath to uphold the law, and to refrain from intentionally delaying the administration of justice – you don't need to be a judge to understand the sacred nature of our duty.

From speaking with Anthony and his teammates, there emerges a sense that the goals of business executives dealing with business and financial distress can often be successfully harmonized if there is a greater appreciation and understanding of the respective viewpoints.

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