

Loan agreements

The wriggle room factor

Shane Simpson

I was recently visiting a major American art museum and the Registrar of International Loans said 'Contracts are really important but we always try and build into them some wriggle room.' It made me think – because it is completely the opposite approach to that which a lawyer takes: a lawyer tries to make the contract as concrete as possible. So I got to thinking: what did she really mean? What was it that she was trying to do when introducing uncertainty into the terms of the relationship?

On further discussion, what she was saying was this: first, there is sometimes an inability to capture all of the possible eventualities in the loan agreement. Secondly, she was saying, *sotto voce*, that if there were ambiguities they would most likely be resolved in favour of her museum because it was so prestigious and powerful. Whilst this approach may be a Real Politic approach, it underestimates the value of certainty that a well-drafted agreement can bring. It is understandable that Loans Registrars who are responsible for drafting agreements adopt this approach – because they are not expert in instructing lawyers to draft and they are not expert in drafting legal documents themselves. High-level drafting is an art. It takes years to learn to do it well and many collecting institutions, bereft of resources, rely on standard contracts that have fitted most loans over the years.

Standard contracts are certainly useful. However, they are generic documents and are designed to accommodate the majority of situations – not individual or idiosyncratic ones. Standard documents definitely have 'wriggle room' because they do not and are

not designed to, deal with situations that fall out of the norm. When a problem arises, too often you find that the key issue is dealt with inadequately or ambiguously, or not at all.

So my first question for you is: 'How long is it since your institution's standard loan documentation was rigorously reviewed to see how it might be improved?'

You may well say, 'Well, we take the standards and change them to make them relevant to the individual case.' And that is a very sensible way to use standard loan agreements. Unfortunately when a well-meaning highly educated amateur gets out his or her drafting pencil to make amendments, that is when lawyers make plans to buy a yacht. I have seen contracts drafted by so-called 'contracts officers' in major Australian institutions that are abysmally amateur: confusing, ambiguous, internally inconsistent, and sometimes simply wrong in law.

This is not their fault. They are doing their best – and often it is good enough. Their job has been designed by others; they have been selected to do the job; presumably there are quality controls over the job they do. The issue goes to one that I raised earlier in this conference – one of risk management. Whilst the board and the senior staff talk earnestly of risk management, they have traditionally left the institution exposed to considerable liability because of the standard of the documentation that articulates the assumption and exclusion of risk and liability.

Private lenders vs Institutional lenders

In my experience, private owners are much more risk conscious and averse than institutional owners. Perhaps it is because a

private lender has fewer pieces of exhibition quality and thus has a greater personal financial and emotional investment in the loan, but they tend to examine the loan-in agreement very closely and often retain their lawyers to do so. They are more assertive than institutional lenders and are increasing prepared to seek recourse to the law.¹

Private owners are often less flexible than institutional lenders: institutions, because they are in the business of making and receiving loans, are very familiar with the processes and are aware that long term relationships are often the best guarantee of solving a loan problem. A little give and take sometimes eases both parties through the rough passages of the loan. For private lenders however, the loan is personal and comparatively unusual and there is rarely a trusted history of loans between lender and borrower. For private lenders, 'wriggle room' is not acceptable.

I would like to spend some time looking at some of the clauses in loan agreements that, over the years, have been frequent visitors to my desk.

Time issues

Most loan agreements contain many stipulations as to time. They may relate to delivery of the loan to the borrower; the duration of the loan; the duration of the exhibition; the date of return or pick-up; and even restrictions as to the amount of time that a piece may be on exhibition or lit.

These are largely dealt with as administrative matters. However, what happens when the unusual arises? For example:

- What happens if a lender demands return of the loan during the course of the exhibition? Will the contract cover this? Will it either state that the loan period cannot be terminated for any reason? If it can be, does it specify those events and does it articulate the many other consequences of the foreshortening of the loan?
- What happens if the lender fails to pick up the loan at the end of the loan period? What rights does the borrower have? Are they clearly spelled out in the agreement?

