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Litigating Lending Agreements During And In The Aftermath Of A Pandemic

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IN DEPTH

Coronavirus (COVID-19) continues to ravage the nation's health and economy. In this challenging environment, deals struck prior to the crisis that have yet to close are being reassessed by all interested parties, including financiers. This article discusses various considerations that parties to a financed transaction face in these uncertain times.

Satisfaction of Conditions Precedent

To begin, most commercial lending agreements require the borrower to meet certain conditions precedent to the lender's satisfaction in order for the lender to have an obligation to fund. For example, a borrower building a facility may have to demonstrate to the lender's satisfaction that the borrower can obtain the parts and equipment necessary to build the facility or obtain the requisite governmental approvals by a certain date. Likewise, parties to a merger or asset acquisition often have a series of requirements to meet in order to close, such as obtaining various regulatory approvals. As supply chains across the world and regulatory timetables are interrupted by lockdowns caused by COVID-19, prospective borrowers' ability to satisfy all of their conditions precedent may be impacted.

That said, the lender's discretion over what is "satisfactory" to the lender is not unfettered. Lenders must exercise their discretion in good faith, which means that neither party will do anything that would "have the effect of destroying or injuring the right of the other party to receive the fruits of the contract" and includes "a promise not to act arbitrarily or irrationally in exercising that discretion." *Dalton v. Educ. Testing Serv.*, 87 N.Y.2d 384, 389 (1995) (internal citation omitted).

In addition, parties to any contract—including merger and acquisition agreements as well as loan and other financing agreements—cannot take action deliberately designed to sabotage or otherwise frustrate the performance of the contract. *See, e.g.*, *Thompson v. Advanced Armament Corp., LLC*,

614 F. App'x 523, 525 (2d Cir. 2015); *Hexion Specialty Chems., Inc. v. Huntsman Corp.*, 965 A.2d 715, 749 (Del. Ch. 2008). Accordingly, it is important for all parties to document their decision-making process both with their respective counterparties and internally to demonstrate that the party is acting in good faith and reasonably based on the agreements and prevailing market conditions.

Force Majeure

Most commercial loan agreements do not contain *force majeure* clauses that would excuse the parties from performing in the event of, for example, a pandemic such as COVID-19. *Force majeure* in commercial lending generally arises in connection with construction loans.

Construction loan agreements typically contain covenants regarding the commencement, prosecution and final completion of whatever is to be constructed with the loan proceeds. Construction loan agreements may, however, recognize that certain events—such as those deemed to be a *force majeure*—are beyond the parties' control and thus may excuse performance at least for a period of time. Philip Lane Bruner & Patrick J. O'Connor, *2A Bruner & O'Connor Construction Law* § 7:229 (2020).

The mere presence of a *force majeure* clause in an agreement is not conclusive as to whether performance will be excused. The party invoking such a provision must demonstrate that (i) the *force majeure* event was outside the party's control, (ii) the *force majeure* event was not reasonably foreseeable by the parties, (iii) the *force majeure* event materially affects the party's ability to perform their contractual obligations, and (iv) the party took all reasonable steps to avoid or mitigate the relevant event.

The outcome of this analysis is heavily dependent on the specific context of the situation, including the unique terms of the governing contract and applicable law and facts. In addition, some courts construe *force majeure* clauses narrowly by, for example, excusing performance "only if the *force majeure* clause specifically includes the event that actually prevents a party's performance" and confining catch-all phrases to the same types of events explicitly mentioned in the clause. *Kel Kim Corp. v. Cent. Markets, Inc.*, 70 N.Y.2d 900, 902-03 (1987); David J. Ball, et al., *Contractual Performance In The Age Of Coronavirus: Force Majeure, Impossibility And Other Considerations*, The National Law Review (Mar. 18, 2020). Accordingly, it is important for parties to review both the language of any *force majeure* clause and the case law from the jurisdiction whose law governs the agreement.

Injunctions and Specific Performance

If a lender refuses to fund a loan, the parties may litigate not only whether there was a breach of the lending agreement, but if so, the appropriate remedy if a breach is found. A disappointed borrower will often seek an injunction and/or specific performance compelling the lender to fund. The borrower also typically seeks monetary damages as an alternate remedy in case an injunction or specific performance is not awarded.

