SYNDICATED CONSTRUCTION LOANS, DEFAULTING LENDERS, AND EQUITABLE REMEDIES

Charles E. Aster[*] *and Michael A. Attaway*[**]

I. INTRODUCTION

Over the past half-century, sophisticated real estate lending transactions in the United States have evolved to include new types of lenders, products, methods, and documentation to deal with the ever-increasing size and complexity of American real estate development. In the construction lending industry, these lenders, products, and methods cover a broad expanse of construction loans, from small construction or renovation loans funded by single private lenders to multi-hundred million dollar construction loans

---

* Director, Kane Russell Coleman & Logan PC. J.D., The George Washington University School of Law. Mr. Aster primarily focuses on real estate and commercial financing while also leading the firm's China and hotel and stadium development practices.

** Associate, Kane Russell Coleman & Logan PC. J.D., University of Mississippi School of Law. Mr. Attaway focuses his practice on commercial financing transactions, real estate transactions, and other business-related matters.

The Authors wish to thank Jeri Leigh Miller for her preliminary research on the issues addressed in this Article.

funded by large syndicates of banks and other institutional lenders.[1] For the larger loans, these lending syndicates are needed to amass the necessary loan funds while hedging each individual lender's institutional exposure. This is especially true in construction lending.

During the 2007–2009 banking crisis (2007 Banking Crisis), some lenders with low cash liquidity failed to honor their construction loan agreements even though their developer–borrower properly satisfied all conditions to funding set forth in their loan documents.[2] Developer–borrowers were—for the first time since the great depression—forced to bear the real risk of one or more of its syndicate lenders defaulting in their commitment to lend their pro-rata share of overall future construction loan proceeds (a defaulting lender), thereby leaving the borrower with insufficient funds to complete its construction project. Before 2007, such a risk—while always a distant possibility for large, sophisticated lending institutions—was seen universally as insignificant so long as the lender was contractually bound to fund by the loan documents. In the "old days" banks were considered secure institutions beyond reproach.[3] However, with the advent and unraveling of international derivatives, hedging, swaps, and other international, inter-lender agreements that led to the 2007 Banking Crisis, the rock-solid image banks once enjoyed has been severely tarnished.[4]

Today, even with legally binding loan documents, developer–borrowers must now worry and ask what happens if one of the lenders in their lending syndicate defaults and fails to fund its share of the construction loan. Without these funds, the borrower most likely will not be able to fully pay construction costs and complete construction of the project on schedule. This often forces the borrower into default under its loan documentation.[5] The result is often catastrophic: a project halted in the middle of construction with a rapidly deteriorating market value; unpaid contractors suing the borrower; a defaulted loan with the remaining syndicate lenders who properly funded their pro-rata shares of construction advances (the non-defaulting lenders) demanding repayment; foreclosure of the property; lender lawsuits against

---

1. *See* Gary A. Goodman, *Special Problems of Syndicated Loans*, DENTONS (Apr. 14, 2014), http://www.dentons.com/en/insights/articles/2014/april/14/special-problems-of-syndicated-loans.

2. *See, e.g.*, Edward Kalikow, *Construction Projects Becoming Collateral Damage in Bank Failures*, NAT'L REAL EST. INV. (Aug. 9, 2012), http://nreionline.com/blog/construction-projects-becoming-collateral-damage-bank-failures.

3. *See* Anthony Johndrow, *Where Did American Banks Go Wrong?*, QUARTZ (Dec. 29, 2014), http://qz.com/315161/where-did-american-banks-go-wrong/.

4. *See* Rebecca Riffkin, *In U.S., Confidence in Banks Remains Low*, GALLUP (June 26, 2014), http://www.gallup.com/poll/171995/confidence-banks-remains-low.aspx.

5. *See* John Caulfield, *FDIC Sells Corus Bank's $4.5 Billion Loan Portfolio to Investment Group*, BUILDER (Oct. 7, 2009), http://www.builderonline.com/land/development/fdic-sells-corus-banks-45-billion-loan-portfolio-to-investment-group_o.

the borrower and any guarantor; bankruptcy of the developer–borrower; and the loss of the project along with all of the borrower's equity in the project.[6]

Traditionally, the law's response to borrower outcry against defaulting lenders has been for the aggrieved borrower to sue the defaulting lender for monetary damages. In other words, the borrower sues the defaulting lender to reimburse the borrower for the costs of obtaining replacement financing to keep construction going or, if the project has collapsed due to the defaulting lender, for the dollar amount the borrower lost from the failed project and the payment of all costs the borrower suffered as a result of the non-defaulting lenders' and third party contractors' claims against the borrower.[7] In reality, such a traditional suit has become impractical to the point of meaninglessness. Besides the extreme difficulty of calculating damages, for the often-bankrupt borrower to succeed, it must fight a multi-year legal battle against an institutional lender. Usually, before the borrower can win the long and expensive suit involving years of discovery, motion battles, and numerous experts spouting conflicting theories, the borrower is forced out of business and the unique project it had hoped to construct and operate becomes a sad and bitter memory. Therefore, though money damages sound reasonable, they are often illusory.

Recently, in litigation brought by borrowers against defaulting lenders, the courts in equity in some states, most importantly in the State of New York, are beginning to allow borrowers an alternate route in fighting defaulting lenders.[8] These courts are allowing, or are progressing toward allowing, borrowers to seek the equitable remedies of injunctive relief, specific performance, or both.[9] This major break is the result of the courts taking notice that traditional monetary damages do not offer an adequate remedy to the aggrieved borrower in a construction loan.

This Article explores the problem of defaulting lenders in syndicated construction loans; the evolution of the courts moving from at-law, monetary damages to the equitable remedies of injunctive relief and specific performance; how syndicate construction loan documents need to change; how this is beneficial to not only the borrowers but also, surprisingly, the lenders; and a suggested provision to include in the current market lender-drafted loan documents to increase a borrower's ability to obtain equitable remedies instead of limiting them to monetary damages.

---

6. *See, e.g.*, *Developer: Bank Only Interested in FDIC Funds, Not in Restarting Stalled Project*, 5 REAL EST. L. & INDUSTRY REP. 546, 547 (July 24, 2012) (quoting a developer of commercial real estate whose project ultimately failed as a result of a bank failure: "I, as a developer who did nothing wrong, have my carcass left on the side of the road like collateral damage. My investors lost their money. I've lost my money, [and] the town lost its project . . . .").

7. *See infra* Part III.A.

8. *See infra* Part III.B.

9. *See infra* Part III.B.

II. MODERN CONSTRUCTION LENDING

A. Primary Elements of Construction Loan Financing

There are two primary elements of construction loans that separate them from other types of loans. First, there is the obvious subject matter of the loan—construction of real estate improvements. Almost all construction loans involve development, construction, or renovation of improvements on real estate. The breadth of the types of construction is only limited by four things: (1) the location and physical attributes of the construction site; (2) the zoning or other legal restrictions applicable to the site; (3) the imagination, creativity, and technical ability of entrepreneurs, architects, engineers, and contractors to envision and create the final product; and (4) the probability that the construction project, once completed, will generate sufficient income to not only pay for its construction and operation, but also provide sufficient profits to make this project more desirable to undertake than other competing investment opportunities.

Second, the construction lenders will disburse in multiple advances or draws over time as the improvements are built (which could be as short as a few months or as long as multiple years).[10] This is very different from single advance acquisition or refinance loans in which the lender funds all loan proceeds at the closing of the loan. The construction loan advances are spread out so that the lender can confirm that the developer uses each advance of loan proceeds only for approved construction purposes and contractor payments for work done or materials supplied.[11]

To confirm that the loan proceeds are being spent directly on the construction of the project or for other lender approved expenses, construction loan documentation includes elaborate provisions establishing multiple conditions for drawing each loan advance. The construction lenders establishes three lists of conditions for funding. The first list includes the major items that the borrower must satisfy to close and obtain the initial funding of the loan. These closing and first-funding conditions include matters such as due diligence on the plot of land itself, the reputation of the contractors and approval of the project plans and specification, the construction schedule, and the construction budget.[12] The lenders' engineers and analysts must confirm that the overall project can be properly built in accordance with the construction plans, with each phase or section being completed on schedule, and with the entire project fully paid for by the construction loan proceeds from the lenders and equity dollars invested by

---

10. *See* PORTER WRIGHT MORRIS & ARTHUR LLP, LAW ALERT: CONSTRUCTION LOAN DRAW PROCEDURES—RESIDENTIAL AND COMMERCIAL (2003), http://www.porterwright.com/files/upload/B&F&RE_Sept2013.pdf.

11. *Id.*

12. STEVEN G.M. STEIN, CONSTRUCTION LAW ¶ 14.03[2] (Matthew Bender ed., 2016).

the borrower.[13] If any of these elements do not pass the lenders' review, the construction loan is never approved or funded.

During the life of the loan, while actual construction is in progress, as a condition to ongoing funding of loan advances, the borrower, often during the first ten days of each calendar month, submits draw requests and accompanying evidence to the administrative agent for the construction lenders requesting an advance to pay (1) the previous calendar month's invoices and bills from the project's contractors, materialmen, and professionals; (2) various fees to government agencies for the appropriate approvals and permits required at different times and stages during the construction process; (3) interest on loan funds previously advanced; (4) other costs specifically approved by the lenders or set forth in the pre-approved budget; and (5) if allowed by the lenders, developer fees to the borrower to pay its staff and officers while the multi-year project is being built.[14]

Finally, the loan documents will include a third set of deliverables required by the lenders for the final construction advance. This will include items to confirm that all construction work has been fully completed, all bills from all contractors and materialmen have been paid, the final advance will be a sufficient final payment to all parties who are still owed money, the parties have signed waivers and lien releases, copies of temporary and permanent certificates of occupancy have been received, and evidence from the title company providing title insurance for the mortgage lien has been received showing that no mechanics' liens or other claims have been filed against the property.[15]

Simply put, if the borrower does not satisfy each and every condition to the requested advance, i.e., delivering all of the deliverables in perfect compliance with the conditions listed in the construction loan documents, the lender is not legally obligated to, and usually will not, fund the requested loan advance. If the borrower is almost perfect or the missing deliverable is only a small matter, the lender may, in its discretion, waive the deliverable and fund in any event.

