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Lyondell Trial Teaches Lender Lessons

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Multiple draw and revolving loan lenders and counsel can find three important lessons in the 84 page trial ruling after eight years of litigation, three federal judges, and more than five interesting opinions. *See Weisfelner, Trustee v. Blavatnik (In re Lyondell Chem. Co.)*, 567 B.R. 55 (Bankr. S.D.N.Y. 2017). First, the conditions precedent to further funding should be independent, robust, and not a simple absence of a Default (or a circumstance that with notice or passage of time would be a Default). Second, at least for this company and this loan document, a financial decline into insolvency was not a material adverse change, so keep the concepts separate in both the conditions to funding and the Events of Default. Consider defining a material adverse change to include the fall into insolvency. Third, a contractual limitation on damages in a loan agreement should give some comfort in declining a borrower's request for a $750 million draw on the eve of bankruptcy.

In its December 2007 LBO, Lyondell borrowed approximately $21 billion on a secured basis, paid out $12.5 billion to shareholders, and contracted for a standby $750 million unsecured revolving line of credit from a new shareholder affiliate. After the collapse of a 30-story crane closed its refinery, two hurricanes hit, raw materials prices increased dramatically, and the Great Recession froze $175 million in a money market fund, Lyondell consulted bankruptcy professionals and sought forbearance from secured lenders. After preliminary notice of a need for $400 million, on December 30, 2008, Lyondell requested a full advance of $750 million. The affiliate refused. Chapter 11 cases were filed on January 6, 2009. *Weisfelner, Trustee v. Blavatnik (In re Lyondell Chem. Co.)*, 544 B.R. 75, 83 (Bankr. S.D.N.Y. 2016). The professionals eagerly pursued the lender liability claims.

The lender defended the claim with the loan agreement's material adverse change clause. "Since the Closing Date, there has been no event or circumstance that could, either individually or in the aggregate, reasonably be expected to have a Material Adverse Effect." The term "Material Adverse Effect" was defined to include, among other things, "a material adverse effect on the business, operations, assets, liabilities (actual or contingent) or financial condition of the Company." 567 B.R. at 85 (internal citations omitted). The court subjected the argument to regular contract analysis. New York case law required the *Lyondell* trial court to read the entire agreement with other evidence of the parties' intention and attention for the particular transaction, the control of the parties, and the magnitude of the impact. Apparently, at closing, no crystal ball focused beyond the boilerplate on an accidental plant closure, natural disasters, price swings, or a Great Recession. *Id.* at 122. Even the accumulation of adverse events was insufficient.

The court found, in the agreement itself, grounds for a narrow construction of the MAC. The loan required that Lyondell represent and warrant that it was solvent as of March 27, 2008. ("On the Closing Date, the Loan Parties and their Subsidiaries (taken as a whole) after giving effect to the transaction contemplated by this Agreement and the payment of the fees and expenses in connection therewith, are Solvent." *Id.* at 85.) However, it was not required to represent and warrant that it was solvent as a condition precedent to loan draws. The lender failed to identify a definition, case law, or expert testimony of industry custom that insolvency constituted a material adverse change. The court found no helpful precedent, excluded the insolvency from the MAC, and ruled that the lender had breached the contract to advance. *Id*. at 121-23.

Applying an earlier ruling, the court enforced the limitations of damages provision under NY law to exclude direct, special, and other consequential damages, but not to limit equitable restitutionary relief. Since the lender had advanced (and been repaid) 40 percent of the loan, the court ordered the lender to refund the unearned loan fee of $7.2 million. *Id.* at 151.

Competitive lending in exuberant times and friendly loans with affiliates sometimes mean going light on covenants, conditions, defaults, and, consequently, protections for lenders. Here, "we all know" that falling from an LBO at $48 per share to being insolvent, seeking secured creditor forbearance, and filing Chapter 11 are material and adverse. Nonetheless, trials are about proof, and this loan document was too narrow to protect its lender. The lack of discussion, and presumably testimony, about custom and use ("what we all know") of material adverse change is puzzling. The force of the plant closure, hurricanes, and Great Recession may simply have been exhausted in supporting the solvency findings. Indeed, the mystery may lie in litigation strategy and brief page limits since defense counsel thrashed the Trustee in the other 80 pages of fact findings about inconsistent insolvency testimony, limits on fiduciary duty, and other back-end bankruptcy issues that look good to all at closing.

Expanding boilerplate MAC's to include transaction specific risks would be a daunting business challenge that needs too much staring into crystal balls; including "loss of solvency" in the definition seems necessary, at least, to the *Lyondell* court at trial.