An injunction or award of specific performance compelling the lender to loan is appropriate where (i) there is a valid contract, (ii) plaintiff has substantially performed under the contract and is willing and able to perform its remaining obligations, (iii) defendant is able to perform its obligations and (iv) plaintiff has no adequate remedy at law. *Goodman Mfg. Co. L.P. v. Raytheon Co.*, No. 98 Civ. 2774(LAP), 1999 WL 681382, at *10 (S.D.N.Y. Aug. 31, 1999). A plaintiff has no adequate remedy at law when the damages are irreparable (*i.e.*, cannot be fully compensated with monetary damages

that can be measured to a reasonable degree of certainty). *Lucente v. Int'l Bus. Mach. Corp.*, 310 F.3d 243, 262 (2d Cir. 2002); *Burke v. Bowen*, 40 N.Y.2d 264, 267 (1976). Accordingly, the general rule is that an agreement to lend money will not be specifically enforced unless "the breaching party is the only source of funds for the injured party to borrow" or "[w]here a tight money market makes it difficult for the plaintiff to obtain a substitute loan or makes the amount of damages speculative because of rapidly rising interest rates . . . ." Charles L. Knapp, *Commercial Damages: A Guide to Remedies in Business Litigation* ¶ 12.05 (1997).

In the merger context, several courts have considered that the opportunity to acquire a business is unique, and therefore may warrant an award of specific performance because the buyer's damages from being unable to consummate the acquisition are not fully compensable with money. *BT Triple Crown Merger Co., Inc. v. Citigroup Global Market, Inc.*, 2008 WL 1970900, at *7-9 (Sup. Ct. N.Y. Co. May 7, 2008); *Triple-A Baseball Club Assocs. v. N.E. Baseball, Inc.*, 832 F.2d 214, 223-24 (1st Cir. 1987); *In re IBP, Inc. S'holders Litig.*, 789 A.2d 14, 82 (Del. Ch. 2001); *Allegheny Energy, Inc. v. DOE, Inc.*, 171 F.3d 153, 163-64 (3d Cir. 1999); *Rand-Whitney Packaging Corp. v. Robertson Grp., Inc.*, 651 F. Supp. 520, 538 (D. Mass. 1986). For example, in *BT Triple Crown*, the court held that there were triable issues of fact as to whether (i) the target company was "unique," (ii) alternate financing can be procured for the acquisition (which was the subject of expert testimony) and (iii) the buyer's money damages can be proven with reasonable certainty. 2008 WL 1970900, at *7-9.

In the non-merger context, courts are more likely to compel a lender to fund if the loan is tied to real estate in some way. For example, in *Destiny USA Holdings, LLC v. Citigroup Global Markets Realty Corp.*, 69 A.D.3d 212 (4th Dep't 2009), the court affirmed the grant of a preliminary injunction requiring a lender to fund a construction development. The court observed that cases involving construction mortgages are an exception to the general rule that agreements to lend cannot be specifically enforced:

Since the law regards land as unique, an agreement to buy land can be specifically enforced even though the defendant's sole obligation is to pay money. Although the question is close, it may not be too great a stretch to include advances under a construction mortgage. In such circumstances, the agreement is not a simple contract to lend money. It is an integral part of a contract to sell or develop real property.

Destiny, 69 A.D.3d at 220-21 (internal quotation marks and citation omitted).

Among other things, the court noted that the construction project at issue was both unique and relevant to public interest, in that it had a "revolutionary" financing model that was based on both private and public money, and furthered a "green" climate change-friendly mission. *Id.* at 214, 221. Given these unique qualities, some commentators have observed that *Destiny USA*'s broader application to other types of financing agreements may be limited. *See, e.g.,* Kenneth Jacobson, et al., *Destiny v. Citigroup – What It Means for Lenders*, Katten Muchin Rosenman LLP (Aug. 4, 2009); Janice Mac Avoy & David Charles Pollack, *When Construction Lenders Stop Funding*, New York Law Journal (June 21, 2010).

Damages: Direct Versus Consequential

If specific performance is not awarded, then the issue becomes what, if any, damages are recoverable and how to measure them. Notably, most loan agreements contain restrictions on recovering consequential, exemplary, special or punitive damages. Such restrictions are typically enforced. *See, e.g.*, *Mu Chapter Of Sigma Pi Fraternity Of U.S. Inc. v. Ne. Const. Servs. Inc.*, 273

A.D.2d 579, 581 (3rd Dep't 2000); *U.S. Bank Nat. Ass'n v. DLJ Mortg. Capital, Inc.*, Index No. 650369/2013, 2013 WL 6997183, at *4 (Sup. Ct. N.Y. Co. Jan. 15, 2013), *aff'd*, 121 A.D.3d 535 (1st Dep't 2014); *Farm Family Mut. Ins. Co. v. Moore Bus. Forms, Inc.*, 164 Misc. 2d 656, 659 (Sup. Ct. Albany Co. 1995).