Long-term loans create their own wriggles. I shall not go into the many issues that can arise from an inadequately drafted long-term loan agreement. Most collecting institutions discourage long-term loans. Those that are accepted should always be subject to a loan agreement that stipulates that:

- the loan will be reviewed every five or so years; and
- that it is the lender's responsibility to advise the borrower of any change of address;
- that the lender will give the borrower a reasonably long and specified period of notice before requiring return of the material;
- that the borrower can terminate the loan on a reasonably short and specified period of notice; and
- that if the material is not collected within a certain period after the expiration of that notice, the borrower may dispose of it as it sees fit and may apply the proceeds of that disposal (if any), as it sees fit.

Unless otherwise specified, most loan agreements should be very particular as to the owner's right to withdraw from or terminate the loan. Where the item is lent for an exhibition the document must be very clear that the owner may not withdraw from the loan until the end of the exhibition period. The exception is a situation where the owner reasonably believes that the loan item is endangered in some way – whether as a result of treatment by the borrower, threat from war or terror, or other such reason.

Restrictions accompanying the loan

Some loans have quite onerous accompanying conditions that are not directly related to the loan. For example, a private owner may agree to lend provided that access to the objects be restricted, that information provided to the public about the objects be limited, that photography be prohibited. These kinds of restrictions tend to be more commonplace with private lenders than institutional lenders.

Everyone at this conference knows that such co-lateral restrictions must be given very careful consideration before they are acceded to. It is important that the borrower

not be unduly restricted in its use of the material – not just for exhibition but also use in its associated functions such as its public programs and research activities. There is a natural balance in this regard: for example, where the loan is particularly valuable or fragile it may be entirely reasonable to restrict secondary activities and thus minimise the risks associated with such uses.

But let me turn this issue on its head. If the lender has a particular reason for not wanting its property to be used in particular ways, it should make sure that this is specified. Similarly, if it is important to a borrower that it is able to use the loan in particular ways, those ways should be specified. Otherwise, you end up in the unfortunate position, in the middle of the loan, having a dispute as to the use that is being made of the loaned property. If the borrower does not specify how it wishes to use the loan and the extent and nature of those uses, it certainly has wriggle room (to say that it was not prohibited and therefore it was permitted). On the other hand the lender also has the wriggle room to argue that as the particular use was not explicitly granted in the agreement, it was never intended or agreed.

Better that the contract should remove the ambiguity and be explicit as to such things.

Calamity

Important loans are often, indeed usually, accompanied by extensive schedules as to what should happen in the event of calamity. I am surprised that it is not absolutely standard practice for loans over a certain value to be accompanied by such requirements. When the loan suffers a calamity there needs to be a pre-agreed protocol so that each party knows exactly what is going to be done in such event. The lender has an obvious reason to insist that this is rigorously drafted because it is the lender's property that is at risk. Similarly, the borrower must be absolutely sure that it can comply with such expectations and obligations before entering the loan agreement. Should a calamity occur, it is essential that the borrower knows exactly what to do, what it is permitted to do and how and when it must communicate with the owner.

I have seen such situations arise in which there is no calamity protocol in place and there have been considerable arguments as to the appropriateness of the conservation steps taken and as to the adequacy of the communication of the borrower with the lender. I have seen loans in which the lender does have calamity protocols but has failed to make them an enforceable legal obligation under the contract simply because of defects in drafting.

When the worst happens, if you are the owner, there must be no wriggle room. You

should be completely secure in the belief that the borrower knows and understands its obligation both in the way that it will treat your damaged or endangered property and in the manner and standard of its communication with you.

Insurance

Will the borrower insure the object for the period of the loan? What are the details of that cover? What is the insurance value of the object? Is it 'wall to wall' insurance or does it exclude transport? Does it cover loss, theft, damage and destruction? Are there any important exceptions of which the lender should be aware?

Museums must remember that insurance policies are only contracts and, as such, are negotiable. The terms of the policy must be read with pedantic care before entering the agreement. Those that do not satisfy the needs of both the borrower and the lender must be renegotiated – and if that is not possible, the loan must usually be refused. Where the material is to be covered by government indemnity, care must be taken to ensure that the exact terms of the indemnity are understood by both parties. With insurance the only wriggler will be the insurance company. In such cases, museums merely squirm.

