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Limiting Liability of Lenders: The Lyondell Case

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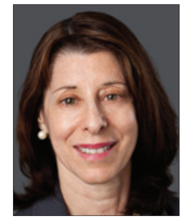

The changes in law arising from the Great Recession were certainly considerable. But it may come as a surprise to many that as much as 10 years later court decisions continue to emerge from those turbulent times.

One example is the long-running bankruptcy of Lyondell Chemical Co. (Lyondell), a case that has spawned a multitude of judicial rulings of interest, the most recent being the decision this past January of Judge Denise Cote in the Southern District Court of New York.

In simple terms, that case, through a series of three court decisions over two years, found a lender to have breached its obligation to fund a borrower on the brink of bankruptcy, notwithstanding the existence of a "MAC" clause, but also that a provision limiting the liability of that lender for such breach was enforceable. However, *Weisfelner v. Blavatnik* (*In re Lyondell Chemical Co.*), Case No. 17cv4375, 2018 WL 565272 (S.D.N.Y. Jan. 29, 2018) is at least as interesting for its facts as its legal conclusions.

Background. This saga begins with Access Industries, a privately held conglomerate created in 1986 by multibillionaire Leonard Blatvanik. The holdings of the Access companies ranged worldwide, but primarily across four sectors: media and telecommunications (including Warner Music Group); real estate properties, including hotels and resorts; technology; and natural resources and chemicals. In 2005, the Access companies acquired Basell B.V., a Netherlands-based petrochemical company. Soon thereafter, Blatvanik began pursuing the acquisition of Lyondell, an American-based refining company, the goal being to create a world-wide petrochemical company.

Access and Basell made several acquisition offers to Lyondell over the course of 2006, proposing a leveraged buyout transaction that would pay between $24-27 per share to Lyondell's shareholders. By early 2007 that offer had increased to $38 dollars a share, and in July 2007 Basell and Lyondell signed an agreement under which Basell would acquire Lyondell for a purchase price of $48 per share. Although markets became increasingly unsettled over the fourth quarter of 2007, and Lyondell disclosed it would not meet its third and fourth quarter projected earnings, the parties remained satisfied that the acquisition made sense.

The acquisition closed on Dec. 20, 2007. Basell renamed itself LyondellBasell Industries AF S.C.A. (LBI) and Lyondell became its subsidiary. Shareholders of Lyondell received approximately $12.5 billion, and in excess of $20 billion of financing secured by the assets of LBI was provided by a syndicate of banks. LBI was left with approximately $2.3 billion of liquidity after giving effect to the acquisition.

Of course, timing is everything. During the course of the following year, things took a dramatic turn for the worse, and by February 2008 LBI's liquidity cushion had dropped to $895 million. Responding to pressure from LBI's syndicate banks, in March 2008 Access agreed to provide a $750 million unsecured revolving credit facility to its subsidiaries, LBI, Lyondell and Basell Finance Company, B.V. In consideration for this facility, the subsidiaries paid an upfront commitment fee of $12 million. The credit agreement required as a condition precedent to any draws that there could not have occurred, since the closing of the facility, any "event or circumstance which could, either individually or in the aggregate, reasonably be expected to have a 'Material Adverse Effect'" (defined to include "a material adverse effect on the business,

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operations, assets, liabilities (actual or contingent) or financial condition of LBI").

Subsequent events, including extreme volatility in oil prices, declines in demand for chemical products, two damaging Gulf Coast hurricanes and having $175 million in a money market account frozen due to the Lehman Brothers bankruptcy, continued to pressure LBI's cash position.

In mid-October 2008, with virtually no other sources of liquidity, LBI drew $300 million from the Access revolver. It then repaid those draws within a matter of a few days. On Dec. 30, 2008, LBI made a draw request for the full $750 million amount of the facility. Aware that LBI had engaged restructuring advisors and that discussions were occurring with lenders over a proposed bankruptcy filing, Access claimed that a Material Adverse Effect had occurred and refused to fund. LBI subsequently filed for bankruptcy on Jan. 6, 2009.

The Lyondell Bankruptcy Court Decision—MAC Clauses. In September 2011, Edward Weisfelner, Trustee of a litigation trust for Lyondell creditors (Trustee), filed a complaint in the Lyondell bankruptcy proceeding with a slew of allegations against Access and Blatvanik under New York, Texas and Luxembourg law. These claims included, among other things, breach of contract from the failure of Access, in the final days of December 2008, to make advances in response to a draw request under its revolving credit facility. (The Trustee also unsuccessfully sought to recover as avoidable preference payments the $300 million of revolving credit advances repaid by LBI to Access in October 2008, a claim denied by both the bankruptcy court and, on appeal, the district court.)

Access and Blatvanik argued before the bankruptcy court that the impending Chapter 11 filing itself created a failure of the "no material adverse effect" condition (referred to by the court as the "MAC" clause). However, Bankruptcy Court Judge Martin Glenn took pains to emphasize that the Access credit agreement did not, either through the MAC clause or otherwise, expressly contain as a condition to funding that LBI be solvent, and refused to allow the defendants to "stretch" the MAC clause to include a solvency requirement. Accordingly, in a fairly narrow reading of the MAC clause, the court held that in the absence of a solvency requirement the MAC clause was not triggered and Access had therefore breached its obligation to LBI and Lyondell to fund the draw request in December 2008. See *Weisfelner v. Blavatnik (In re Lyondell Chemical Co.)*, 567 B.R. 55 (Bankr. S.D.N.Y. 2017.)