This concept of delivering satisfactory and compliant draw requests meeting all of the conditions to funding is crucial in the analysis to follow. It must be clearly understood that if the borrower does not comply with the advance or draw conditions, the lenders are not obligated to fund and are not in default.

Accordingly, the following discussion assumes that all draw requests submitted by the borrower have all the necessary deliverables and that such

---

13. *See id.* ¶ 14.03[3].
14. *See id.* ¶ 14.03[4][d].
15. *See id.* ¶ 14.03[4][g].

deliverables meet all conditions to the draw. Hence, the lender is now legally obligated to fund the draw request in question.

B. Lender Syndication

Over the last half-century, the growth in the dollar amount of individual real estate construction loans has increased dramatically as the cost, size, and complexity of new developments have soared.[16] The staggering breadth of these developments is often limited only by imagination and engineering capabilities. From luxurious, multi-building resort complexes in the most remote and exotic locations to single, massive one-hundred story office towers and domed sports stadiums, the construction loans for these large projects have skyrocketed from tens of millions to hundreds of millions of dollars. Some real estate projects, such as certain signature projects in New York City, have recently exceeded billion dollar price tags.[17]

Surprisingly, this growth has placed lenders in an awkward position. Banks derive income from many sources and businesses. In construction lending, the two primary sources of income are (1) fees paid by borrowers in exchange for the lenders agreeing or committing to lend the loan, and (2) the interest charged on funds actually loaned to the borrowers.[18] There are other fees and mechanics for banks to raise funds, but commitment fees and interest are the two largest sources of lender income in construction lending. Therefore, banks are incentivized to commit and lend as much as possible to good, quality borrowers on safe, large projects.

However, even if a project is of superior quality and the borrower is beyond reproach, banks must still take a conservative approach and not allow themselves to lend too much to any single project. No matter how good the borrower's planning and the bank's underwriting, unforeseen events might occur, resulting in the project suffering a serious, if not a total, loss. Accordingly, a single bank will not allow itself, and will not be permitted by government regulation, to lend so much to a single project that it jeopardizes the bank's financial well-being.[19]

Anecdotally, we have found that the largest twenty-five banks in the United States will not lend more than \$25–\$100 million in any single construction loan. Usually, the larger the bank, the larger the construction

---

16. *See* Goodman, *supra* note 1.

17. *See, e.g.*, Eliot Brown, *Tower Rises, and So Does Its Price Tag*, WALL ST. J. (Jan. 30, 2012), http://www.wsj.com/articles/SB10001424052970203920204577191371172049652; Keiko Morris, *Javits Center to Expand, N.Y. Gov. Andrew Cuomo Says*, WALL ST. J. (Jan. 7, 2016, 9:02 PM), http://www.wsj.com/articles/javits-center-to-expand-n-y-gov-andrew-cuomo-says-1452185537; Liz Robbins, *In Brooklyn, Bracing for Hurricane Barclays*, N.Y. TIMES (Sept. 21, 2012), http://www.nytimes.com/2012/09/23/nyregion/with-barclays-center-arena-set-to-open-brooklyn-braces-for-the-storm.html.

18. *See* Ruth King, *Why Is Interest Income Important to Banks?*, MKT. REALIST (Mar. 31, 2015, 3:26 PM), http://marketrealist.com/2015/03/interest-income-important-banks/.

19. *See* Goodman, *supra* note 1.

loan amount the bank is willing to fund. So if a project requires $300 million in loan funds (not an uncommon amount for a new class-A office tower complex in a major urban center), the lenders' resistance and inability to take too large of a risk means a borrower will need more than one lender to fund the entire construction loan.

To solve this problem, banks and other lenders often band together to form informal lender syndicates to make loans collectively, which exceed their individual internal lending limits. Though the name *syndicate* sounds formal and imposing, a syndicate is, in reality, a loose grouping of banks and other lenders who decide to invest together in a loan and fund, receive, and take a proportionate part of the loan's advances, fees, interest income, and risk.[20]

We use the term *invest* because that is what each bank and lender is really doing; they are investing their funds in a loan in return for a corresponding portion of the commitment fees and interest. True, the lenders structure the investment as a secured first lien loan, but it is still an investment that could suffer a partial or total loss.[21]

When a major real estate developer approaches its primary relationship bank with its development concept and loan proposal, the borrower's relationship bank will, if it has initially approved the loan proposal, then try to act as the lead bank, or administrative agent, for the potential syndication. The relationship bank, or administrative agent for the syndicate of lenders, as it will now be acting, will contact other lenders with whom it has successfully worked with in previous syndicated loans to form a new syndicate for the new loan.[22] Often, these syndicates consist of a customary group or "club" of banks or other lenders that invest in each other's loan syndications, along with other random lenders that were broadly canvassed by the relationship bank and assembled for a single loan.[23] These syndicates can also develop from large, investment banking houses such as Goldman Sachs or Morgan Stanley acting on behalf of the borrower. These investment banks, in exchange for fees, guide the borrower in structuring the loan so that the proposal is as appealing as possible to a broad spectrum of lenders.[24] They also find and convince lead lenders or agents and other potential lenders to commit to the loan.

Whether a relationship bank/administrative agent or an investment bank assembles the banks and lenders, the interested lenders announce to the lending syndicate and borrower what size piece that lender is willing to advance under the loan. There is no set amount for any lender, though for

20. *See id.*
21. *See id.*
22. *See id.*
23. *See id.*
24. *See id.*

administrative sanity, each syndication usually requires a minimum amount that each lender must lend.[25]

The original, large relationship bank, which first met with its relationship borrower, usually leads the loan syndicate or group of lenders. If the relationship bank has the administrative capability and construction department necessary to review the mountains of engineering, technical, and financial data to underwrite and administer the loan, during the course of the construction loan, it acts as the administrative agent for the group of lenders and will be the sole contact between the lending syndicate and the borrower.

The relationship bank's major role as administrative agent for the loan is to interact with the borrower on a day-to-day basis and take responsibility for interactions between the lending syndicate and the borrower. Foremost among these responsibilities is creating and negotiating the original construction loan documentation and reviewing all borrower draw requests to confirm that they satisfy all of the conditions set forth in such documentation.[26] Upon confirming that each draw meets such conditions, the agent takes actions to fund the draw and ensure that the other lenders contribute their share of each advance. If the agent believes that the draw request does not meet the conditions of the loan documents, the agent will reject the draw request and inform the borrower of its deficiencies. The borrower will then fix the deficiencies and keep resubmitting the draw request until it gets it right.

C. Loan Participations, Syndications, and Recent Developments

As construction loans have evolved in size and complexity, the ways lenders approach making construction loans have also evolved. In the early 1980s, it was customary to see lenders "participating" their loans rather than using syndicates.[27] When a lender sells participations in a loan, the lender enters into the construction loan directly with the borrower and takes sole responsibility and legal liability for funding the entire loan over the term of the construction.[28] There is only one lender signing the lending documentation and the borrower looks to that single lender to fund all draws. The sole lender, in separate documentation not involving the borrower, enters into binding agreements with other lenders, or participants, to sell each a portion of the sole lender's economic interest in the loan.[29] In exchange for each participant funding or reimbursing its pro-rata portion of the loan funds

25. David Line Batty, *Necessity Is the Mother of Innovation During the Credit Crisis*, 14 N.C. BANKING INST. 1, 8 (2010).

26. *Id.* at 2–3.

27. Keith Mullen, *Understanding Differences Between a Syndicated Loan & Participated Loan Is Crucial When It Turns Bad*, LENDERS 360 (Mar. 7, 2010), http://www.lenders360blog.com/2010/03/understanding-differences-between-a-syndicated-loan-participated-loan-is-crucial-when-it-turns-bad/.

28. *Id.*

29. 1 LENDER LIABILITY LAW AND LITIGATION § 21.02 (Matthew Bender ed., 2015).

to the sole lender, the participant will receive the same pro-rata share of the loan's income from fees and interest.[30] If the loan experiences problems leading to a foreclosure and loss on the loan, the participating lenders, pursuant to their participation agreements, suffer a proportionate share of the loss.[31] This all occurs outside of the interaction and legal relationship between the sole lender and the borrower.

If everything proceeds according to the structure set forth in the separate participation agreements between the sole lender and its participants, the participating lenders will fund their participation amounts and there will be little economic difference between a participated loan and a syndicated loan. That should be true for either a successful loan or a loan in foreclosure.

However, it is not true in the case of a defaulting lender. After the late 1980s and early 1990s savings and loan crisis (the S&L Crisis), the use of loan participations for larger construction loans dramatically tapered off. Since the 2007 Banking Crisis, loan participations in large construction loans are a rarity.[32]

In the defaulting lender context, the key difference between a loan syndication and a loan participation is that, in a syndicated loan, the administrative agent and other syndicate lenders have no responsibility or liability to fund the defaulting lender's share of the construction loan.[33] The borrower must pursue legal action directly against the defaulting lender for breach of the loan agreement.[34] However, in a participated loan, the sole lender is legally responsible for funding the entire loan to the borrower over the course of construction, even if all of the sole lender's participating lenders default under their participation agreements and fund nothing to the sole lender.[35] The sole lender can then separately pursue legal action against each defaulting lender or participant for breach of its participation agreement.

