

# The Banking Law Journal

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**Editor's Note: Principles and Considerations**

Victoria Prussen Spears

**Understanding How “Course of Performance” Principle Impacts Financings**

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***Personae Non Gratae* in the Loan Market: Trading Considerations for Disqualified Institutions**

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**Insurance and Private Markets: A Mutually Beneficial Relationship**

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Darryl Tarver, Aurélie Ercoli, Jonathan Haray, Jason Lewis, Eric Forni and Sean Fulton

**Payments and the UK Government's Pro-Growth Agenda: Financial Conduct Authority Examines Potential Changes to Contactless Limits**

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Lerong Lu and Ci Ren



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VOLUME 142

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<b>Editor's Note: Principles and Considerations</b> Victoria Prussen Spears	281
<b>Understanding How "Course of Performance" Principle Impacts Financings</b> Kiel A. Bowen, Frederick C. Fisher, Andrew O. Vouziers and Linda E. Boss	284
<b><i>Personae Non Gratae</i> in the Loan Market: Trading Considerations for Disqualified Institutions</b> Robert J. Waldner and Paul B. Haskel	287
<b>Control Issues: Federal Court Rules Depository Bank Breached Deposit Account Control Agreement</b> Jonathan M. Petrakis, Joel N. Ephross and Max W. Fargotstein	292
<b>Who Owns the Policy Versus Who Owns the Proceeds? The Distinction Matters During Bankruptcy</b> Lorelie S. Masters and Geoffrey B. Fehling	296
<b>Insurance and Private Markets: A Mutually Beneficial Relationship</b> Michael James and Alexander Argyris	301
<b>Securities and Exchange Commission Roundtable Presents Both Risks and Opportunities of Artificial Intelligence in the Financial Industry</b> Darryl Tarver, Aurélie Ercoli, Jonathan Haray, Jason Lewis, Eric Forni and Sean Fulton	304
<b>Payments and the UK Government's Pro-Growth Agenda: Financial Conduct Authority Examines Potential Changes to Contactless Limits</b> James Black and Virginia Montgomery	308
<b>Impact of U.S. Outbound Investment Rules on Loan Transactions in China and Practical Considerations</b> Olivia Ngan, James Mendenhall, Carys Golesworthy and Lloyd Lyall	315
<b>Achieving Financial Stability and Resilience: How China Could Learn from the United States and the United Kingdom in Building a Financial Safety Net – Part IV</b> Lerong Lu and Ci Ren	321

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Matthew T. Burke at ..... (800) 252-9257  
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# Understanding How “Course of Performance” Principle Impacts Financings

*By Kiel A. Bowen, Frederick C. Fisher, Andrew O. Vouziers and  
Linda E. Boss\**

*In this article, the authors explain the scope of the “course of performance” interpretation principle, how it could impact financing facilities, and considerations for lenders to minimize unintended consequences.*

The common law principle of “course of performance” has been used by legal systems for centuries. Essentially, a written agreement can be modified by a course of performance if one party repeatedly deviates from or changes the performance required and the other party accepts or acquiesces to that deviation or change. While courts have historically used this interpretation principle in case law, it is also codified by the Uniform Commercial Code (UCC). Thus, if a financial contract is governed by Article 9 of the UCC, Section 1-303 of the UCC will likewise apply, including the application of the course of performance principle.

Consistent with its common law definition, UCC 1-303 defines “course of performance” as “a sequence of conduct between the parties to a particular transaction that exists if: (1) the agreement of the parties with respect to the transaction involves repeated occasions for the performance by a party, and (2) the other party, with knowledge of the nature of the performance and opportunity for objection to it, accepts the performance or acquiesces in it without objection.”

It is important to note that a course of performance specifically relates to the conduct during or after the agreement is executed; it does not pertain to conduct before an agreement is executed (a course of dealing) or conduct that is an expectation or assumption due to a particular trade or vocation (a usage of trade). Although “course of dealing” and “usage of trade” principles are also part of UCC 1-303, these concepts are outside the scope of this article.

## **HOW COURSE OF PERFORMANCE APPLIES TO FINANCING FACILITIES**

Although parties to a financing facility look to the underlying contract to determine required performance, there may unfortunately be cases of ambiguity or competing interpretations of provisions from time to time. If this happens,

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\* The authors, attorneys with Mayer Brown LLP, may be contacted at [kbowen@mayerbrown.com](mailto:kbowen@mayerbrown.com), [ffisher@mayerbrown.com](mailto:ffisher@mayerbrown.com), [avouziers@mayerbrown.com](mailto:avouziers@mayerbrown.com) and [lboss@mayerbrown.com](mailto:lboss@mayerbrown.com), respectively.

interpretation principles – such as course of performance – may be used to determine the intended meaning of the contract.

UCC 1-303(d) states that course of performance “is relevant in ascertaining meaning of the parties’ agreement” and “may supplement or qualify the terms of the agreement.” Comment 1 to this clause further provides that “the meaning of the agreement of the parties is to be determined by the language used by them and by their action, read and interpreted in light of the commercial practices and other surrounding circumstances.” While this clause and the accompanying comment provide some direction, the scope and opportunity for use is relatively broad.

### **HIERARCHY OF INTERPRETATION**

While at first glance this provision seems problematic, UCC 1-303(e) provides a hierarchy of interpretation to make clear that the express terms of a financial contract will be considered in interpretation before course of performance. Accordingly, unambiguous contract language is critical to ward off potential disputes regarding course of performance. If the express terms are clear, interpretation principles like course of performance do not come into consideration.

### **WHEN COURSE OF PERFORMANCE CONSTITUTES A WAIVER OR MODIFICATION**

UCC 1-303(f) states that “a course of performance is relevant to show a waiver or modification of any term inconsistent with the course of performance.” Accordingly, course of performance may be used as a defense to non-compliance with the contract’s terms, with the non-compliant party arguing that course of performance effectively modified the contract terms. In other words, when lenders routinely overlook or fail to enforce defaults, their conduct may inadvertently signal acceptance of such deviations, thereby modifying the terms of the contract.

This leniency, even when unintended, can be interpreted as a waiver of strict compliance with the original agreement with respect to the default, making it crucial for lenders to address defaults promptly and consistently to avoid unintentional amendments to the contractual obligations.

### **BEST PRACTICES TO AVOID COURSE OF PERFORMANCE DEFENSES**

- *Include Unambiguous Contract Language.* The best way to avoid a course of performance defense is to ensure that course of performance is never on the table for consideration. If the express terms of the contract are clear and unambiguous, the express terms will govern the agreement.

- *Clearly Document Deviations and Waivers.* When a party deviates from the required performance under a contract, documentation is critical to avoid a course of performance defense. When documenting waivers or consents, it is essential to explicitly document in writing that deviations are a one-time event and do not constitute a course of performance. Without documented waivers and consents that include this language, it is easier for parties to argue that course of performance altered the terms of the financial contract.
- *Consider Formal Amendments Rather Than Multiple Waivers.* Since the mere act of consistently or routinely agreeing to waivers (particularly waivers relating to the same breach or act) could arguably constitute a course of performance, if a party cannot or will not be able to comply with the terms of the financial contract for a known period of time, consider a formal amendment to the contract rather than using multiple, ongoing waivers. This will more accurately reflect the parties' intent and agreement.

## TAKEAWAYS

UCC 1-303 can play an important role in financing facilities, especially if the contract's terms are ambiguous and disputes regarding performance arise. To avoid the risk of a party using a "course of performance" claim as a defense to its obligations, lenders should take care to include explicit and clear language in financing facilities and ensure that carefully documented waivers and consents are executed in the event of any deviation or breach.