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The breach of contract claim was the one claim on which the Trustee prevailed. But the court handed the Trustee a somewhat Pyrrhic victory. The Access revolving credit agreement contained a provision stating that neither the Lender nor its affiliates shall have "any liability for any special, punitive, indirect or consequential damages relating to this Agreement or any other Loan Document or arising out of its activities in connection herewith or therewith (whether before or after the Closing Date)." The bankruptcy court, on the basis of an earlier ruling by Judge Robert E. Gerber (who retired shortly after this decision) (see *Weisfelner v. Blavatnik (In re Lyondell Chemical Co.)*, 544 B.R. 75, 92 (Bankr. S.D.N.Y. 2016)) held that this limitation of liability clause prevented recovery for anything other than restitutionary damages. The Trustee was entitled to receive solely a return of the $12 million commitment fee less 40 percent ($3.8 million) to account for the court's calculation of the benefit LBI received from the October draws. The Trustee appealed that ruling to the U.S. District Court.

The Lyondell District Court Decision—Enforceability of Limitation of Liability Clauses. In analyzing the limitation of liability provision, U.S. District Court Judge Denise Cote first summarized the general rule in New York—that contract provisions between sophisticated parties limiting remedies are generally enforceable. She then described two limited exceptions to this rule. One exception relates to the provision itself, and requires the provision to lack both procedural and substantive fairness, something derived from unequal bargaining power but also either "not within the reasonable expectations of the party" or "unconscionable or unduly oppressive" as a substantive matter. The judge also allowed that a provision could be "so outrageous as to warrant holding it unenforceable on the ground of substantive unconscionability alone." The other exception, referred to by the court as the Kalisch-Jarcho doctrine, focuses on the conduct of the party seeking to limit its liability.

This doctrine provides that a limitation will not be enforced when such party has engaged in conduct that "smacks of intentional wrongdoing."

The court went on to hold that the limitation of liability provision in the Access credit agreement was not so unbalanced or oppressive that it should be set aside on the basis of procedural and substantive unfairness. The judge stated that the Access revolver effectively conferred a benefit on LBI and Lyondell, and limiting the scope of that benefit in this manner does not render the contract unconscionable.

The judge next reviewed application of the Kalisch-Jarcho exception. While the Trustee alleged a number of instances of Access misconduct, the court stated that the misconduct must be tied to the particular breach of contract alleged in the complaint. Here, the allegations of misconduct related to the refusal to lend in December 2008 constituted, in the court's view, merely an intentional failure to perform. Judge Cote held that unless there is some intention to inflict harm on the other party through breach, or the breach itself is independently tortious, Kalisch-Jarcho does not apply. In the court's view, deciding not to perform because it became economically disadvantageous to do so did not constitute the type of intentional misconduct required to invalidate the limitation of liability clause. Further, intentional breach of a contract to lend, even if partially motivated by a desire to act as a post-petition lender, was held not "contrary to the rights afforded to a party to a contract to refuse to perform."

> Together, these rulings emphasize the importance to lenders of taking a closer look at what may (or may not) be standard provisions of their credit agreements.

As a result, the court confirmed the bankruptcy court award of restitutionary damages in the amount of the $12 million commitment, but disagreed that there was sufficient evidence of value to the Access subsidiaries from the October draws to warrant reducing return of a portion of that fee.

Conclusion. Collectively, Judges Gerber, Glenn and Cote forged an interesting path in analyzing the MAC clause and limitation of liability provisions in the Access/Lyondell revolving credit agreement.

Judge Glenn read the MAC clause to find that only a MAC clause with an insolvency component (and it is unclear how an insolvency component would work in a MAC clause) would have excused Access from lending, despite the fact that LBI was on the brink of bankruptcy. Notably absent from this part of his opinion is whether the Access subsidiaries suffered any material decline in revenues from the Closing Date (it certainly seemed so). However, the defendants may not have alleged as a defense any decline in revenues or other typical MAC events. In fact, the opinion notes the opposite—that in the view of the defendants the impending Chapter 11 filing itself triggered the MAC clause.

Judge Cote also rode a narrow path in interpreting the misconduct required to override a limitation on liability provision of a lender. In her view, a lender must act in a way that would essentially constitute tortious behavior, similar to what would be required for a successful lender liability claim.

Both Judges Gerber and Cote appeared to adopt the view that an exclusion for "special, punitive, indirect or consequential damages" meant, at least in this instance, restitutionary and not compensatory (or "general") damages. (According to Judge Gerber, the term special damages is "synonymous with consequential damages, and both refer to damages that do not flow directly from the breach of the contract, but are still caused by the breach. 544 B.R. at 52. See also the excellent discussion on types of damages in *In re CCR Communications*, 464 B.R. 97 (Bankr. S.D.N.Y. 2011) by Judge Stuart Bernstein.) It seems unlikely that compensatory-type damages could have easily been asserted here, given the wide-ranging and somewhat speculative nature of damages.

Together, these rulings emphasize the importance to lenders of taking a closer look at what may (or may not) be standard provisions of their credit agreements. Based on Judge Glenn's opinion, a typical MAC clause may not provide a defense to funding even with a debtor clearly poised to file for bankruptcy. Lenders should consider including a solvency test as a condition to each funding. However, neither MAC clauses nor solvency tests may be sufficient protection to a creditor grappling with a request for funding from such a debtor. Limitation of liability provisions are also important protections for a lender. Judge Cote's view of their enforceability, and of a lender's right to refuse to fund in the face of a pending bankruptcy filing, should provide a considerable degree of comfort to lenders confronted with this dilemma.