As noted earlier, the S&L Crisis and 2007 Banking Crisis led construction lenders to shift the risk of a defaulting lender from the sole lender in participation loans to the borrower in syndicated lending.[36]

D. Current Lender Loan Documentation

The administrative agent who reports to the other lenders regarding the progress of negotiations and prepares them to fund their portion of the initial loan advance at closing also handles the construction loan documentation in a syndicated loan.[37] The only parties the borrower side deals with are the

30. *Id.*
31. *Id.*
32. Batty, *supra* note 25, at 1.
33. Goodman, *supra* note 1.
34. Batty, *supra* note 25, at 4–5.
35. *Id.* at 10.
36. *Id.* at 4.
37. *Id.* at 3–4.

agent and its legal counsel, who actually prepare the loan documents, unless unusual circumstances require consultation with the other lenders and joint negotiation.

Both the business and legal terms of the construction loan are set forth in the loan documents. The conditions to draw an advance usually are very detailed and take up a number of pages in the loan agreement. If the construction proceeds as planned, this is the only section the borrower and lender will, hopefully, regularly utilize as the borrower submits its monthly draw requests. However, if problems develop with the borrower or in the construction, the parties will then look to other clauses in the documents such as default and remedies.

In today's word-processing age, it is not uncommon for the borrower's counsel to receive a loan agreement of seventy to one hundred or more pages along with other documentation, including the promissory note, mortgage, guaranties, collateral assignments, and other documents totaling in excess of two or three hundred pages. It is an arduous and expensive process for the parties to negotiate these documents. Because the first drafts prepared by the administrative agent's legal counsel almost always heavily favor the agent and lenders, the borrower's team has its work cut out for it when negotiating to modify the more egregious terms.

Through our experience in dealing with a number of large syndicated loans, either as borrower's or lender's counsel, we have noted that the large lender community has adopted, in their loan documents, a set of almost industry standard provisions dealing with specific issues. Those issues include the establishment of the syndication; the commitment of each syndicate lender to fund its portion of the overall loan; the terms under which the borrower, lenders, and agent interact; and who is liable to whom for what. These lender-community-approved documents also include provisions dealing with defaulting lenders.

In a recent large construction loan involving a top-five United States national bank acting as administrative agent and lender of a substantial portion of the loan, our firm, acting as counsel for a large national borrower, received a set of construction loan documents (the example loan documents) containing what we believe, from experience, are typical defaulting lender provisions (the example provisions). The example provisions in the example loan documents are identical or almost identical to other current large construction loan documents we see from other large syndicate lenders. We chose to use this language as our example because it is the actual language given to us in a large construction deal, as opposed to picking among forms circulating among sophisticated lenders.

The below example provisions are the primary provisions dealing with a defaulting lender's failure to fund its pro-rata share of a complying construction draw request. These provisions are not all of the provisions dealing with defaulting lenders, but they are the key ones for this discussion.

While these provisions contain terms elaborately defined in the definitions section of the example construction loan agreement, reading the capitalized terms without including or reviewing their definitions still provides the reader with their general meaning and intent (some of the clauses are italicized for emphasis):

> "Defaulting Lender" means any Lender that (a) has failed, within two Business Days of the date required to be funded or paid, to (i) fund any portion of its Loan, or (ii) pay over to any [Lender Party] any other amount required to be paid by it hereunder, unless in the case of clause (i) above, such Lender notifies the Administrative Agent in writing that such failure is the result of such Lender's good faith determination that a condition precedent to funding (specifically identified and including the particular Default, if any) has not been satisfied; (b) has notified Borrower or any [Lender Party] in writing, or has made a public statement, to the effect that it does not intend or expect to comply with any of its funding obligations under this Agreement (unless such writing or public statement indicates that such position is based on such Lender's good faith determination that a condition precedent to funding (specifically identified and including the particular Default, if any) cannot be satisfied) or generally under other agreements in which it commits to extend credit; (c) has failed, within three Business Days after request by a [Lender Party], acting in good faith, to provide a certification in writing from an authorized officer of such Lender that it will comply with its obligations to fund under this Agreement, provided that such Lender shall cease to be a Defaulting Lender pursuant to this clause (c), upon such [Lender Party]'s receipt of such certification in form and substance satisfactory to it and the Administrative Agent; or (d) has become the subject of a Bankruptcy Event.
>
> 2.01 Right to Advances, Generally. Each Lender severally agrees, on the terms and conditions set forth in this Agreement, to make Loans to Borrower from time to time in amounts not to exceed in the aggregate the amount of its Commitment. Each Advance hereunder shall consist of Loans made by the several Lenders ratably in proportion to the ratio that their respective Commitments bear to the Aggregate Commitment. *No Lender shall be responsible for the failure of any other Lender to perform its obligations to make Loans hereunder, and the Commitment of any Lender shall not be increased or decreased as a result of the failure by any other Lender to perform its obligation to make Loans hereunder.*
>
> 3.03 Funding of New Loan Advances.
>
> (a) Generally. *Each Lender shall make each Loan to be made by it hereunder on the proposed date thereof by wire transfer of immediately available funds by 11:00 a.m., [location of the project] _____ time, to the account of Administrative Agent most recently*

designated by it for such purpose by notice to the Lenders. Unless otherwise provided in Section 2.04 hereof, Administrative Agent will make such Loans available to Borrower by promptly crediting the amounts so received, in like funds, to an account of Borrower maintained with Administrative Agent and designated by Borrower in Administrative Agent's Disbursement and Rate Management Signature Authorization and Instruction Form.

(b) Advance Fundings. *Unless Administrative Agent shall have received notice from a Lender prior to the proposed date of any Advance that such Lender will not make available to Administrative Agent such Lender's share of such Advance, Administrative Agent may assume that such Lender has made such share available on such date in accordance with paragraph (a) of this Section and may, in reliance upon such assumption, make available to Borrower a corresponding amount. In such event, if a Lender has not in fact made its share of the applicable Advance available to Administrative Agent, then the applicable Lender and Borrower severally agree to pay to Administrative Agent forthwith on demand such corresponding amount with interest thereon, for each day from and including the date such amount is made available to Borrower but excluding the date of payment to Administrative Agent, at (i) in the case of such Lender, the greater of the Federal Funds Effective Rate and a rate determined by Administrative Agent in accordance with banking industry rules on interbank compensation or (ii) in the case of Borrower, the interest rate applicable to Floating Rate Loans.* If such Lender pays such amount to Administrative Agent, then such amount shall constitute such Lender's Loan included in such Advance.

3.14 Mitigation Obligations: Replacement of Lenders.

(b) Replacement of Lenders. If any Lender requests compensation under Section 3.10 hereof, or if Borrower is required to pay any Indemnified Taxes or additional amounts to any Lender or any Governmental Authority for the account of any Lender pursuant to Section 3.12 hereof, or *if any Lender defaults in its obligation to fund Loans hereunder, then Borrower may, at its sole expense and effort, upon notice to such Lender and Administrative Agent, require such Lender to assign and delegate, without recourse (in accordance with and subject to the restrictions contained in Section 11.04 hereof), all its interests, rights (other than its existing rights to payments pursuant to Section 3.10 or 3.12) and obligations under this Agreement to an assignee that shall assume such obligations (which assignee may be another Lender, if a Lender accepts such assignment);* provided *that (i) Borrower shall have received the prior written consent of Administrative Agent, (ii) such Lender shall have received payment of an amount equal to the outstanding principal of its Loans, accrued*

> *interest thereon, accrued fees and all other amounts payable to it hereunder, from the assignee (to the extent of such outstanding principal and accrued interest and fees) or Borrower (in the case of all other amounts); provided however, that in the case of Borrower's replacement of a Defaulting Lender for failure to fund Loans hereunder, the assignee or Borrower, as the case may be, shall holdback from such amounts payable to such Lender and pay directly to Administrative Agent, any payments due to Administrative Agent or the Non-Defaulting Lenders by Defaulting Lender under this Agreement*, and (iii) in the case of any such assignment resulting from a claim for compensation under Section 3.10 hereof or payments required to be made pursuant to Section 3.12 hereof, such assignment will result in a reduction in such compensation or payments. A Lender shall not be required to make any such assignment and delegation if, prior thereto, as a result of a waiver by such Lender or otherwise, the circumstances entitling Borrower to require such assignment and delegation cease to apply.

E. How These Defaulting Lender Provisions Purportedly Work

While the language is clearly legalistic, it can be boiled down to a few primary concepts. First, as can be seen from the definition of "defaulting lender," there are a number of reasons a lender can become a defaulting lender; however, the primary reason is a lender's failure to fund a draw request that complies with all draw conditions.

Second, when the borrower submits its complying draw package to the administrative agent, the agent will, if it approves the draw package as complying, notify all of the syndicate lenders of the complying draw request. Each lender, pursuant to the first sentence of § 3.03(a), must then wire transfer to the agent their proportionate share of the respective draw advance.

Third, the last sentence of § 2.01 makes very clear that no non-defaulting lender is responsible or liable to the borrower or other lenders to make up or replace the funds of any defaulting lender who has not funded its pro-rata share.

The above concepts are discussed step-by-step; but then, from a borrower's perspective, the provisions take a terrible turn for the worse.

Section 3.03(b) provides that, unless the agent receives prior notice from the defaulting lender that it does not intend to fund, the agent may advance to the borrower the defaulting lender's share of the advance from the agent's own funds, assuming that the defaulting lender's funds will be wired to the agent simultaneously or promptly thereafter. However, after the agent funds the defaulting lender's share, if the agent discovers that the defaulting lender has not and does not intend to fund, the agent will then send out a demand to *both* the defaulting lender *and* the borrower for return of the funds plus interest. The second sentence of § 3.03(b) clearly states that the borrower and defaulting lender are "severally" liable, meaning they each separately agree to reimburse the agent for the advanced funds.

