

Turnaround Consultants Help Banks Avoid Lender Liability

THERE HAS BEEN an alarming increase, particularly during the past six to eight months, in the number of lawsuits filed and judgments entered against banks and other secured lenders. The debtor companies have filed on behalf of themselves and others complaining of excess lender control and other "sins" including the original sin — a fraudulent conveyance during a leveraged buyout (LBO). In short, unsecured creditors are successfully suing secured lenders that have not exercised satisfactory due diligence in reviewing the borrower's business plan, solvency management strength in the front end, and have not practiced restraint in the back end.

These lender liability pitfalls have prompted many lenders to add independent turnaround consultants to their due diligence teams. Whereas banks typically employ well-educated and aggressive loan officers, turnaround consultants can add reliability and credibility to the due diligence process.

An independent due diligence review runs the full gamut of financial and business analysis, ranging from testing assumptions of the business plan and examining financial data, to evaluating personal qualifications of management and solvency both before an LBO or other secured financing, and after giving effect to it.

An experienced financial/management consultant's objective review and evaluation provides lenders with invaluable third-party verification of the borrower's financial condition, viability and ability to repay the loan. Such impartial documentation is especially important in LBOs, whether at the loan origination stage or in a workout.

Prior to closing an LBO or other leveraged funding transaction, it is recommended that the lender thoroughly review and document the impact of the financing on the borrower's existing and future financial condition, and projected cash flow.

In addition to more traditional documentation, the lenders's closing file should contain as many of the following items as possible:

- Pro forma statements, certified by a company official, of the "real" borrower's assets and liabilities, on a non-consolidated basis, using market, orderly liquidation and liquidation values giving effect to any contemplated financing.
- In addition, the orderly liquidation and liquidation value statements should include all debts, such as contingent, unmatured and disputed obligations, along with an explanation of how the figures were determined by the borrower.
- Cash flow projections, certified by a company official, for at least the term of the loan on a "going concern" and "orderly liquidation" value basis.
- A statement, certified by a company official, that all non-disputed payables are current.
- In an LBO, confirmation from the seller that it is aware of participating in a leveraged funding transaction and understands the impact of such financing on the business going forward. Accordingly, if the transaction is attacked at a later date, liability could rest with the seller, the real beneficiary of the financing, rather than the lender. — *D.M. Morris*