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Leveraged Finance Newsletter

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IN THE SECOND PART OF THIS TWO PART SERIES... Baker McKenzie's leveraged finance teams in London and New York consider available remedies under both English and New York law if commitments are not met.

In the first part of this series we set out the importance of funding certainty and examined how that certainty is created under both English and New York law governed documentation. We now consider what the consequences might be for a borrower should a lender choose not to fund under a commitment and what remedies might be available in such situation.

FINDING CERTAINTY IN UNCERTAIN TIMES - PART TWO

What if a lender decides not to fund?

English law

The 2016 English law case of *Novus Aviation Limited v Alubaf Arab International Bank*[1] *(Novus)* examined a commitment letter under which Alubaf agreed to provide the equity portion for the purchase of an aircraft but later refused to provide the agreed funding. The High Court found that the refusal to fund was a repudiatory breach of contract and Alubaf was required to pay damages for the loss caused to Novus. The legal issues examined and the conclusion reached are generally thought to apply equally to commitments to provide debt financing.

At the heart of the case, the Court needed to determine whether or not the commitment documentation was enforceable. In doing so it considered three key issues:

(i) **whether the basic contract requirements of offer and acceptance had been fulfilled.** A commitment letter will be signed by the bank and will contain an offer from the lender to the borrower. It will usually indicate that the offer remains open for a set period of time during which the borrower can accept that offer. In practice a borrower will likely accept the offer at some later date – in order to coincide with the signing of a sale and purchase agreement (SPA). However, it is important to be aware that even where an offeror (in this case the lender) has indicated that they will keep an offer open for a specified time they still have the right to revoke that offer at any time before it is accepted.[2] So careful coordination of signing the commitment letter and the SPA by the borrower is of utmost importance;

(ii) **whether there was an intention to create legal relations and be bound by the commitment documentation.** This is a question of fact and in considering this issue the Court

[1] Novus Aviation Limited v Alubaf Arab International Bank [2016] EWHC 1575 (Comm)

[2] Halsbury's Laws of England/Contract (Volume 22 (2019))/3. Formation of Contract/(2) Offer and Acceptance/(ii) Offer and Invitation to Treat/45. Revocation by offeror; *Routledge v Grant* (1828) 4 Bing 653.

will apply an objective test, i.e. they will not look at the subjective state of mind of the parties but at the particular words used and the conduct of the parties. In *Novus* the Court gave particular weight to the fact that the commitment letter contained governing law and jurisdiction clauses and contained words such as "shall" and "covenanted", which the judge considered to be the "language of obligation". Importantly, the Court also rejected the argument that it was the *industry norm* not to be bound until definitive documentation was put in place (i.e. an executed loan agreement) arguing that if such practice did exist it could not impact upon an agreement that otherwise very clearly demonstrated an intention to create legal relations.

Parties to a financing arrangement can easily remove any doubt by clear drafting (e.g. by stating expressly that the commitment letter is non-binding or subject to contract). In the absence of such clear statements the Court will consider the language used in the commitment letter to ascertain whether it is consistent with a binding obligation.

Current market practice involves including substantial provisions around the terms and form of documentation that should be used for the definitive agreement between the parties (e.g. a comprehensive term-sheet and reference to a base precedent). In addition, use of a fully negotiated interim facility agreement has become standard on larger deals. So, although the agreement of long form financing documents will provide ultimate certainty these customary approaches should be sufficient to indicate an intention to create legal relations; and

(iii) whether the terms are sufficiently certain to be enforceable. In *Novus* it was argued that the statement that the agreement was "subject to satisfactory documentation" made the commitment letter too uncertain to be enforceable. This argument was dismissed by the Court. English Courts apply an overarching principle of interpretation that where parties have reached an agreement a Court will do everything it can to give that agreement meaning. This point was clearly made in *Novus* when the Court concluded that it should always be a Court's last resort to find an otherwise legally binding contract too uncertain to be enforceable. Consequently, if it is established that parties have an otherwise legally binding, clearly drafted commitment letter, it appears unlikely that one party will be able to establish sufficient uncertainty in respect of a fundamental term of that contract leading to its unenforceability.