Section 10.11(c) in the loan agreement provides that if the non-defaulting lenders do elect to fund the defaulting lender's share of the advance, then both the defaulting lender and the borrower, again severally, are immediately obligated to reimburse the non-defaulting lenders.

What the loan agreement provisions do not discuss is what happens if neither the administrative agent nor the non-defaulting lenders fund the defaulting lender's share of the advance. In this situation, the borrower is simply left short of funds to pay its construction and other bills for the immediately preceding month along with the prospect that such shortfalls will continue from the defaulting lender each month thereafter. The above provisions make it clear that the administrative agent and the non-defaulting lenders are not responsible to make up such shortfall.

In this sequence of events, the borrower and agent are caught off-guard when one of the syndicate's lenders is not funding its share of the advance. Even if the defaulting lender does notify all parties that it does not intend to fund, the agent and borrower are still surprised by the defaulting lender's failure because the agent has reviewed and approved the draw package as complying with the loan advance conditions.

While the defaulting lender will of course try to claim that the draw package is defective, the fact that the agent and other non-defaulting lenders approved the draw package as complying puts the defaulting lender in an awkward position, arguing against the agent and other lenders that the draw package does not meet the draw conditions. Unless the defaulting lender discovers a defect the agent and all of the other lenders failed to catch, the defaulting lender is contractually obligated to fund. Even if the defaulting lender is correct, the borrower is allowed to cure the defect and resubmit its draw request. Once the borrower resubmits its corrected draw package, the defaulting lender no longer has a valid objection.

Though the lenders in the syndicate and the borrower may hear rumors that the defaulting lender is experiencing financial or regulatory difficulty, either the defaulting lender's notice of non-payment or its failure to timely fund will be extremely upsetting to the borrower, administrative agent, and non-defaulting lenders. By failing to fund, the defaulting lender has put the timely and proper completion of the entire project in jeopardy. If the defaulting lender's failure to fund leads to a borrower's default and foreclosure of the construction loan, all of the lenders will face a serious risk of not receiving payment of accrued interest and, worse yet, repayment of only some portion of the principal amounts they loaned the borrower. In this world of large, sophisticated lenders, institutional memories run deep and any lender who cannot be trusted to fund its share of construction draws will often be omitted from future syndicates, becoming a syndication outcast. But if the regulators are scrutinizing the defaulting lender's cash reserves, the defaulting lender may view getting through its immediate present troubles as much more important than its syndication reputation.

From the borrower's perspective, the defaulting lender's failure to fund is often devastating. When the agent has advanced the draw and then discovers that the defaulting lender will not reimburse the agent for the defaulting lender's share, the borrower must forthwith, on demand from the agent, send the portion of the draw representing the defaulting lender's share back to the agent. Adding insult to injury, the borrower must repay such funds at a higher rate of interest than the interest rate the borrower normally pays under the loan.

It is easy to imagine the borrower's position. It has worked hard to comply with the numerous conditions contained in the hundreds of pages of loan documents and has delivered a complying draw package to pay its construction contractors and subcontractors for the work they performed and the materials they delivered the month before. The borrower receives the full draw advance from the agent and immediately, in accordance with its loan document covenants, pays the contractors and subcontractors so that no mechanics' liens arise and the contractors and subcontractors continue working to complete the project by the completion deadline set forth in the loan documents.

Suddenly, the borrower receives a call or official notice from the agent that it has to return to the agent the funds in question. It would be beyond reason to believe that the contractors and subcontractors will return their payments without claiming a payment default under their construction contracts, thereby triggering their mechanics' lien rights. Both the borrower and the lenders want to avoid a dispute with the contractors and subcontractors because all parties want them to continue their work on the project uninterrupted; for in the real estate and banking industries, there are few things worse than a construction project stopped dead in its tracks for lack of funds with lawsuits, liens, and cross-claims flying in all directions. The only certain result is that with each day construction is halted, the costs of re-starting construction, possibly with different contractors and subcontractors, are skyrocketing, and the expected profit and return on the project is deteriorating.

Accordingly, the borrower has to move quickly, but its options are limited. If the funds have been advanced, the borrower is most likely required to reimburse the agent because the defaulting lender would have funded on time or shortly thereafter if it was going to fund at all. The problem is not about a couple of days' delay in funding. The problem is that the share of the loan the defaulting lender is still obligated to fund in the upcoming months cannot be counted on. Even if the defaulting lender timely notifies all parties that it does not intend to fund the draw and the agent does not advance the defaulting lender's share to the borrower, the borrower still needs that same amount of funds to pay the contractors, subcontractors, and other parties that are to be paid out of the draw.

It is possible that one of the non-defaulting lenders might voluntarily fund the defaulting lender's share to avoid a collapse of the construction project. But it is also possible that the non-defaulting lenders will not want to unexpectedly come out of pocket for all future shares of each draw on behalf of the defaulting lender. It sets a bad precedent for future syndications if defaulting lenders believe they can ignore their legal obligations because the other lenders will bail them out by funding their share. Also, if the lending industry and financial markets are in turmoil, as they were in the 2007 Banking Crisis, then the non-defaulting lenders may have balanced their lending budgets to fund their respective share only and have no excess funding capacity to cover a defaulting lender's share.

In most cases, the borrower will likely be forced to seek additional funds to replace the defaulting lender's share of not only the draw request in question but also all future draw requests. Unless the disputed draw is at the very end of the construction, the present and future funding deficit the borrower now faces is possibly in the tens of millions of dollars. This deficit is not an easy amount to come up with in a short period to pay the contractors and to keep work progressing without stoppage.

With time working against the borrower, the borrower must quickly find an alternate funding source to keep construction on schedule. Looking at its options, the borrower will first look to the loan documents and the law to see if it has an easy and quick solution. Unfortunately, while the solutions the loan documents offer appear very practical and straightforward, they are, in truth, illusory.

First, the borrower, agent, and other lenders will complain to the defaulting lender that it is in default of its loan agreement and is placing all of them at risk of suffering large losses if, due to the defaulting lender, the project fails and foreclosure becomes necessary. The borrower will threaten to sue the defaulting lender for the traditional legal remedy of breach of contract and damages. However, undoubtedly the defaulting lender already anticipated these responses and still made the decision to not fund. Accordingly, the non-defaulting lenders' and borrower's threats usually do not change the defaulting lender's decision.

In fact, the defaulting lender may not put much value in the borrower's threats to sue. For the borrower to sue the defaulting lender and obtain all damages to which it is entitled, the borrower must sue a large lending institution with an army of attorneys and, even though the defaulting lender is strapped for cash, it probably still possesses substantially more financial resources to fight a prolonged legal battle than the borrower. Unfortunately, the borrower will often collapse as an entity under the weight of not only this legal battle but also a foreclosure fight with the agent and non-defaulting lenders. There will also be countless lawsuits with contractors, subcontractors, and other third parties with binding agreements (such as pre-signed leases with large, corporate tenants) signed in anticipation of completion of the project.

Hence, the borrower's threats of a breach of contract suit and claim for damages might be the lesser of two evils to a defaulting lender who decides it would rather face the borrower's claims years later in court than exacerbate whatever problems that caused the lender to forego its funding obligations in the first place—especially if there is a good chance the lender can litigate the borrower into financial oblivion.

When the borrower gives up threatening the defaulting lender, it will again scour the construction loan agreement to see if it provides an alternative, quick, and cost-effective solution against the defaulting lender. As set forth above, § 3.03(c) provides that if a lender is a defaulting lender, the borrower may "require" the defaulting lender to assign its share of the committed loan to either a lender who is already a member of the syndicate or to a completely new lender who the borrower, the agent, or another non-defaulting lender has asked to step in and take over the defaulting lender's share. This sounds logical and straightforward but, as certain courts in various jurisdictions have already taken judicial notice of, it is not a realistic or practical answer.[38]

First, by the time a new lender is found, the project, which is not receiving full funding due to the defaulting lender, may already be in trouble as contractors and subcontractors stop work or file liens due to nonpayment. In that scenario, an unrelated new lender will be hesitant to invest new money into a loan when construction has stopped and the parties are at each other's throats. Additionally, even if a new lender was interested, it would have to undertake its own due diligence review and underwriting of the project to determine why the defaulting lender stopped funding. In the interim, the situation may deteriorate further to the point that the new lender regretfully gives up on the idea.

Second, § 3.03(c) above requires that the purchasing lender pay the defaulting lender at par or 100% for the defaulting lender's share of loan funds that have already advanced and accrued interest and other fees still due and owing to the defaulting lender. This clause is virtually suicidal for purposes of bringing a new, unrelated lender into the loan. If the defaulting lender is desperate for cash, it might see this clause as a way to "extort" the other lenders to overlook the defaulting lender's breach of contract and buy it out at par. In other words, the defaulting lender tries to force the other lenders to buy its share for one hundred cents on the dollar so the other lenders can avoid the risk of a loan default, foreclosure, and loss on the loan.

38. *See, e.g.*, First Nat'l State Bank v. Commonwealth Fed. Sav. & Loan Ass'n, 610 F.2d 164, 174 (3d Cir. 1980) (taking judicial notice of poor economic conditions); Destiny USA Holdings, LLC v. Citigroup Glob. Mkts. Realty Corp., 69 A.D.3d 212, 217 (N.Y. App. Div. 2009).

This would be a substantial win for the defaulting lender who has now successfully not only avoided making further loan advances but has also obtained a return of 100% of its already-advanced loan funds and accrued interest without having to assign its interest at a discount. By requiring payment of the defaulting lender at par, the documents almost encourage a defaulting lender to engineer a default as a strategy to force the borrower and other lenders to find a third-party lender to step in and buy the defaulting lender out at par. To say this would reward the defaulting lender for its bad acts would be an understatement.

For new, unrelated lenders analyzing whether they should be the "white-knight" lender rescuing the loan from the defaulting lender, the requirement of paying the defaulting lender at par is usually a non-starter because any new lender will want to purchase the defaulting lender's loan share at a meaningful discount to compensate the new lender for the additional risk of stepping into what by that time has become a precarious loan situation.

A dramatic solution to this problem is to change the initial construction syndication form to provide that if a defaulting lender fails to fund its share of a complying draw request, the borrower, administrative agent, or non-defaulting lender is allowed to bring in a new, replacement lender to, or the non-defaulting lenders can, purchase the defaulting lender's share of the unpaid principal and accrued interest at a pre-agreed significant discount. This would build into the loan a significant penalty for defaulting lenders. Normally, such a penalty might seem unfair, but the risk of loss to the borrower and non-defaulting lenders is even greater.

While imposing such a penalty discount against defaulting lenders might sound like a quick and easy fix, unless there is a significant increase in broken loans caused by defaulting lenders, the Authors see very little chance of the lending community imposing such penalties on not just each other but also against themselves.

For these same reasons, hoping that one of the non-defaulting lenders will step in and invest additional loan funds to take over the defaulting lender's position is a long shot. Even though the existing lenders want to avoid the borrower being forced into default and having to foreclose on the project, rewarding a defaulting lender in this way would send a terrible message within the lending community that holding the borrower and other lenders hostage is a viable strategy for a troubled lender.

Finally, the borrower will look to see if there is any possibility of raising possibly tens of millions of dollars in additional equity to keep the construction project on track while also funding the fight against the defaulting lender in court. However, even though the borrower may be completely in the right and have sound legal claims, it may be exceedingly difficult for the borrower to raise this additional equity without suffering significant dilution to its existing equity owners. Like a white-knight lender requiring the defaulting lender to sell its loan share at a discount, any similar white-knight equity investor will demand a high investment price in exchange for involving itself in a problem construction project.

III. THE NEED FOR AN ALTERNATIVE REMEDY

Fortunately, the above scenario rarely happens. But when it does, the effects are usually disastrous for all parties. In a construction loan in which we acted as bankruptcy counsel for the borrower, the list of horribles described above predictably occurred one after the other as though we were watching dominoes fall one into the other. In the end, the project was not completed; many lawsuits were filed by unpaid contractors; the borrower entity was liquidated in bankruptcy; and the lenders, after foreclosing the property, received what we were told was ten to twenty cents on every dollar they lent. In other words, everyone lost.

Therefore, because damages at law are often inadequate to prevent an extremely predictable and inequitable result, the law needs to provide construction borrowers with a viable alternative: an equitable remedy in place of a contractual one. This means veering away from a century and a half of English and American common law.

A course correction in the law is usually a deliberate and slow-moving process—not an immediate turn. Courts review how the applicable body of law developed and if the law's original and evolving purpose and rationale are still sound and relevant today.[39] They will also review whether the existing law provides adequate and proper relief, or whether a new legal concept is needed.[40] Then, the courts will usually tailor any change they believe is necessary to cause the least possible upheaval in the business and legal environment in which the question arose.[41]

Fortunately, regarding defaulting lenders, the courts in many states have already started this process.

A. At-Law Monetary Damages: The Traditional Remedy

Courts have traditionally taken the view that monetary damages provide a borrower with an adequate remedy at law when a lender breaches a contract to lend; accordingly, borrowers historically have not been entitled to equitable remedies, such as injunctive relief or specific performance. This legal precedent, which was established more than 150 years ago, is steeped

---

39. *See* Ilya Shapiro & Nicholas Mosvick, *Stare Decisis After* Citizens United*: When Should Courts Overturn Precedent*, 16 NEXUS: CHAP. J.L. & POL'Y 121, 135 (2011).

40. *See* Marion A. Oliver, Comment, *Rule 90: The Limited Publication Controversy*, 25 TEX. TECH L. REV. 929, 934 (1994).

41. *See, e.g.*, Jones v. Flood, 716 A.2d 285, 287 (Md. 1998).

in legal tradition and a legal principle that has been "exploded" today.[42] Since the early twentieth century, courts have examined the traditional rule and in some cases created exceptions.[43] However, like most evolution in legal thought, many states have not yet decided the issue.

Interestingly, the precedent and policy behind the traditional rule that a borrower is not entitled to specific performance to enforce a contract to lend was established in the mid-1800s in a suit by a lender, *Rogers v. Challis*.[44] *Rogers*, an English case published in 1859, is the first reported case in which a plaintiff sought specific performance of a contract to lend money.[45] In that case, the lender sought specific performance, ordering the borrower to accept a loan for which it had contracted.[46] Although it involved the reverse of the situation examined in this Article, *Rogers* is generally viewed as the case that established the rule, still recognized in many jurisdictions today, that neither borrowers nor lenders are entitled to specific performance of lending contracts.[47]

In *Rogers*, the court refused to grant the lender specific performance of a contract to lend for a number of reasons, including that the plaintiff–lender had an adequate remedy at law—the recovery of monetary damages.[48] The court reasoned that the lender's damages for the breach of contract could be easily determined.[49] They were simply the difference between the return the lender would have received on the defaulting borrower's loan and the return the lender could reasonably anticipate to receive on an alternate loan to a different party.[50] Therefore, since a remedy at law—an award of monetary damages—could be easily calculated, there was no reason to consider equitable remedies such as specific performance.[51]

Even though a lender sought specific performance in *Rogers* based on the legal principle of mutuality of remedy, *Rogers* established the precedent that the remedy of specific performance is also not available to a borrower.[52] In other words, when courts later addressed cases in which a borrower sought specific performance from a lender, they honored the doctrine of mutuality of remedy—which was "in vogue in equity jurisprudence" for a considerable amount of time and used primarily to "deny specific performance in certain cases"[53]—and held that an aggrieved

42. *See* JOSEPH M. PERILLO, CALAMARI AND PERILLO ON CONTRACTS §§ 16-6, 16-16 (6th ed. 2009).
43. *See* Roger D. Groot, *Specific Performance of Contracts to Provide Permanent Financing*, 60 CORNELL L. REV. 718, 724 (1975).
44. *See id.* at 722–23.
45. *See id.*
46. *See id.*
47. *See id.*
48. *Id.* at 723.
49. *Id.*
50. *Id.*
51. *Id.*
52. *Id.*
53. PERILLO, *supra* note 42, § 16-6.

borrower has the same remedies as an aggrieved lender—monetary damages.[54] The courts did not engage in original analysis of the issue from the borrower's perspective.[55] Rather, they reached their holding by relying on a doctrine that has been exploded[56] and generally abandoned unless a state has expressly adopted it by statute.[57] Accordingly, the traditional rule that a borrower is not entitled to specific performance of a contract to lend arose out of a case that did not even involve a borrower seeking specific performance and is based upon a legal principle that is no longer given deference by modern courts.[58]

Therefore, when a defaulting lender fails to fund a construction loan, the traditional remedy for a borrower is the award of monetary damages for the lender's breach of contract.[59] In such a case, a construction loan borrower would likely seek both general compensatory and consequential damages.[60] Each of these elements of damages is intended to fully compensate the borrower for its losses.

The measure of general compensatory damages for a construction loan borrower is based on the principle that money is fungible; therefore, a borrower may go into the market place to obtain alternative financing when a lender fails to fund a draw request or some other required sum.[61] General compensatory damages are intended to compensate the borrower for the costs of obtaining this replacement financing.[62] Hence, the aggrieved borrower is generally entitled to collect damages in an amount equal to the incremental cost of obtaining alternate financing.[63] "Because money is fungible, a party seeking enforcement of an agreement to lend money would be expected to borrow money elsewhere and recover damages based on the higher costs associated with the replacement loan."[64]

On the other hand, consequential or special damages are intended to compensate the borrower for actual economic loss that resulted from the lender's breach or failure to fund.[65] In the case of a construction loan, as previously discussed, the economic loss to a borrower can be enormous.[66] The failure to fund a construction draw can lead to the failure of the project

54. Groot, *supra* note 43, at 723.
55. *Id.* at 723–24.
56. PERILLO, *supra* note 42, § 16-6.
57. *Id.* § 16-11.
58. *Id.* § 16-6.
59. *See* Groot, *supra* note 43, at 720–21.
60. *See id.* at 721.
61. *See id.* at 720–21.
62. *See* STEIN, *supra* note 12, ¶ 14.02[9].
63. *See id.*
64. Destiny USA Holdings, LLC v. Citigroup Glob. Mkts. Realty Corp., 69 A.D.3d 212, 217 (N.Y. App. Div. 2009) (citing Bradford, Eldred & Cuba R.R. v. N.Y., Lake Erie & W. R.R., 123 NY 316, 325–27 (N.Y. 1890)).
65. *See* Groot, *supra* note 43, at 721.
66. *See supra* Part II.E.

in its entirety, causing the borrower to lose its investment and incur significant liabilities to multiple third parties.[67] Additionally, and in many cases more importantly, the borrower will also lose its anticipated profits it would have earned if the project had been completed and the property began producing income.[68]

Because consequential damages are intended to compensate the borrower for its entire economic loss, these damages are likely exponentially larger than the general damages to which the borrower is entitled.[69] For this reason, consequential damages are harder to prove because courts impose limits to ensure a measure of reasonableness with respect to what an aggrieved party may claim and recover. Courts generally hold that an aggrieved party may not recover consequential damages unless the losses suffered by the party are reasonably foreseeable or within the reasonable contemplation of the parties at the time of the agreement.[70] In other words, a construction loan borrower's ability to recover consequential damages is tied to its ability to prove (1) the defaulting lender's failure to fund a draw request caused the damages; (2) the amount of the damages with certainty; and (3) the damages were foreseeable to the defaulting lender, and thus, contemplated by the parties.[71]

As previously discussed, while a suit to recover monetary damages by an aggrieved borrower of a syndicated loan sounds good in theory, that right is often useless in practice. First, as recognized by the court in *Destiny v. Citigroup*,[72] and in other courts,[73] the current economic environment and the realities of the lending marketplace may make it almost impossible for a borrower to timely obtain replacement financing in the middle of a construction project.[74] Instead, the construction project will likely fail before the borrower can obtain replacement financing, meaning the borrower will not have any general damages, only consequential ones. While consequential damages are intended to provide the borrower with a recovery for its total economic loss, the causation, amount, and foreseeability of those damages is exceedingly difficult to prove.[75] Further, given the failure of the project and

---

67. *See* STEIN, *supra* note 12, ¶ 14.02[9].

