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New York Appellate Division Decision Provides Comfort for Secured Lenders Negotiating With Their Defaulting Borrowers

Overview

On October 28, the New York Supreme Court, Appellate Division – First Department affirmed the dismissal of claims brought by a defaulting borrower against its lender, Siemens First Capital Commercial Finance LLC*, in [*Whitecap \(US\) Fund I LP v. Siemens First Capital Commercial Finance LLC*](#), Index No. 650888/12. Siemens declared a default and initiated remedies after its borrower failed to meet a contractual deadline for consummating an initial public offering (IPO) that was intended to generate capital to repay the loan. The borrower sued, claiming Siemens wrongfully contributed to its failure to meet the deadline by, among other things, allegedly failing to provide required approvals for the IPO. The borrower also alleged that Siemens continued to negotiate with the borrower past the deadline and waived its right to enforce the default.

The Appellate Division unanimously rejected the borrower's arguments and affirmed the dismissal of the complaint. In a ruling that should give comfort to secured lenders seeking to negotiate with their borrowers despite a pending default, the Appellate Division found that, even if Siemens' actions could theoretically constitute a waiver, the agreement's non-waiver clause protected and preserved Siemens' enforcement rights.

Factual Summary and Decision

Siemens is a joint venture of two commercial finance companies: Siemens Financial Services and FCC, LLC, which does business as First Capital. Siemens loaned more than \$40 million to Castlerock, a home alarm company owned by Whitecap (US) Fund I LLP, a private equity fund.

Whitecap sought to take Castlerock public to raise capital to pay off its debt to Siemens. Siemens consented to the proposed IPO, provided that the IPO was consummated—and Siemens received cash—by March 1, 2011. Castlerock's failure to meet the deadline constituted a default under the credit agreement. When Castlerock missed the deadline, Siemens declared a default and replaced Castlerock's board of directors, one of its default remedies. The new board terminated Castlerock's IPO plans.

Whitecap commenced an action in New York Supreme Court against Siemens directly, and derivatively against Siemens and the newly appointed directors, asserting claims for breach of fiduciary duty, breach of contract, and breach of the implied covenant of good faith and fair dealing. After the New York Supreme Court dismissed Whitecap's complaint, Whitecap appealed to the Appellate Division.

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Whitecap argued that Siemens waived its right to enforce the March 1st deadline and declare a default through its actions. Whitecap contended that in December 2010 it advised Siemens that it would need an extension of the IPO date, and Siemens did not “immediately object.” Further, Whitecap asserted that Siemens affirmatively promised to negotiate an extension to the March 1st deadline, and actively negotiated past the March 1st deadline about the terms on which Siemens would be willing to extend. Finally, Whitecap claimed that Siemens frustrated its ability to meet the March 1st IPO deadline by failing to provide various approvals Whitecap needed for the IPO.

Citing *Burgess Steel Prods. Corp. v. Modern Telecom.*, 205 A.D.2d 344 (N.Y.A.D. 1st Dep’t 1994), *Simon & Son Upholstery, Inc. v. 601 W. Assocs., LLC*, 268 A.D.2d 359 (N.Y.A.D. 1st Dep’t 2000), and *Avendanio v. Marcantonio*, 75 A.D.2d 796 (N.Y.A.D. 2d Dep’t 1980), Whitecap argued that Siemens’ conduct waived its default remedies despite the existence of non-waiver and “no oral modification” clauses in the parties’ credit agreement.

After affirming the dismissal of the derivative claims based on Whitecap’s failure to plead demand futility under Delaware law, the Appellate Division addressed Whitecap’s waiver arguments. The Appellate Division acknowledged that “courts may find a waiver where one party encourages another to continue to perform for the first party’s benefit,” but concluded that “this case presents a different situation: [Castlerock] pursued the IPO for its own and Whitecap’s benefit, not Siemens’s.”

In powerful language which reaffirms a secured lender’s ability to engage in negotiations and preserve its rights to declare a default, the Appellate Division further held:

“At any rate, even assuming for the sake of argument that Siemens’s actions could constitute a waiver, the credit agreement contained a no-waiver clause. Unfruitful negotiations to restructure or extend the terms of the ... credit agreement did not limit Siemens’s rights [under the credit agreement], as the no-waiver clause protected those rights....We decline to find otherwise, as a contrary holding could have a chilling effect on parties’ willingness to renegotiate mutually acceptable terms rather than simply foreclose on collateral or resort to costly litigation.”

The Appellate Division affirmed the lower court unanimously and dismissed Whitecap’s complaint.

Practical Advice

Secured lenders can protect themselves through a series of practical steps, including ensuring that credit agreements contain airtight non-waiver and no oral modification clauses, sending timely default notices, entering into “pre-negotiation agreements” that confirm that no negotiations can waive defaults, and entering into forbearance agreements in which their borrowers acknowledge defaults and forbearance periods are carefully defined.

Despite such steps, borrowers may still devise arguments that lenders waived their rights. In these circumstances, *Whitecap v. Siemens* provides significant comfort to a lender that may be inclined to negotiate with a borrower rather than immediately enforcing default remedies. The Appellate Division made clear that it favors business resolutions and will act to protect lenders’ rights. Thus, if litigation with a borrower does ensue, the *Whitecap v. Siemens* decision should provide important precedent for a secured lender facing claims by its borrower that the lender contributed to borrower’s defaults or waived its remedies through affirmative conduct or delay.

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