Valuations

Where the loan agreement specifies a value for the loaned item, that valuation is legally significant. If the item is lost or damaged, that valuation will be taken as an admission on the part of each of the parties. It will be difficult for the owner to argue that the real value was higher and just as difficult for the borrower to argue that it was an over-estimate – no wriggle room. If it doesn't look about right at the time of negotiation of the loan, that is the time to raise the issue. Also, remember the consequences that such clauses may have on your insurance policy. It is important that the insurer has checked the insurance and valuation provisions in your loan agreements lest the drafting voids the cover in some way.

Vagueness or specific dispute resolution mechanisms

One of the frequent criticisms of contracts is that they cannot foresee everything that can possibly go wrong in the course of the agreement. Of course that is so. What a good contract will provide however, is a dispute resolution mechanism. Where the loan is between collegiate institutions, this happens in a generous and informal way. There is a mechanism – but it is informal and is based on the personal relationships of the staff.

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Even where the contract contains a dispute resolution clause, it is often the personal relationship and communication between lender and borrower that resolves the issue. Just because the contract provides a mechanism does not mean that good old fashioned things like reasonableness and professionalism cannot be deployed. However, where those qualities are missing or collapse, it is very important that the agreement specifies a mechanism for resolving the dispute – other than simply going to court. It is not in the interests of public institutions to be a party to litigation and they generally will settle (to their disadvantage) rather than end up in a courtroom. Better that the loan agreement sets out the mechanism that either party can activate and which will inexorably lead to a settlement of the dispute.

The gap between loan-in agreements and loan-out agreements

If ever there was proof that this business likes ‘wriggle room’: we have only to look at the differences between our loan-in agreement (which is as short a form as possible, tending to be silent or vague on issues of liability and standards of care) and your loan-out agreement – which tends to be a longer form, much more explicit about the obligations being assumed by the borrower.

Why do we do this? Why do we conveniently forget that in every loan relationship, someone is an owner and someone is a borrower?

With this in mind institutions would be well advised to make no distinction substantial between the two situations. It would be more sensible to distinguish on the basis of value of the loan rather than the role of the party issuing the loan documentation. No sensible, well-advised owner would accept most of the loan-in agreements offered. These almost always require negotiation and redrafting. So why not change the practice?

Cut down on the expense, risk, and time spent on loan-in agreements by having them mirror the obligations of the loan out documents. The present practice, whereby the strong and powerful institutional borrower insists on undertaking fewer liabilities than it demands when it is a lender – is a very out of date approach. It may have worked when lenders were legally and commercially unsophisticated and treated institutions with a reverence and respect that their commercial success could only attain by means of association. But those days are gone. Private lenders are very well advised. The value of their material is unthinkably huge. They are very risk averse. Their standard practice is to use expert legal advice on all transactions. They are not interested in ‘wriggle room’. The loan is just another transaction and is to be treated with the same respect and due diligence that would go into the negotiation and drafting of a partnership deed or joint venture agreement.

Conclusion

I think of contracts as the expression of a relationship. Seeking ‘wriggle room’ is to seek a unilateral and undisclosed advantage. It is the antithesis of the very basis of the relationship.

In all relationships we need to have a feeling of security and certainty and constancy. One of the most important ways of ensuring that this is achieved is by candid and intensive discussion prior committing to the relationship. This allows each party to be explicit as to their needs and expectations. This is no time for assumptions and short hand. Such discussion permits the agreement to cover not just the usual points but also the particular features of the relationship. It can never be ‘one size fits all’.

Once such an agreement has been entered, there may well be times of tension and disagreement, but both parties are secure in the knowledge that underlying everything, the relationship is firm and dependable.

Throughout the term, neither party should ever take the relationship for granted and each should communicate and deal with the other in a candid, respectful and ethical manner. Each must treat the other as it wishes to be treated itself.

If the parties approach the loan agreement in this way they do not need ‘wriggle room’. What they will find is that the relationship, engendered and promoted by the contract process, creates a trust that will promote a flexible and collegiate approach to the resolution of any difficulties that may arise. And if, as sometimes happens, the relationship irretrievably breaks down, the contract itself should set out how the parties are going to deal with the issues so that, at a time when there is no trust left, the parties need only follow the exact mechanisms provided by the contract.

Oh, and if all that fails *In ius voco spurium*

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1 ‘The Evolution of Loans Practice: Development of Procedures and Documentation at the Powerhouse’, Penny Huisman, Powerhouse Museum (Newsletter of the Australian Registrars Committee, June 2000, 4