68. *See id.*

69. *See* 22 AM. JUR. 2D *Damages* § 324 (2013).

70. *See id.*

71. *See, e.g.*, Schonfeld v. Hilliard, 218 F.3d 164 (2d Cir. 2000).

72. Destiny USA Holdings, LLC. v. Citigroup Glob. Mkts. Realty Corp., 69 A.D.3d 212, 222–23 (N.Y. App. Div. 2009) (taking judicial notice of poor economic conditions).

73. *See, e.g.*, First Nat'l State Bank v. Commonwealth Fed. Sav. & Loan Ass'n, 610 F.2d 164, 174 (3d Cir. 1980).

74. *Destiny*, 69 A.D.3d at 222–23. The *Destiny* decision occurred at the height of the 2007 Banking Crisis when few, if any, lenders were entering into new construction loans. *Id.* at 214. However, even though the 2007 Banking Crisis is over, the court's judicial notice of the economic realities of obtaining alternative financing should still apply generally. *See id.* at 222–23.

75. *See generally* 22 AM. JUR. 2D *Damages* § 324 (stating that the recovery of special damages in a particular case is subject to limitations).

the legal fights—most likely including bankruptcy and litigation with the non-defaulting lenders, contractors, and subcontractors—the borrower will often not have sufficient resources to pursue the multi-year litigation necessary to obtain a consequential damages award.

For these reasons, the precedent and reasoning in *Rogers*, which serves as the basis for the traditional rule that a borrower is not entitled to specific performance of a contract to lend, is not satisfactory when applied to a construction loan.[76] Monetary damages, as a legal remedy, is not an adequate remedy for a construction loan borrower who faces the failure of its entire construction project because one lender fails to fund a draw request.[77] Instead, the remedies that are necessary and proper for construction loan borrowers are the equitable remedies of injunctive relief and specific performance.

B. Equitable Remedies

The reasoning behind a court's grant of an equitable remedy is based upon its determination that an award of monetary damages (or other legal relief) does not provide the borrower an adequate legal remedy.[78] The equitable remedies of injunctive relief and specific performance can provide a construction loan borrower with something that monetary damages cannot—almost immediate access to the money needed to complete the borrower's construction project in a timeframe that allows the borrower to continue construction with as few interruptions as possible and thus prevents catastrophic failure of the project. For this reason and others, since *Rogers*, and in spite of *Rogers*, borrowers continue to seek equitable remedies to enforce contracts to lend. As a result, beginning in the early twentieth century, courts created exceptions to *Rogers*.[79] One such exception focuses on construction loans.[80]

This Section of the Article discusses application of the equitable remedies of injunctive relief and specific performance to contracts to lend. In particular, this Section focuses on exceptions to the *Rogers* rule related to construction lending that have developed in New York and other jurisdictions. The Section discusses two recent New York cases in which the courts granted an aggrieved borrower equitable remedies, forcing a

76. *See* STEIN, *supra* note 12, ¶ 14.03[9]; *see also* Caulfield, *supra* note 5.
77. *See* STEIN, *supra* note 12, ¶ 14.03[9].
78. PERILLO, *supra* note 42, § 16-1.
79. *See, e.g.*, Columbus Club v. Simons, 236 P. 12, 15–16 (Okla. 1925).
80. *See, e.g.*, John C. Williams, Annotation, *Specific Performance of Agreement to Lend or Borrow Money*, 82 A.L.R. Fed. 3d 1116 (1978).

defaulting lender to fund a construction loan draw,[81] and it explains why other jurisdictions should adopt the reasoning proposed in those cases.

1. Injunctive Relief and Specific Performance in General

When discussing the equitable remedies of injunctive relief and specific performance in connection with contracts to lend, it is important to understand the interplay between the two and the common thread a borrower is required to exhibit—irreparable injury to the borrower with no available adequate remedy at law.

Immediate injunctive relief—variously referred to in different jurisdictions as a "temporary" or "preliminary" injunction, or "temporary restraining" relief—can be a borrower's first line of attack when a defaulting lender fails to fund a loan advance. The purpose of a temporary or preliminary injunction is to preserve the status quo pending a final trial on the merits.[82] Accordingly, "[a] temporary or preliminary injunction is one that restrains the doing of an alleged unlawful and wrongful act during the pendency of proceedings that seek permanent relief."[83] A temporary injunction is an extraordinary remedy and thus is not available when there is an adequate remedy at law.[84]

The ability to obtain a temporary injunction is crucial to the construction loan borrower in an action against a defaulting lender because, as discussed above, time is at a premium. The borrower must force the defaulting lender to fund the loan advance as quickly as possible, and temporary injunctive relief provides the quickest judicial mechanism to do so. Accordingly, the ability of a borrower to obtain a temporary injunction requiring a lender to fund its share of the applicable loan advance can be the difference between the life and death of a construction project.

In most jurisdictions, a temporary injunction usually presents the opportunity to obtain relief immediately or within a few weeks. Accordingly, when a defaulting lender fails to fund a loan, a borrower can immediately seek judicial relief by seeking the issuance of a temporary injunction.[85] If the borrower is successful, the court will then set a date for a trial on the merits to determine the borrower's right to permanent relief.[86] In the case of a

81. *See* Destiny USA Holdings, LLC v. Citigroup Glob. Mkts. Realty Corp., 69 A.D.3d 212, 212 (N.Y. App. Div. 2009); Petra Mortg. Capital Corp. v. Amalgamated Bank, No. 101283/2010, 2014 WL 2607087, at *14–16 (N.Y. Sup. Ct. June 6, 2014).

82. 44 TEX. JUR. 3D *Injunctions* § 13 (2016).

83. *Id.*

84. *Id.*

85. *See* Redwood Ctr. Ltd. v. Riggs Nat'l Bank, 737 F. Supp. 671, 672 (D.D.C. 1990).

86. *See Destiny*, 69 A.D.3d at 217–18.

construction loan borrower that needs a defaulting lender to fund its loans, that permanent relief is usually specific performance.[87]

The elements of proof for a preliminary injunction are similar in most states. In New York, for example, an injunction is appropriate when a plaintiff proves by clear and convincing evidence: "(1) a likelihood of ultimate success on the merits; (2) the prospect of irreparable injury if the provisional relief is withheld; and (3) a balance of equities tipping in the moving party's favor."[88] In Texas, "[t]o obtain a temporary injunction, the applicant must plead and prove three specific elements: (1) a cause of action against the defendant; (2) a probable right to the relief sought; and (3) a probable, imminent, and irreparable injury in the interim."[89]

Obtaining a temporary injunction is a significant short-term victory for an aggrieved borrower. The defaulting lender is forced to fund construction advances for the term of the temporary injunction or suffer the consequences of ignoring a court order. Depending on the term of the temporary injunction, the borrower may have what it needs to complete the project. For example, if the loan will be fully funded in four months, and the court sets the hearing on the merits for six months later, the borrower will not need to prove that it's entitled to permanent relief. However, all borrowers are not so fortunate. The court may set the hearing on the merits for a date that precedes the final advance of the construction loan. Therefore, it is important to keep in mind that a temporary injunction is just that: temporary. Ultimately, to obtain permanent relief and force the defaulting lender to fund all future draw requests, the borrower must prove to the court that it is entitled to specific performance of the lending contract at the trial on the merits.[90]

A court sitting in equity may award specific performance as a remedy for breach of contract.[91] The decision to order specific performance rests in the trial court's discretion.[92] The court may use this discretion to award specific performance for a wide range of contractual issues,[93] but courts most often award specific performance when the subject matter of the contract is unique, such as real property.[94]

---

87. *See* First Nat'l State Bank v. Commonwealth Fed. Sav. & Loan Ass'n, 610 F.2d 164, 171–74 (3d Cir. 1980).

88. *Destiny*, 69 A.D.3d. at 216.

89. Butnaru v. Ford Motor Co., 84 S.W.3d 198, 204 (Tex. 2002).

90. *See* DiGiuseppe v. Lawler, 269 S.W.3d 588, 594 (Tex. 2008).

91. *Id.*

92. Stafford v. S. Vanity Magazine, Inc., 231 S.W.3d 530, 535 (Tex. App.—Dallas 2007, pet. denied); Claflin v. Hillock Homes, Inc., 645 S.W.2d 629, 635–36 (Tex. App.—Austin 1983, writ ref'd n.r.e.) (ordering the breaching party to pay money to the seller for the purchase of a home on the basis of considerations of equity).

93. *See* Petra Mortg. Capital Corp. v. Amalgamated Bank, No. 101283/2010, 2014 WL 2607087, at *7–8 (N.Y. Sup. Ct. June 6, 2014) (awarding specific performance for failure to fund an ongoing real estate project); *Stafford*, 231 S.W.3d at 536 (affirming an award of specific performance to enforce a stock purchase agreement).

