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



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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* (4<sup>th</sup> 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?
    - 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
  - Wholesale and retail grocery business in Knoxville, TN; case decided by Sixth Circuit in 1985
  - 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 liability case, but applicable to anything with a future funding commitment



## Lender Beware (cont.)

- **Destiny case**
  - Deficiency issue
  - Decided by NYS Supreme Court in Onondaga County.
  - 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.)

- Oral waivers v. oral modifications
  - Cases support view that lenders can by their actions waive a written requirement
  - Summary judgment does not apply where the court finds there is a bona fide question of fact on which the case could turn
  - Frequent written communication is highly advisable



## 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
  - Problem with customary admissions in forbearance agreements
  - Foreclosure action on one property can lead to shutdown of sales on others
  - Lender has to deal with the borrower until it is convinced the borrower does not add anything

# 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?
  - Triage
  - 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



## Additional Suggestions for the Future (cont.)

- Guaranties
  - Do not negotiate the boiler plate – ever
  - The basic merger clause
  - Proper waiver of suretyship defense language

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