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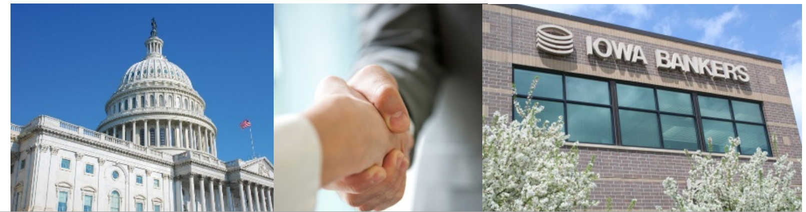

Challenges Lenders Face in Today's Ag Economy

Bob Hartwig

Legal Counsel

Iowa Bankers Association

Fenwirth was known for his uniquely gullible style of cross-examination.

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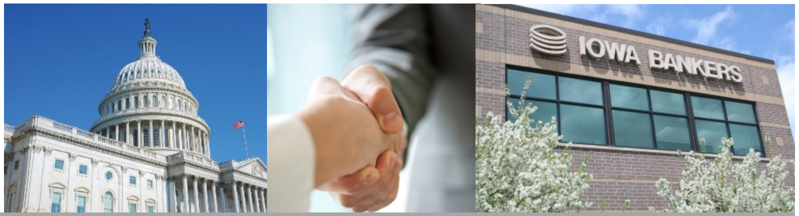


Challenges Lenders Face in Today's Agricultural Environment

Lender Liability

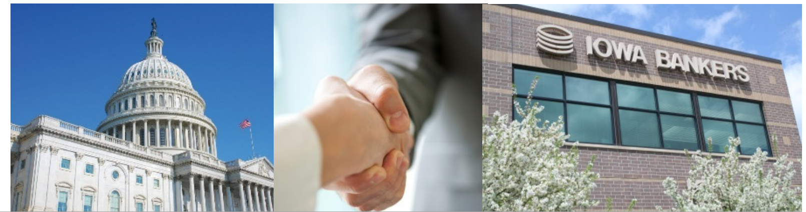
What is it and why should producers care?

Lender liability is a result of a lenders <u>conduct</u>.

This may include behaviors, activities and communications

Most cases are the result of:

1. **Negligent conduct**
2. **Breach of fiduciary obligations**
3. **Excessive control by the lender**

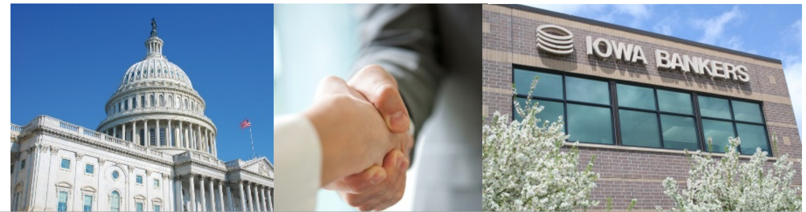


Lender Liability, continued

Negligent Conduct

- **Iowa courts have been hesitant to hold lenders liable for negligence in the processing, originating and servicing of loans as banks are typically held to a standard of conducting arms length transactions, and not in the business of making warranties or claims regarding the loan.**

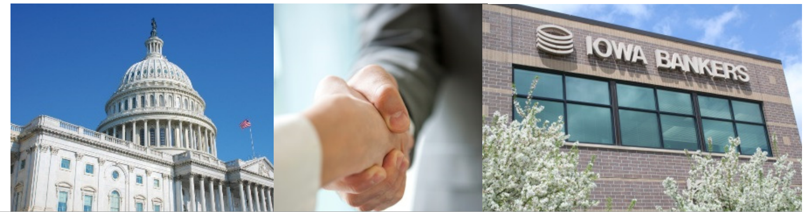
- **However if banks are also conducting inspections, appraisals, etc., it could be in the business of supplying such information and would need to do so in a non-negligent manner.**



Lender Liability, continued

Breach of Fiduciary Obligations

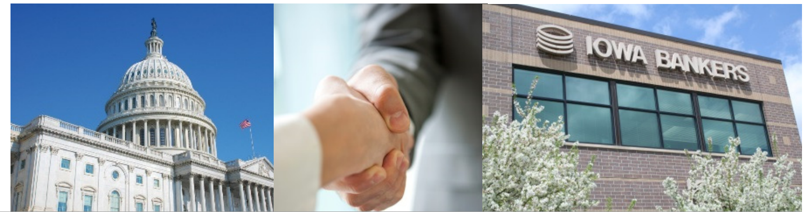
- **The Lender/Borrower relationship under Iowa law does not automatically create a fiduciary duty on behalf of the lender.**
- **Situations where Iowa courts <u>have</u> found a fiduciary duty include:**
  - **Where there are repeated dealings between the lender and borrower over a long period of time;**
  - **A lender’s advice to the borrower about the borrower’s financial position when the lender is in a position of influence or particular trust over the borrower;**
  - **Lender’s exercise of control over borrower’s affairs; and**
  - **When the lender has a self interest in the transaction.**