94. Tauber v. Quan, 938 A.2d 724, 733 (D.C. Cir. 2007).

Generally, to obtain specific performance, a party must prove (1) performance or the ability to tender performance under the contract and (2) that no adequate remedy at law exists.[95]

In this Article, we assume that the borrower has satisfied all conditions to submitting its draw request and obtaining funding from all of the syndicate lenders, including the defaulting lender. Therefore, the borrower has tendered performance under the contract. Accordingly, whether the borrower has an adequate remedy at law will determine whether the borrower is entitled to specific performance. Generally, a party has no adequate remedy at law either when payment of money damages would fail to restore the status quo or when the defendant's non-performance would cause a plaintiff irreparable injury.[96]

2. *Irreparable Injury and Exceptions to the* Rogers *Rule*

As mentioned above, establishing an irreparable injury for which no adequate remedy at law exists is the common thread of proof between injunctive relief and specific performance. When the borrower seeks a temporary injunction and, ultimately, an award of specific performance forcing the defaulting lender to fund, it must show that the defaulting lender's failure to fund will result in irreparable injury to the borrower for which there is no adequate remedy at law.[97]

In our experience, the most likely outcome of a lender's failure to fund is the ultimate injury to the borrower: the failure of the project, foreclosure and loss of the property, multiple lawsuits with multiple parties, the loss of the borrower's significant investment, and ultimately, bankruptcy that results in the dissolution and termination of the borrower's business and significant harm to its business reputation. Courts recognize that such catastrophic loss is irreparable injury sufficient to entitle a borrower to specific performance[98] and that termination of financing can cause that irreparable injury.[99]

In *Semmes Motors, Inc. v. Ford Motor Co.*, the court held that irreparable injury occurs when the lender's breach threatens the borrower's ability to stay in business.[100] In that case, the plaintiff operated a Ford dealership in New York.[101] After a manufacturer terminated its relationship

95. *Stafford*, 231 S.W.3d at 535.

96. *See id.*

97. *Id.*

98. *See, e.g.*, Semmes Motors, Inc. v. Ford Motor Co., 429 F.2d 1197, 1205 (2d Cir. 1970); Backpage.com, LLC v. Dart, No. 15C06340, 2015 WL 5174008, at *12 (N.D. Ill. Sept. 2, 2015) (stating that damages are insufficient if a business goes under), *rev'd*, 807 F.3d 229 (7th Cir. 2015).

99. B.P.G. Autoland Jeep-Eagle, Inc. v. Chrysler Credit Corp., 785 F. Supp. 222, 229 (D. Mass. 1991).

100. *Semmes*, 429 F.2d at 1205.

101. *Id.* at 1199.

with the dealership, the plaintiff sued, seeking injunctive relief.[102] In addressing the irreparable injury prong, the court reasoned that although damages could be easily ascertained at a later trial, the plaintiff wanted to continue in his line of business rather than live on a damages award.[103] In such instances, a "*judgment for damages acquired years after [the plaintiff's] franchise has been taken away and his business obliterated is small consolation.*"[104]

While termination of a manufacturing relationship threatened the livelihood of a business in *Semmes*, courts have also recognized that the termination of financing can result in the failure of a business and thus constitutes irreparable injury to the borrower.[105] In *B.P.G. Autoland Jeep-Eagle, Inc. v. Chrysler Credit Corp.*, Chrysler Credit Corporation (CCC) provided a revolving line of credit to a Chrysler franchisee to allow the franchisee to purchase vehicles from the manufacturer.[106] After the franchisee experienced financial difficulty and violated its loan documents, CCC sent letters to the franchisee stating that the line of credit would be canceled if the franchisee did not obtain a $425,000 capital infusion.[107] When the franchisee failed to obtain the required capital infusion, CCC terminated the line of credit.[108] The franchisee then filed suit seeking a preliminary injunction ordering reinstatement of the line of credit.[109]

After first determining the franchisee was not, at that time, in breach of the loan funding conditions,[110] the court, in discussing irreparable injury to the borrower, held that the franchisee demonstrated irreparable injury sufficient to justify injunctive relief because failure to reinstate the line of credit would result in the failure of the franchisee's business. In reaching its conclusion, the court noted that the line of credit was vital to the franchisee's business.[111] Without the line of credit, the franchisee could not replenish its inventory and would ultimately cease operations.[112] Thus, the court reasoned the franchisee's circumstances fit squarely within those promulgated by the legal textbook authors, Wright & Miller, and justify a preliminary injunction:

> Injury to reputation or goodwill is not easily measurable in monetary terms, and so often is viewed as irreparable. Indeed, when the potential economic loss is so great as to threaten the existence of the moving party's business,

102. *Id.* at 1201.
103. *Id.* at 1205.
104. *Id.* (emphasis added) (quoting Bateman v. Ford Motor Co., 302 F.2d 63, 66 (3d Cir. 1962)).
105. B.P.G. Autoland Jeep-Eagle, Inc. v. Chrysler Credit Corp., 785 F. Supp. 222, 229 (D. Mass. 1991).
106. *Id.* at 224–25.
107. *Id.* at 226.
108. *Id.*
109. *Id.* at 223.
110. *Id.* at 228–29.
111. *Id.* at 229.
112. *Id.*

> then an injunction may be granted, even though the amount of direct financial harm is readily ascertainable.[113]

Like the franchisee in *B.P.G. Autoland*, the availability of ongoing financing is critical to the existence of the construction loan borrower's business—stop funding the construction loan; stop construction; no completed construction; no completed project; the borrower is out of business.[114] Additionally, case law indicates that borrowers may also be entitled to specific performance of initial financing. For example, in *Bregman v. Meehan*, the court held that a borrower was entitled to specific performance of a purchase money mortgage because "specific performance [was] the only realistic protection available for the borrower's expectation interest, since only specific performance can protect against all the intangible and immeasurable losses occasioned by a broken commitment."[115] The court noted that "in recent years, there has been a noticeable erosion of the rule that a borrower cannot obtain specific performance on an agreement to lend money. Rather, specific performance has been granted, particularly when the loan relates to the sale of real property."[116]

In *First National State Bank v. Commonwealth Federal Savings & Loan Ass'n*, the court held that the assignee of a shopping center developer was entitled to specific performance of a permanent loan intended to refinance the project's construction loan.[117] In reaching its holding, the court concluded that shopping center financing is "unique" under New Jersey law because the subject matter is "unavailable in similar form."[118] Further, the court adopted the reasoning in another New Jersey case, noting that attempts to obtain alternative financing would be futile and thus were not required:

> [T]he would be permanent mortgage lender must contemplate that if, at the last minute, it cancels its commitment such action would be disastrous to the borrower; that in such event obtaining a new permanent mortgage loan would be well-nigh impossible, for the reason that whatever brought about the cancellation would in all likelihood prevent another lender from entering the fray . . . .[119]

---

113. *Id.* (quoting 11 CHARLES WRIGHT & ARTHUR MILLER, FEDERAL PRACTICE AND PROCEDURE § 2948 (Rev. ed. 1973 & Supp. 1991)).

114. *Id.*

115. Bregman v. Meehan, 479 N.Y.S.2d 422, 433 (N.Y. Sup. Ct. 1984) (quoting Michael J. Mehr & Lawrence A. Kilgore, *Enforcement of the Real Estate Loan Commitment: Improvement of the Borrower's Remedies*, 24 WAYNE L. REV. 1011, 1034 (1978)).

116. *Id.* at 432.

117. First Nat'l State Bank v. Commonwealth Fed. Sav. & Loan Ass'n, 610 F.2d 164, 172 (3d Cir. 1980).

118. *Id.*

119. *Id.* (alteration in original) (quoting Selective Builders, Inc. v. Hudson City Sav. Bank, 349 A.2d 564, 569 (N.J. Ch. 1975)).

In contrast, other courts have held that there is an important distinction between initial financing, such as an acquisition loan, and ongoing financing, such as a construction loan or revolving line of credit.[120]

As previously mentioned, courts find it appropriate to award specific performance when the subject matter of the contract has a special, peculiar, or unique character.[121] One subject matter is almost universally recognized as unique: real estate.[122] In the real estate world, location, location, location is crucial to the success of almost any project.[123] What might work wonderfully at one location might fail miserably at another. "When land is the subject matter of the agreement, the legal remedy is assumed to be inadequate, and specific performance is available since each parcel of land is unique . . . . [S]pecific performance is the presumed remedy for the breach of an agreement to transfer real property."[124] Therefore, as the courts have acknowledged, separate real estate properties are unique.

This legal principle is of the utmost importance when analyzing whether the borrower of a construction loan is entitled to specific performance. The real estate on which the project is being built will be encumbered by a mortgage lien, and if the project is not completed as required under the loan documents, the non-defaulting lenders will foreclose and take the real estate away from the borrower.[125]

As the court noted in *Bregman*, beginning in the early twentieth century, some courts began eroding the *Rogers* rule when the subject of the loan was real estate.[126] The early cases in which a borrower was granted specific performance of a contract to lend money had three elements in common: "(1) the lending was to occur in installments; (2) the lending had commenced; and (3) the borrower had executed a note and mortgage in favor of the lender."[127] All three of these elements are present in a construction loan, and beginning with *Columbus Club v. Simons* in 1925, courts reasoned that construction loans are, in actuality, an interest in real property.[128] Accordingly, in some states, construction loan mortgages are a recognized exception to the *Rogers* rule.[129]

---

120. Harlem Algonquin LLC v. Canadian Funding Corp., 742 F. Supp. 2d 957, 961 (N.D. Ill. 2010) ("But pulling the plug on an ongoing business venture differs greatly from refusing to fund the venture in the first place.").

121. Madariaga v. Morris, 639 S.W.2d 709, 712 (Tex. App.—Tyler 1982, writ ref'd n.r.e.) (affirming an award of specific performance in a contract for the sale of a hot sauce business).

122. 71 AM. JUR. 2D *Specific Performance* § 130 (2016).

