

Loans: Universal truths

How borrowers can understand and limit legal risks for all loan types

INTERVIEWED BY JAYNE GEST

Virtually every business and individual borrows money at some point. Although there are many different loan types available, some universal concerns apply to every loan. Borrowers need to understand these issues and know that they may be able to limit their risk through negotiating their loan documents.

“Borrowers don’t always fully appreciate the risks they are taking when borrowing,” says Catherine A. Marriott, a member at Semanoff Ormsby Greenberg & Torchia, LLC. “Often, a default which could have been avoided can result in acceleration of a loan, putting personal and business assets at risk.”

Smart Business spoke with Marriott about what provisions counsel should review, whether or not he or she participates in the negotiations.

What are issues borrowers should consider?

Often, borrowers extend lines of credit via a simple modification document, without reviewing the documents signed when the loan was first obtained. In doing so, they run the risk of violating representations and warranties that were true when the loan was first made, but are not necessarily true when the loan is modified. Further, borrowers may not be aware of operating and financial covenants that apply to their business, and often think that because they have not had any issues in the past, there is no need for concern now. While that may be true, reviewing the initial documents is critical in avoiding defaults going forward, as circumstances and goals may have changed.

For new and existing loans, borrowers must be sure that they understand:

- All business terms, such as the monthly payment obligation, interest rate,

amortization term, prepayment penalty, and operating and financial covenants.

- What collateral is pledged for the loan, including security interests in equipment, inventory and accounts receivable, and, most importantly, personal guarantees.

- The remedies that the lender has upon a default, including confession of judgment for money or possession of real property, and what effect enforcement of these remedies could have on business and personal assets.

What should be considered regarding personal guarantees?

Many borrowers form entities to keep business and personal assets and liabilities separate. Notwithstanding this goal, principals of small and midsize businesses are almost always required to personally guarantee business loans, resulting in risk to personal assets. Although these individuals are aware of their personal liability, the extent of their exposure may not truly be appreciated.

How does confession of judgment work to increase borrower risk?

Confession of judgment is a powerful remedy available to commercial lenders in Pennsylvania. It allows a lender to immediately obtain a judgment against a borrower or guarantor (or both) for money or possession of mortgaged property. The



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money judgment will include the accelerated amount of the balance of the loan, plus interest, late fees, attorney’s fees and costs of collection. A borrower or guarantor will have the opportunity to open the judgment only after it is entered, rather than defend the matter before it becomes a judgment. An attorney can advise of the risks and consequences of confession of judgment.

When should counsel be reviewing the loan documents?

Certain loan provisions are legal in nature, so borrowers should consult with an attorney to understand the legal risks. By doing so at the outset, counsel can advise not only on whether borrowers are receiving market terms, but also can assist with modifying or eliminating provisions that are negotiable. Counsel can make sure that borrowers understand their obligations, and that the loan terms adequately address the borrowers’ needs and business goals. The later counsel gets involved, the more difficult it becomes to improve the loan terms.

Even if a borrower has never had problems with its loans or lender, things can happen. Considering what is at stake, all borrowers should strive to minimize their risk. Spending a little time and money now to protect business and personal assets in the future is invaluable. ●