Lender Liability, continued

Breach of Fiduciary Obligations

- **Lenders in these transactions will always try to avoid:**
  - **A chain of events where the borrower has complete trust in his or her lender and the lender takes advantage of that trust and thereby obtains an "unconscionable advantage" in the eyes of the court.**
  - **Lenders should also avoid putting into question particularly during a workout situation that it exercised "excessive control" over the management and operation of the borrower.**



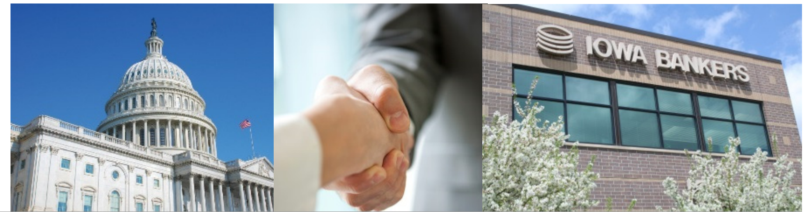
Lender Liability, continued

Excessive Management and Control by Lender

A common fiduciary breach claim in the ag lending area, where courts in some situations have held lenders become fiduciaries by reason of their <u>dominion and control</u> over operations of the borrower. Factors holding lenders liable in these cases include:

- **Voting power**
- **Section of management**
- **Economic leverage**
- **Control of financial affairs**

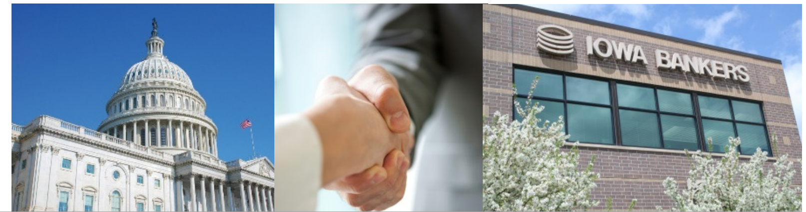
Most courts have stated that economic leverage alone, without some actual control or ability to control, will not rise to the level of excess dominion and control by lender.



Other Lending Considerations

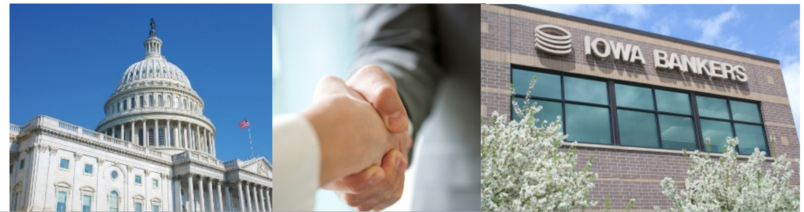
Loan Classification Issues

- **Total Debt Reconstruction – What is this and how is it viewed by the federal and state bank regulatory agencies? This is a restructuring of debt that:**
  - **Is made to a borrower experiencing financial difficulties; and**
  - **For economic or legal reasons, a creditor grants a concession to a debtor that it would not otherwise consider.**
  - **Creditors always aim to:**
    - **Maximize collection/recovery; and**
    - **Expect that by granting concessions this will increase repayment likelihood by matching with borrowers ability.**



Loan Classification, continued

- **Total Debt Reconstruction – Regulators require banks to write down loan amounts where the loan exceeds:**
  - **Present value of future cash flows for loans not collateral dependent; and**
  - **Fair value of collateral – if collateral dependent.**
  - **Collectability of these loans must be reviewed quarterly and any portion of the loan deemed uncollectable must be charged off.**



Loan Classification, continued

Other General Loan Classification Issues

- **Carry over debt from Ag Operating Loans – Not automatically "classified" by the regulators and charged against loan loss reserve but:**
    - **Examiners will look at ability to restructure debt and amortize the carry over amount – cash flow is very important!**

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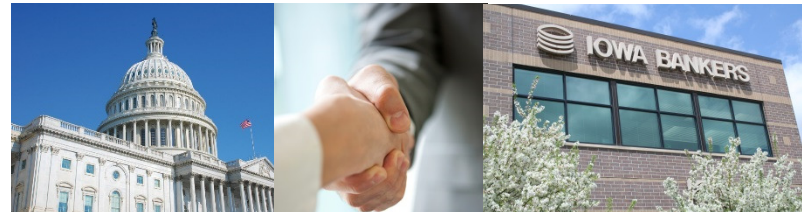

Questions?

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