New York law

The market consensus is that a commitment letter containing properly-drafted '*SunGard*' provisions is a binding and enforceable agreement under New York law. However, in the notable decision by the Appellate Division, First Department, of the Supreme Court of New York in *Amcan Holdings, Inc. v. Canadian Imperial Bank of Commerce ("CIBC")*[3], the Appellate Division held that an executed term sheet which set forth a detailed description of the parties' financing terms was not an enforceable contract, but rather an agreement to agree, the enforceability of which was dependent on the parties entering into definitive loan documentation. In that case, the term sheet contained language that the credit facilities would only be established upon execution of definitive loan documentation and included a closing condition requiring that the parties execute and deliver such definitive documentation reflecting the terms and conditions set forth in the term sheet. The definitive documentation was never executed. CIBC and its affiliates were sued by plaintiffs for breach of contract, breach of the common law duty of good faith and fair dealing and fraud. The Appellate Division held that while the "Summary was detailed in its terms, it was clearly dependent on a future definitive agreement...[the] fact that the Summary was extensive and contained specific information regarding many of the terms to be contained in the ultimate loan documents and credit agreements does not change the fact that the defendants clearly expressed an intent not to be bound until those documents were actually executed."[4]

As a result of the Appellate Division's holding in *Amcan*, so-called "*Amcan*" provisions have been subsequently implemented in debt financing commitment letters. These provisions make clear that the parties intend for

[3] *Amcan Holdings, Inc.* v. *Canadian Imperial Bank of Commerce*, 70 A.D.3d 423, 894 N.Y.S. 2d 47 (N.Y. App. Div. 1st Dep't 2010)

[4] Id. at 50.

the commitment letter to be a binding and enforceable agreement (including the parties' agreement to negotiate the definitive documentation in good faith and consistent with the terms of the commitment letter), notwithstanding that execution and delivery of definitive loan documentation is a condition precedent to the availability of the financing. The parties may further reduce the conditionality in the commitment letter and enhance the certainty of funds by referring to specific precedent documentation and/or precedent documentation provisions.

What remedies are available?

English law – damages
The starting point in terms of remedies in the English Courts for a failure to fund is an award of damages. In order to bring a successful claim for damages the borrower will need to demonstrate breach, causation, (i.e. that the loss suffered has resulted from the breach of contract by the lender) and that the damages are not too remote (i.e. the damages were reasonably foreseeable).

The argument for causation would be that the borrower has suffered loss by the lender breaching its agreement to provide funds for the acquisition resulting in either the deal being aborted completely or, for example, the borrower having to seek funds elsewhere perhaps at a higher rate and with the incurrence of additional costs.

There are a number of categories of damages that a borrower may seek to recover. The following are the key ones a borrower may seek to prove for in the particular circumstances under consideration here:

(i) expectation-based damages (also known as 'loss of bargain' damages) are the most common method for calculating damages. The main objective of this calculation would be to put the borrower back into the same position they would have been in had the breach not occurred and the contract been satisfactorily performed – the measure being the net value of the benefit the borrower failed to get. Due to the obligation on the borrower to mitigate its losses, if it is at all possible to raise finance from alternative sources in order to complete the proposed transaction, damages are likely to represent any reasonable additional costs (both legal costs and any increased cost of borrowing) of securing financing elsewhere.

In contracts for the loan of money, this is the normal measure of damages for the lender's failure to provide the money: the amount required by the borrower to go into the market and effect a substitute loan for itself less the amount that the contractual loan had required. If, despite reasonable steps, borrowing cannot be secured elsewhere on reasonable terms in order to complete the acquisition, damages may reflect the loss of the acquisition. For this to be possible the lender must have had express notice of the purpose of the loan, which is obviously likely to be satisfied in acquisition finance transactions. Such losses might be calculated based on an assessment of the loss of profits from not completing the planned acquisition, for example: (i) based on a forecast of the net profits for future years; or (ii) the loss of value that would have been added to the borrower's overall business by completing the purchase; or (iii) the difference (if any can be established) between the purchase price for the proposed acquisition and the market price;

(ii) reliance based damages that would seek to put the borrower in the position they would have been in had they never entered into the contract. The loss here is from wasted expenditure so would likely cover fees paid and costs and expenses incurred, including professional advisory fees, or perhaps internal administrative costs incurred specifically in relation to the pursuance of the deal.