There is often debate, however, over whether certain damages qualify as "direct" (also known as "general") damages as opposed to "consequential" damages. As the New York State Court of Appeals has held, "[g]eneral damages are the natural and probable consequence of the breach of a contract. They include money that the breaching party agreed to pay under the contract. By contrast, consequential, or special, damages do not directly flow from the breach." *Biotronik A.G. v. Conor Medsys. Ireland, Ltd.*, 22 N.Y.3d 799, 805 (2014) (internal quotation marks and citations omitted).

Typically, if alternate financing is available, courts will measure damages as the difference between the contracted for rate of interest and the rate of interest at the time of the breach over the term of the loan, discounted to present value and subject to a foreseeability requirement. *Int'l Fid. Ins. Co. v. Cty. of Rockland*, 98 F. Supp. 2d 400, 416 (S.D.N.Y. 2000); *Teachers Ins. & Annuity Ass'n of Am. v. Butler*, 626 F. Supp. 1229, 1236 (S.D.N.Y. 1986). If alternate financing is not available, then the borrower has a stronger case for specific performance.

Amending the Agreements

As the effects of COVID-19 continue to weigh down the economy, parties may seek to renegotiate their deal. Before amending an agreement as a result of the pandemic by, for example, extending the closing date, parties must consider that a delayed closing or other material changes may trigger a lender's right to walk away from the transaction, or result in additional fees or otherwise more expensive debt. Accordingly, parties should consider the extent to which their agreement addresses their ability to renegotiate with the lender or obtain alternate financing.

For instance, the purchaser in a merger or acquisition agreement may have included a clause relieving the buyer of any obligation to seek to compel the lender to lend or otherwise to obtain alternate financing. An example of such a clause reads:

Notwithstanding anything to the contrary contained in this Agreement, in no event shall the efforts of the Purchaser be deemed or construed to require, the Purchaser to (i) bring any enforcement action against any financing source to enforce its rights under any lending agreement, (ii) seek equity financing in any amount in excess of that contemplated by the Purchaser's equity commitment letter, (iii) seek or accept debt financing on terms less favorable than the terms and conditions described in the debt commitment letters as determined in the reasonable judgment of the Purchaser, or (iv) pay any fees in excess of those contemplated by the debt commitment letters (whether to secure waiver of any conditions contained therein or otherwise).

Alternatively, the buyer may have agreed to keep the seller informed of financing changes and/or to not change materially the terms of financing.

Of course, a buyer and a seller can always agree to amend their deal and alter such obligations. However, absent an agreement otherwise *with the lender*, the lender likely has no obligation to accept the changes if they materially affect the terms of the financing.

Takeaways

In view of the foregoing, parties to any financing that may be impacted by COVID-19 or otherwise should consider the following when assessing an actual or potential dispute over funding obligations:

- Carefully review the *force majeure* clause in any of the transaction documents to determine whether any party's performance may be delayed or excused, which, as detailed above, is a highly fact-specific and often strict inquiry depending on the governing law.

- Carefully review any provisions in the transaction documents for clauses that speak to any obligation to obtain financing for the transaction, including alternate financing if the in-place financing falls through.

- Carefully review all conditions precedent to performance and carefully document whether and when the conditions have been satisfied.

- If the lender does not fund, document the availability of all efforts to obtain alternate financing available and on what terms. Line up one or more experts to opine on the issue and testify if necessary.

- Identify the extent to which the non-breaching party cannot be fully compensated by an award of monetary damages, such as if the subject matter of the transaction is unique in some way or if any damages cannot be measured to a reasonable certainty for any other reason.

- Itemize all potential damages and assess all damages limitation provisions, including the extent to which any damages were foreseeable by the parties at the time of contracting and can be measured to a reasonable degree of certainty. Again consider lining up one or more experts to assess these issues and testify if necessary.

Following these steps will help best position a party for any dispute with its counterparties in these difficult times and maximize the likelihood of a positive outcome.

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