123. David Peress, *Location*, 21 AM. BANKR. INST. J. 30, 30 (2002).

124. 71 AM. JUR. 2D *Specific Performance* § 130.

125. *See* STEIN, *supra* note 12, ¶ 14.02.

126. Bregman v. Meehan, 479 N.Y.S.2d 422, 433 (N.Y. Sup. Ct. 1984); *see also* Columbus Club v. Simons, 236 P. 12, 15 (Okla. 1925).

127. Groot, *supra* note 43.

128. *Columbus Club*, 236 P. at 15.

129. *See, e.g.*, 82 A.L.R. 3d 1116, § 4[b] (1978); Southampton Wholesale Food Terminal v. Providence Produce Warehouse Co., 129 F. Supp. 663, 664 (D. Mass. 1955).

In *Columbus Club*, the court awarded specific performance to a borrower who contracted with a lender for a loan to fund the construction of a clubhouse.[130] The plaintiff executed a promissory note and a mortgage granting the lender a lien on the land upon which the clubhouse was to be built.[131] After the plaintiff satisfied all conditions to the funding of the loan, the lender refused to fund.[132] The court initially noted the general rule that a borrower may not be awarded specific performance of a contract to lend money.[133] However, the court also noted that exceptions to the rule may be warranted in certain circumstances.[134] Ultimately, the court concluded:

> [T]he case resolves itself into a contract for the conveyance of the interest in land, and falls within the jurisdiction of equity to decree specific performance of the contract . . . .
>
> "Where land or any estate or interest in land is the subject-matter of the agreement, the jurisdiction to enforce specific performance is undisputed, and does not depend upon the inadequacy of the legal remedy in the particular case. It is as much a matter of course for courts of equity to decree a specific performance of a contract for the conveyance of real estate, which is in its nature unobjectionable as it is for courts of law to give damages for its breach."[135]

Following *Columbus Club*, courts in several other states adopted the reasoning promulgated by the court in that case and held that a borrower is entitled to specific performance to enforce a construction loan.[136] In *Southampton Wholesale Food Terminal v. Providence Produce Warehouse Co.*, for example, the court reasoned:

> It has been held, however, that cases of construction mortgages are an exception. Since the law regards land as unique an agreement to buy land can be specifically enforced even though the defendant's sole obligation is to pay money. Although the question is close, it may not be too great a stretch to include advances under a construction mortgage.[137]

---

130. *Columbus Club*, 236 P. at 15.
131. *Id.* at 13.
132. *Id.*
133. *Id.* at 14.
134. *Id.*
135. *Id.* at 15 (quoting 36 CYCLOPEDIA OF LAW AND PROCEDURE 563 (1913)).
136. *See, e.g.*, Southampton Wholesale Food Terminal v. Providence Produce Warehouse Co., 129 F. Supp. 663, 664 (D. Mass. 1955); Jacobson v. First Nat'l Bank, 20 A.2d 19, 21 (N.J. Ch. 1941), *decree aff'd*, 23 A.2d 409, 409 (N.J. 1942); Spoolan Realty Corp. v. Haebler, 262 N.Y.S. 197, 198 (N.Y. Sup. Ct. 1931); *see also* Cuna Mut. Ins. Soc. v. Dominguez, 450 P.2d 413, 418 (Ariz. Ct. App. 1969) (ordering specific performance of a loan for the acquisition of real property).
137. *Southampton Wholesale Food Terminal*, 129 F. Supp. at 664 (citations omitted).

3. Recent New York Cases

In two recent New York cases, *Destiny*[138] and *Petra Mortgage v. Amalgamated Bank*,[139] the courts adopted the reasoning first espoused in *Columbus Club* and awarded aggrieved borrowers a preliminary injunction and specific performance, respectively. These cases embody the heart of this Article and merit closer examination for many reasons. First, the circumstances involved in each case provide an excellent example of the perils associated with construction financing and why the issues discussed in this Article are of the utmost importance to both the construction loan borrower and its lenders. Second, because the cases are relatively recent, they show that what many view as a remote possibility can quickly become reality in today's economy. Finally, because the borrower in each case was successful, they provide a useful roadmap of the facts and legal analysis that an aggrieved borrower may argue.

In *Destiny USA Holdings, LLC v. Citigroup Global Markets Realty Corp.*, the Supreme Court of New York—Appellate Division upheld the decision of a lower court granting Destiny USA Holdings, LLC (Destiny), a preliminary injunction requiring Citigroup Global Markets Realty Corp. (Citigroup) to fund pending draw requests for a construction loan.[140] The dispute in *Destiny* centered on a construction loan from a three-lender syndicate used by Destiny for the development and construction of a shopping center and tourist destination.[141] Citigroup, the administrative agent for the lenders, refused to fund several draw requests even though Destiny had satisfied all conditions precedent to the draw requests.[142] Destiny then filed suit against Citigroup seeking a preliminary injunction to compel Citigroup to fund the pending draw requests.[143] The Supreme Court of New York ordered Citigroup to fund the draw requests.[144]

The appellate court began its review of the case by noting the elements of proof required for granting injunctive relief in New York and the traditional rule that a borrower is not entitled to injunctive relief or specific performance with respect to a contract to lend.[145] However, the court noted that there are exceptions to this rule and that "specific performance has been awarded where 'the subject matter of a particular contract is unique and has

---

138. Destiny USA Holdings, LLC v. Citigroup Glob. Mkts. Realty Corp., 69 A.D.3d 212, 224 (N.Y. App. Div. 2009).

139. Petra Mortg. Capital Corp. v. Amalgamated Bank, No. 101283/2010, 2014 WL 2607087, at *12–15 (N.Y. Sup. Ct. June 6, 2014).

140. *Destiny*, 69 A.D.3d at 220–21.

141. *Id.* at 214.

142. *Id.* at 215.

143. *Id.*

144. *Id.* at 224.

145. *Id.* at 217.

no established market value.'"[146] The court then concluded that Destiny had proven that it had satisfied the first prong of the test for a preliminary injunction—likelihood for success on the merits—because Destiny showed that it had properly satisfied all conditions precedent for funding the draw requests.[147] Next, the court analyzed the second prong of the test for a preliminary injunction, "whether there will be irreparable injury if the provisional relief is withheld."[148]

The court held that Destiny had established that there would be an irreparable injury if Citigroup did not fund the construction loan; thus, an exception to the general rule was warranted for several reasons.[149] First, the court ruled that construction mortgages are an exception to the general rule[150] because a construction mortgage is "an integral part of a contract to sell [or develop] real property."[151] Second, the court ruled that it would be difficult to calculate the damages suffered by Destiny because of the project's character.[152] The court noted the project was "unique" and, as such, damages could not be calculated with "reasonable precision" because it had "no established market value."[153] Finally, the court ruled that an exception was warranted because of the potential harm to Destiny's reputation and the entire construction project, and noted that monetary damages are insufficient to remedy harm to a business's reputation.[154]

Prior to concluding that Destiny also satisfied the final prong of the test for injunctive relief—balancing of the equities—the court addressed an argument from Citigroup. Like the lender in *First National State Bank*,[155] Citigroup argued that Destiny could have avoided irreparable injury by obtaining alternate financing.[156] Interestingly, the court dismissed this argument by taking judicial notice of the prevalent economic conditions when the construction loan was made (during the 2007 Banking Crisis) and concluded that alternate financing was not available.[157]

Destiny is a landmark case for construction loan borrowers for many reasons. First, although the highest court of New York did not issue the opinion, it is an instructive opinion in the nation's most important lending

146. *Id.* (quoting Van Wagner Advert. Corp. v. S & M Enters., 67 N.Y.2d 186, 193 (N.Y. 1986)).
147. *Id.* at 219–20.
148. *Id.* at 220.
149. *Id.*
150. *Id.* (citing Southampton Wholesale Food Terminal v. Providence Produce Warehouse Co., 129 F. Supp. 663, 664 (D. Mass. 1955)).
151. *Id.* (alteration in original) (quoting Bregman v. Meehan, 479 N.Y.S.2d 422, 433 (N.Y. Sup. Ct. 1984)).
152. *Id*.
153. *Id.* at 221.
154. *Id.* at 222.
155. First Nat'l State Bank v. Commonwealth Fed. Sav. & Loan Ass'n, 610 F.2d 164, 172–73 (3d Cir. 1980).
156. *Destiny*, 69 A.D.3d at 222.
157. *Id.* at 222–23.

jurisdiction. Further, because *Destiny* adopted the reasoning promulgated by many prior cases and provides a clear and concise analysis of the irreparable injury prong of the test for injunctive relief, it provides an excellent roadmap for an aggrieved construction loan borrower seeking equitable remedies to compel a defaulting lender to fund. The borrower in *Petra Mortgage v. Amalgamated Bank* used that roadmap to obtain an order of specific performance ordering the defaulting lender in that case to fund its construction loan.[158]

In *Petra Mortgage*, Petra Mortgage Capital Corp. (Petra) and Amalgamated Bank (Amalgamated) created a two-lender syndicate to make a construction loan to their borrower, Fort Tryon Tower SPE, LLC (Fort Tryon), to build a condominium in Manhattan.[159] Petra and Amalgamated entered into an intercreditor agreement (ICA), which set forth the lenders' respective funding obligations and designated Amalgamated as the administrative agent with the primary responsibility of administering the loan.[160] The loan closed in 2007.[161] Amalgamated declared a default on the loan in August 2009 and commenced foreclosure proceedings in January 2010, which was consolidated into a suit between the two lenders.[162] Fort Tryon fought the foreclosure, arguing that its defaults under the loan resulted from Amalgamated's failure to fund its draw requests. Fort Tryon also filed a counterclaim seeking specific performance of those funding obligations.[163]

The facts in *Petra Mortgage* provide a classic illustration of the damage caused by the failure of a defaulting lender to fund. In this case, