Armstrong Teasdale

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SOMETHING COMMERCIAL LENDERS CAN LEARN FROM CONSUMER LENDERS

The Secured Lender

Lenders regularly say that there are only two good days in the life of a loan: the day it closes and funds, and the day it's paid off. Everything else is work. That said, the day-to-day work of administering a loan, reviewing borrowing base certificates, making advances, and assuring that the borrower is in good stead is what the lender bargained for when it made the loan. But that part of loan administration that lenders never bargained for is collecting out a loan after it has gone bad. Workouts may be stressful, but litigation is something beyond that. No lender wants to spend good money after bad trying to collect out a loan and defend itself against claims - usually unfounded - of a lender's alleged misconduct. Defending itself in court is one thing where it is assumed that rational minds will prevail. However, defending itself in court also means that it is defending itself in a public forum, often with press coverage, which means that it is defending itself against emotion and not reason.

It is worse for consumer lenders where they are more prone to having to defend themselves against class actions. As a result, consumer lenders learned to turn to arbitration and to restrict such arbitrations to single claimants. Arbitration, coupled with a waiver of class action, can provide comfort to the consumer lender. Consumer claimants continue to bring their claims in arbitration, and where warranted, arbitrators grant awards in favor of consumers. But when that happens the lender is generally spared the negative publicity that often follows such results.

Critics of arbitration may call this *forced arbitration*, but it is anything but forced. Despite claims to the contrary, consumer arbitration clauses tend to be in bold face or otherwise highlighted in the agreement. In addition, consumers are given a period of time to opt out of arbitration - even after the loan has closed and funded. It is noteworthy that consumers are not given the option to opt out of any other provisions of the loan, such as the obligation to repay the money borrowed.

But because of *bad press* about consumer lenders (some of which may have been well-deserved), as well as pressure from critics such as the Consumer Financial Protection Bureau and various state attorneys general concerning

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forced arbitration and other complaints, consumer lenders allow a borrower to rescind the arbitration provision during a reasonable period following the closing and funding of the consumer loan.

So, what can commercial lenders learn from this? First, recognize that there is a significant difference between consumer borrowers and commercial borrowers, who are presumed to have the requisite knowledge and experience (including access to legal advice) to *knowingly* enter into a loan agreement containing a mandatory arbitration provision. As a result, arbitration provisions contained in a commercial loan are not prone to the type of criticism of their counterparts in consumer loan agreements.

That is not to say that a prospective borrower will not push back on a mandatory arbitration provision contained in a loan agreement just as it may push back on any other loan provision. The negotiations of the loan agreement will result in whether the arbitration provision, or any other provision for that matter, will remain in the executed loan agreement or be modified in some way.

So why arbitration and not litigation? Those of us who have been engaged in lawsuits concerning a commercial loan know that it can often turn into a rabbit hole. Yes, a typical collection case, an action to recover on a note or a guaranty action, will typically be resolved by a motion for summary judgment on the pleadings. But even these cases can take a long time to work their way through the court system.

Consider what happens to these ordinary course cases when the borrower alleges bad acts by the lender and a court sustains those claims denying the motion for summary judgment. The lender is then faced with a costly litigation, including open-ended discovery – document production, including electronic discovery; depositions; experts; discovery motions; pre-trial memorandums; trial testimony; and post-trial briefs. And then come the appeals.

Ka-ching! Document production, electronic discovery (ouch) and depositions comprise the greatest expense of a litigation.

And all (or most) of this is contained in public records and offer fodder to reporters looking for anything hot that will get the attention of their readers and viewers.

Lenders may consider avoiding (or at least mitigating) all of this by replacing their typical *litigation* clause with an arbitration clause. If the Lender wishes to retain the right to bring its action in a state or federal court, it may reserve that right while it requires arbitration for any action brought against the Lender. Typically an arbitration clause will provide that the proceedings and results be kept confidential. That can save the Lender from the *bad press* that results from rare (but painful) instances when borrowers prevail on their claim of a

lender's bad acts.

Keep in mind the benefit of confidentiality. Even when the lender is successful in a court decision and succeeds in obtaining an order dismissing lender bad-act claims, the story is out there and *bad press* results even from such a successful decision.

How do you invoke arbitration? Arbitration begins with the loan agreement. Remove the litigation jurisdiction sections and replace them with a comprehensive arbitration clause. In drafting an arbitration provision, you can limit those things that run up the cost of a litigation. Yes, the parties must pay for the arbitration, but those costs are easily mitigated by scaling down the extent of those things that run up costs and make litigation so expensive. And you can require a timetable that puts the arbitration on a shorter schedule than you would get in court. Of course, your arbitration clause will contain a confidentiality provision that would bar any negative ruling from finding its way to a court – and the press.

There are many tools available to assist one with drafting an arbitration clause such as AAA ClauseBuilder. ClauseBuilder and similar drafting tools takes you through all the necessary elements of a proper clause and explains why each element is important.

Your arbitration clause can include such things as selecting the arbitration administrator (e.g. AAA, JAMS, etc.), the venue for the arbitration, the number of arbitrators (typically one for smaller cases and three for larger cases), the experience of the arbitrator, the method of selection of the arbitrator, limitations on discovery, variations from the standard rules of the administrator.

You can also provide for a "documents only" arbitration, whereby there will be no hearing – just an exchange of briefs and exhibits. You may wish to include a fast-track provision where there is minimal or no discovery (absent for good cause shown to the arbitrator) and where the hearing, if any, and the decision are locked into a strict schedule.

The perception that arbitration is more costly than litigation is a fallacy, although at first blush it may appear to be because the arbitrator gets paid much more that the filing fees for a typical lawsuit. But considering the time and expense of lender's legal counsel, an arbitration can pay for itself by keeping the case on track and by preventing runaway costs. And, of course, the arbitration clause may provide that the borrower pays, as litigation provisions impose the costs on the borrower.

Cross-border loans have long been subject to arbitration for the resolution of disputes, where choice of law and the location for hearing might otherwise be chaotic. The Loan Syndication and Trading Association model loan agreements

for cross-border loans contain arbitration provisions in place of the litigation provisions that you might see in its domestic forms.

With more and more lenders tipping their toes into arbitration and recognizing its benefits, this is a roadmap to the future of dispute resolutions in commercial finance. The time has come to take that next step.