However, three important points to note are: (i) that the general rule of remoteness is more likely to be a factor in calculating these types of damages, (i.e. for damages to be recoverable it must have been within the reasonable contemplation of the parties that a breach of the commitment documentation would cause the expenditure in question to be wasted); (ii) double recovery is not permitted. So, unless it is envisaged that the borrower will be unable to prove loss of profits (which is counter intuitive considering the level of due diligence that is likely to have been conducted ahead of a planned acquisition), reliance based damages are likely to be a secondary option; and (iii) reliance loss is not a measure separate from, and independent of, the expectation measure. It is simply a presumption that a contract will break-even and, therefore, any

wasted costs are a recoverable loss. Finally, if it can be proved that the agreement (either the proposed loan or the proposed acquisition) was a bad bargain such that no loss has in fact been suffered (i.e. the borrower would have suffered greater losses had the transaction proceeded), reliance based damages will not be recoverable; and

(iii) **consequential loss damages** – these may include, in addition to a loss of profits, loses to the borrower resulting from: (i) damage to their reputation as a result of pulling out of the acquisition may mean other market participants are reluctant to engage in future deals with that borrower; (ii) liability to third parties, for example, because the borrower has to pull out of the SPA resulting in the seller pursuing the borrower for breach of contract; or (iii) unlimited economic loss beyond loss of profits, for example, in circumstances where the seller goes on to dispose of the asset to a competitor of the borrower resulting in damage to the borrower's business. These damages will also be subject to the application of the general rule of remoteness.

In assessing all these types of damages a court will also take into consideration what is referred to as the claimant's 'duty to mitigate'. This means that if a claimant acts in a way that increases its losses or does not take action available to it to reduce or avoid its loss, that action or failure to act will be taken into account when assessing the amount of damages it will be awarded. It essentially breaks the causation link. An example, in this scenario, might be that the borrower does not seek alternative funding in order to complete the acquisition when it has a clear opportunity to do so.

The important point to stress is that all assessments for damages will be conducted on the basis of the facts and circumstances of the case before the court.

English law – specific performance

In the event that a lender decides not to fund under enforceable commitment documentation, it would be understandable for a bidder to seek a lender's specific performance of its contractual obligations under that commitment documentation. In other words to expect that funds are made available for the completion of the acquisition and the commercial objective of the overall arrangement is fulfilled. However, specific performance is an equitable and discretionary remedy and under English law there has been a long standing view (which has not gone unchallenged) that it is not possible to obtain the remedy of specific performance for a loan contract.[5]

The reason for the traditional position rests on the idea of the absence of mutuality, i.e. why should a lender be forced to lend under a loan when a borrower could not reasonably be forced to accept the money.[6] In addition, there is a prevailing view that where the loss is considered to be pecuniary (i.e. financial) that an award of damages can provide an adequate remedy for such loss.

This does not mean that specific performance cannot be sought in the first instance, especially if there are particular circumstances which would mean that a subsequent award of damages would not be an adequate remedy to the borrower. A court will make its decision based on the individual facts and circumstances of each case brought before it whilst giving thought and weight to certain established considerations, such as:

(i) whether there are any particular circumstances of the proposed purpose for which the finance was being sought that would mean that a subsequent award of damages would not be an adequate remedy to the borrower;

(ii) whether it would cause hardship to the lender or grant a disproportionate benefit to the borrower. This consideration is likely to take account of the reasons for the lender's decision to pull out of the funding, especially in the current economic climate;

(iii) the conduct of the bidder, who must come to the court 'with clean hands' i.e. the borrower must have acted properly towards the lender ensuring that, for example, they have been transparent with the lender with regards to the terms and conditions of the SPA;

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5 Chitty on Contracts (33rd edn.), vol. II, para. 39-265

6 Sichel v Mosenthal (1862) 54 E.R. 932

(iv) the ability to enforce the order and the idea that 'time is of the essence' e.g. it would not be possible to enforce specific performance if by the time the court makes its order the asset intended to be acquired has been sold to another party; and

(v) that the bidder was at all times ready, willing and able to perform its own obligations and not in breach of the terms of the commitment letter.

