



THE PITFALLS OF LOAN PARTICIPATIONS

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CONTEXT

- **Reasons for Participations**
 - increase lending limits
 - diversify portfolio
 - manage risk
- **Historical Treatment**
 - the times are changing
- **Define Your Role: Lead or Participant**
 - examine the strength of your business relationship
 - define acceptable level of risk in those contexts

DECIDING TO PARTICIPATE

- Duty to Provide Accurate Information by Lead
- Duty to Investigate by Participants
- Common Standard for Both: Exercise Prudent Bank Judgment
- Practice Pointer: Segregate Materials

THE PARTICIPATION AGREEMENT

- Contract that Governs Relationship
 - form vs. individually negotiated
- Same Form for All Participants?
 - may vary by \$, relationship, etc.
 - want to know if some participations treated differently
- What Documents With the Borrower Might Be Incorporated?
 - credit agreement, note, mortgage, security interest

SELECT CONTRACTUAL PROVISIONS

- Duty/Standard of Care by Lead
 - usually relates to the administration of the loan
 - contracts are normally attendant with duty of good faith and fair dealing
- Most Participation Agreements Limit Applicable Standard
 - disclaim warranties
- Examples:
 - “shall act with honesty in fact but shall not be liable for any action taken or omitted except in case of willful misconduct . . .”
 - “Seller will not be liable to Purchaser for any action taken or omitted or for any error in judgment, except for bad faith or willful misconduct.”
- Practice Pointer: Clarify which obligations are governed by the Standard of Care

SELECT CONTRACT PROVISIONS

- Duty of Disclosure
 - obligation to provide pertinent financial information
- What Must the Lead Provide?
- Examples:
 - “complete and current credit information regarding the following: loan accrual status; status of principal and interest payments; financial statements; property values and lien status”
 - “any factual information bearing on the continuing credit worthiness of the Borrower”
- When?

SELECT CONTRACT PROVISIONS

- **Actions by the Lender**
 - additional lending to Borrower
 - within loan
 - outside of loan
 - modify the loan agreement
 - extend the loan
 - declare default
- **Do the Participants Have Voting Rights or Written Approval?**

SELECT CONTRACT PROVISIONS

- Assignments
 - by Lead
 - by Participant

SELECT CONTENT PROVISIONS

- Remedies vis-à-vis Borrower
 - veto select actions
 - audit books and records
 - call default
 - any action under the loan agreements?

SELECT CONTRACT PROVISIONS

- Remedies vis-à-vis Lead
 - negotiate written approval or voting rights
 - removal and substitution of Lead
 - lawsuit
- Qualifying Events to Trigger Remedies
 - breach of participation agreement
 - insolvency

CONCLUSION

- General vs. Specific Provisions
- Offset Risk (standard of care) with Protections (voting rights, written approval, remedies)

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