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**Commercial Loan
Workouts:
An Update from the
Front Lines**



September 15, 2009
Herrick, Feinstein LLP



Non-Recourse Carveout Provisions

- Full recourse
 - Bankruptcy
 - Additional liens
 - Violation of separateness covenants
- Partial recourse
 - Misappropriation of funds
 - Waste / real estate taxes
 - Misrepresentation



Non-Recourse Carveout Provisions (cont.)

- Bankruptcy filings
 - Dismissal of the bankruptcy proceeding is irrelevant
 - *111 Debt Acquisition* (S.D. Ohio)
 - Enforceability consistent with Bankruptcy Code
 - *First Nationwide* (N.Y.)
 - Involuntary bankruptcy proceeding commenced by general partner
 - *Prince George* (4th Cir.)



Non-Recourse Carveout Provisions (cont.)

- Additional liens
 - Removal of lien prior to default
 - *SB Rental* (N.J.)
 - Additional loans by guarantor
 - *LaSalle Bank* (E.D. La.)
 - Knowledge of liens is unimportant
 - *Heller Financial/Lee* (N.D. Ill.)



Non-Recourse Carveout Provisions (cont.)

- Miscellaneous cases
 - Violation of separateness covenants
 - *Blue Hills Office Park* (D. Mass.)
 - Misrepresentation
 - *Diamond Point Plaza* (Md.)
 - Misappropriation of funds
 - *Heller Financial/Whitemark* (N.D. Ill.)
 - Waste / real estate taxes
 - *Nippon Credit Bank* (Cal.)



Deeds-In-Lieu of Foreclosure

- Basic requirements
 - Form of deed
 - Merger vs. non-merger language
 - Ancillary recording documents
 - Need for consideration
 - Satisfaction of the mortgage debt



Deeds-In-Lieu of Foreclosure (cont.)

- Legal issues raised by deeds-in-lieu
 - Equitable mortgages
 - Real Property Law § 320 (N.Y.)
 - *Leonia Bank* (N.Y.)
 - *Basile* (N.Y.)
 - Fraudulent conveyances
 - State law
 - Bankruptcy Code



Deeds-In-Lieu of Foreclosure (cont.)

- Deeds-in-lieu in escrow
 - Deeds enforced
 - *In re Webb Mountain* (Bankr. Tenn.)
 - *Nash Finch* (Iowa)
 - *Ringling Joint Venture* (Fla.)
 - Deeds not enforced
 - *Vitvitsky* (N.Y.)
 - *Gioia* (N.Y.)
 - *Esco Credit* (N.Y.)



Deeds-In-Lieu of Foreclosure (cont.)

- Belt and suspenders approach
 - Combination of a deed-in-lieu with a consent judgment
 - Requires the filing of a foreclosure action
 - Combination of a deed-in-lieu with a confession of judgment
 - Advantages vs. disadvantages



Credit Bid and Other Intercreditor Disputes

- Common dispute: whether to credit bid or to consent to a sale of a debtor's assets
- Opponents of proposed bid often cite clauses stating that loan documents may not be amended to release the liens on collateral without written consent of all lenders
- Credit agreements typically provide that the agent is authorized to exercise any and all rights a secured party has under the UCC or applicable law



Credit Bid and Other Intercreditor Disputes (cont.)

- The clear pattern emerging from *Chrysler*, *Metaldyne* and *GWLS Holdings*:
 - Dissenting members of the lending group have been unable to prevent the collateral agent from acting on its behalf consenting to a Section 363 sale



Credit Bid and Other Intercreditor Disputes (cont.)

- Concluding observations:
 - The dispute is really about modification, sale or acquisition of control
 - The loan documents should expressly address rights of the parties regarding 363 sales
 - Possibility of claims against collateral agent left open



Credit Bid and Other Intercreditor Disputes (cont.)

- The mortgage vs. the mezz lender
 - Intercreditor agreements typically include subordination provisions
 - Can the mezz lender sue the guarantor on the mezz loan before the mortgagee fully recovers on the senior loan?
 - o Highland Park CDO I Grantor Trust, Series A. v. Wells Fargo Bank, N.A., (S.D.N.Y. June 16, 2009)



Lender Insolvency – The Defaulting Lender

- Syndicated agreements
 - Usually assume lenders are solvent
 - Usually permit the borrower to require a defaulting lender to assign its loan and commitment to another lender
 - “Yank-a-bank” remedy has limitations
- Alternative to yank-a-bank – credit agreement permits the borrower to repay defaulting lender’s loans and terminate its loan commitments



Lender Insolvency – The Defaulting Lender (cont.)

- Suggested changes to loan documents:
 - Borrower should be excused from prepaying the defaulting lender
 - Defaulting lender should lose right to vote regarding loan modifications and waivers
 - Defaulting lender should not be permitted to collect a commitment fee from borrower



Lender Insolvency – The Defaulting Lender (cont.)

- Suggested changes to loan documents (cont.):
 - Allow offset of lender's right to share in loan repayments before maturity against amounts lender has failed to fund
 - If defaulting lender is part of syndicate, lender issuing a letter of credit should be permitted to require:
 - o Posting of cash collateral in advance, or
 - o Reduction of the availability under the letter of credit by the amount of the defaulting lender's pro-rata share



Lender Insolvency – The Defaulting Lender (cont.)

- Where insolvent lender is the factor
 - Factor may collect the receivables but not pay the borrower, creating a liquidity crunch
 - Terminate the factoring agreement before a bankruptcy filing
 - If the factor returns receivables to the borrower, that conveyance may be challenged as an avoidable transfer



Lender Insolvency – The Defaulting Lender (cont.)

- Where the insolvent lender is the lead lender
 - Participants concerned that the lead lender may file for bankruptcy
 - Do you have a true sale or a loan?



Lender Insolvency – The Defaulting Lender (cont.)

- Where the insolvent lender is lead lender (cont.)
 - If the lead has filed and begun collecting loan payments from borrower, the participant should require lead to:
 - o Segregate proceeds of the loan
 - o Provide adequate protection of the participant's interest in those funds
 - o Pay the participant its proportionate share of proceeds
 - Lehman Commercial Paper, Inc.



Lender Beware

- The Old Irving Trust case
 - Beware of so-called discretionary or advised lines of credit
 - Courts will infer a covenant of good faith, and may honor a borrower's "reasonable expectations"



Lender Beware (cont.)

- Destiny case
 - Deficiency issue
 - Change in counsel coincides with change in strategy
 - Deep liquidity problems and TARP dependency
 - Public interest in finishing the project
 - Lessons learned
- Fontainebleau Las Vegas case
 - Balancing default with a different outcome
 - Lenders were on solid ground



Lender Beware (cont.)

- Condominiums
 - Receiver cannot sell units
 - Reservation of rights letters and default notices can lead to rescission of pending contracts and stoppage of sales
 - Foreclosure action on one property can lead to shutdown of sales on others
- Deed in escrow without Confession of Judgment or Consent Judgment
 - The purpose of the deed in escrow is to expedite
 - This invites litigation



Ineffective UCC Termination Statements

- To what extent can you rely on a clean UCC search?
 - Statements can be filed without the secured party's signature
 - Filed terminations may be ineffective
 - How does incoming lender handle due diligence?
 - Mistaken, seemingly authorized termination
 - Heller Ehrman
 - Agency law defense



Additional Suggestions for the Future

- Keep your default pricing high
 - Letter of credit fees
 - Often no default L/C pricing in the loan documents
- Compound interest
 - Must be explicit in New York
 - Default interest compounding on unpaid interest is not spelled out very well

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