New York law

In general, under New York law, the remedy for breach of an agreement for payment of money is usually a monetary award, with limited exceptions for cases where damages might be deemed inadequate because (i) the subject of the contract is unique, (ii) the loss cannot be reliably monetized or (iii) the remedy of specific performance has been expressly provided in the underlying contract.[7] In the absence of such an express specific performance provision, specific performance has generally not been available with respect to agreements for the payment of money, except in the limited context of loans to purchase real estate.[8] In the context of a loan agreement among sophisticated parties with respect to which the lender thereunder has refused to make loans, granting a remedy of specific performance would potentially require a New York Court to supervise the parties' in the context of a deteriorated relationship, which New York Courts are generally reluctant to do. Further, against the backdrop of sophisticated parties, New York Courts may likely be reluctant to insert their judgment in lieu of a reluctant lender that borrower can perform under the underlying loan agreement, which is a condition to a specific performance claim.[9] Conversely, a court will not be required to engage in such supervision to the extent it makes provision for a damages award. Moreover, the provision of monetary damages also provides parties with a more efficient remedy than specific performance, as under a damages model, both parties have the option to perform or breach and pay damages.

Many New York law governed credit agreements contain waiver provisions which foreclose the availability of special, indirect, consequential or punitive damages and which foreclose even the possibility of specific performance as a potential remedy.

[7] See, e.g., Restatement (Second) of Contracts § 359 (1981) ("Specific performance…will not be ordered if damages would be adequate to protect the expectation interest of the injured party); See *See Cho v. 401-403 57th St. Realty Corp.*, 300 A.D.2d 174, 175 (1st Dep't 2002) ("In general, specific performance is appropriate when money damages would be inadequate to protect the expectation interest of the injured party"); See Wells Fargo Bank, N.A. v. Bank of Am., N.A., 2013 WL 372149, at *9 (S.D.N.Y. Jan. 31, 2013) (holding that "specific performance is the appropriate remedy" in a breach of loan agreement dispute where the contract stipulated this relief).

[8] BT Triple Crown Merger Co., Inc. v. Citigroup Global Markets Inc., 2008 BL 101135 (N.Y. Sup. Ct. May 7, 2008).

[9] *See, e.g., Edge Grp. WAICCS LLC v. Sapir Grp. LLC*, 705 F. Supp. 2d 304, 319 (S.D.N.Y. 2010) ("if a party cannot perform at the time of the application for specific performance, that fact will preclude the grant of specific performance.")

Conclusion

Given that it is unlikely that an English or New York court will award the remedy of specific performance for a breach of commitment documentation, well advised borrowers will look to minimise the risk that the funding does not occur.

In addition to the European use of Interim Facility Agreements, a prudent borrower may consider putting in place arrangements such as those seen in the high yield bond market where it is common to deposit completion funds in advance with an Escrow Agent. Pursuant to an escrow agreement the Escrow Agent will agree to release the funds upon a specified event or the satisfaction of stipulated conditions.

With increasing frequency we also see acquisition debt financings closing with pre-funded accounts in place that are released via undertakings. Under this arrangement a lender will place the acquisition funds into the account of the lawyers acting for the seller who will agree to hold the funds in escrow subject to certain closing undertakings and the satisfaction of all conditions precedent. Usually an all parties completion telephone call will be held following which the funds will be released to the seller.

Such approaches provide greater comfort and protection against the occurrence of a failure to fund but putting such an arrangement in place will not be without careful thought, negotiation, logistical planning and additional costs to the parties involved.

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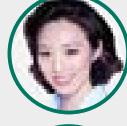

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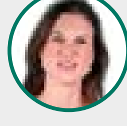

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