Professional Perspective

Implications of Borrowers Rejecting Assignments of Syndicated Bank Loans

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Loan agreements frequently require the borrower's consent to the assignment or sale of a syndicated bank loan. Recently, however, the settlement of many secondary bank loan trades has been thwarted or delayed because the borrower has refused to consent to the assignment by the applicable loan agreement. In an environment of increasing financial stress, borrowers may deny consent over concerns that the new, prospective loan buyer may in the future be uncooperative should the borrower need approval of a future loan agreement amendment or facility restructuring.

For bank loan buyers and sellers, the denial of consent can result in delay, increased cost and even trade failure. For the market, outright denials and the uncertainty created undermine the growing liquidity of the secondary bank loan market. This contraction hinders the increasingly open and evolving model of liquid bank loan trading.

Syndicated bank loans often contain a standard condition to assignment that the borrower and the administrative agent consent to the assignment. Standard language continues that this consent right is generally limited by that it may not be "unreasonably withheld." In many cases, loan market participants that have been denied consent have questioned whether such denial was in fact "reasonable" or what constitutes unreasonable denial.

The unreasonable refusal to grant consent can be costly to participants in the secondary market, and market participants who are denied consent to assign a loan may seek to challenge such refusal. This memorandum briefly discusses the consent requirements, issues raised by the increasing number of consent denials, and the legal framework that might be used to analyze a challenge to such denials.

Consent Requirement

In general, agents and borrowers include consent requirements in their loan agreements to ensure that their lender syndicate consists of sophisticated, creditworthy institutions that will see "eye to eye" in connection with lender group issues. To the extent the relevant loan facilities include revolving or delayed draw term loan commitments, the borrower and the agent also have an interest in insuring that each syndicate member has the ability to meet its future funding obligations. In addition, agents want to have confidence that new lenders are able to meet their obligations to indemnify the agent against any costs or liabilities they may incur on behalf of the lending group.

To address these concerns, most US syndicated loan agreements require that prospective assignees be "accredited investors" and have experience in making or purchasing bank loans. In addition, these loan agreements provide that the effectiveness of any assignment to a non-lender is conditioned on receiving the consent of both the agent and the borrower, which consents will not be "unreasonably withheld."

This consent right provides an opportunity for agents and borrowers to review information concerning potential lenders' financial and legal condition. The diligence process takes time, but consent is provided to the vast majority of proposed assignments.

Increase in Borrower & Agent Refusal to Provide Consent

In recent months, a substantial number of assignments have failed to garner approval because a borrower—or, by proxy, the borrower's private equity sponsor—has withheld consent to all or certain classes of prospective lenders. Some borrowers have used their consent power to ensure that new lenders will be receptive to their requests for waivers or restructurings of the loans.

Borrowers and agents that have already begun the process of gathering lender support for an amendment, waiver or restructuring of the loan agreement are often reluctant to admit new lenders to the syndicate that are not supportive of the deal. Many borrowers contend that commercial banks are likely to be more receptive than other lenders to restructuring or refinancing proposals and therefore reject investment funds that have reputation for being aggressive or activist. In addition, borrowers controlled by private equity funds will often reject other private equity funds who wish to become lenders.

Regardless of the explanation, the increased difficulty in obtaining consents to assignments has been disruptive to the secondary market for bank loans. In many cases, substantial amounts of time pass before the borrower or agent responds to the consent request, and lenders will often be required to submit large amounts of confidential diligence materials for review.

Loan Participants

Parties to a trade that have used a standard Loan Syndications and Trading Association (LSTA) trade confirmation that cannot get approval for an assignment are obligated to then settle by participation, a settlement mechanism that can have many disadvantages for the parties. In acquiring a participation interest, the buyer of loans is thwarted in its ability to become a lender of record and finds itself as the holder of only a beneficial interest in the loan, with no direct relationship with the borrower and no direct voice in any lender discussions regarding proposed loan amendments or restructurings.

As a result, increasingly we see disputes arise between these "accidental" loan participants, who naturally want more control over the decision-making with respect to the underlying loan, and the grantors of the participations who are unhappy or unwilling to do the participant's bidding. Understandably, the grantor banks are not only concerned about their reputations and future relationships with the borrower and fellow lenders, but they may disagree with the participant's decision making and often have their own loan positions to worry about.

While the LSTA form participation agreement provides some guidance on how these rights should be allocated, the inability of market participants to settle loan transactions by assignment will inevitably lead to more discord.

Dispute Between Borrowers & Lenders Likely

Lenders who are unable to assign their loans because of a borrower's or agent's refusal to provide consent are concerned, and we believe that more disputes are inevitable. Unfortunately, courts have not yet established parameters for when consent may be reasonably withheld with respect to the transfer of syndicated loans.

Case law developed in other contexts has given rise to the principle that where a party has promised not to unreasonably withhold its consent, it may do so only for a "legitimate business reason" exercised in good faith. All contracts have a duty of good faith and fair dealing, and the consent right may not be exercised to deny one party the benefit of the bargain.

Thus, for example, a denial of consent cannot render the loan untransferable. See, e.g., *Ferolito v. Vultaggio*, 911 N.Y.S.3d 323, 325 (App. Div. 2010). Borrowers who with agreements that have an express requirement that consent not be unreasonably withheld may find themselves facing claims such condition creates a covenant, the breach of which can create claim for damages.

The largest body of law dealing with the reasonableness of consent to assignment arises in the landlord tenant context, and that case law is informative but hardly elucidating. See, e.g., *Est. of Del Terzo v. 33 Fifth Ave. Owners Corp.*, 25 N.Y.S.3d 154, 156 (App. Div. 2016); *Dress Shirt Sales, Inc. v. Hotel Martinique Assocs.*, 190 N.E.2d 10, 11 (N.Y. 1963). When a lease provides that consent to assign cannot be unreasonably withheld, the lessor may only refuse consent based on objective factors, not based on subjective, personal, or speculative concerns. See, e.g., *Est. of Del Terzo*, 25 N.Y.S.3d at 157; *Logan & Logan, Inc. v. Audrey Lane Laufer, LLC*, 824 N.Y.S.2d 650, 651 (App. Div. 2006). Acceptable objective factors could include the proposed assignee's financial responsibility, their suitability for the particular property, and the nature of the occupancy—i.e., office, factory, retail.

But what constitutes a legitimate business reason in the syndicated loan market is not clear. Borrowers that establish blanket policies limiting the types of entities that are acceptable or that refuse to consent absent a buyer's commitment to vote a certain way will argue that they are acting to protect a legitimate business interest and, thus, are acting reasonably in denying consent.

Such refusals, however, may be deemed unreasonable if the borrower is trying to get more than what they bargained for under the loan document in the guise of the consent right. See, e.g., *Chanslor-Western Oil & Dev. Co. v. Metropolitan Sanitary Dist.*, 266 N.E.2d 405 (Ill. 1970) (withholding consent unreasonable where made conditional upon altering lease terms). Also, a rejected loan purchaser may not have standing to challenge the denial of consent given that a prospective purchaser is not a party to the loan agreement. See *Atl. Gas & Wash LLC v. 3170 Atl. Ave. Corp.*, 964 N.Y.S.2d 57 (Sup. Ct. Nov. 14, 2012)

Lenders will likely respond that the only reasonable criteria that may be used to evaluate prospective lenders are their credit-worthiness and their ability to otherwise meet their obligations as lenders. They will argue that borrowers are improperly attempting to use their consent rights to add borrower-favorable terms that were not part of the original loan agreement. For instance, the refusal to consent to an assignment merely because the new lender may exercise its rights under the loan agreement in a manner adverse to the borrower's interest is probably not reasonable. The borrower has already granted voting rights to lenders and should not seek to alter the terms of the loan agreement as a condition of assignment.

Similarly, by selectively excluding certain entities as lenders based on their actual or perceived response to the borrower's proposed loan agreement amendments or waivers, an argument can be made that the borrower is, in essence, using its consent right to push through an amendment of the loan agreement. Thus, the categorical refusal to provide consent to an assignment to say, "all hedge funds," in this view, would violate the terms of the loan agreement. See, e.g., *Ferolito v. Vultaggio*, 911 N.Y.S.3d 323, 324–25.

Conclusion

Not since the 2008 financial crisis has the secondary loan market seldom faced the types of obstacles to the assignability of a loan that have recently begun to emerge. As a result, the line between reasonable and unreasonable withholding of consent has not yet been drawn. Until clear rules emerge, loan market participants, when assessing the risks associated with transactions in bank loans, should consider the risk that required consents will not be obtained.

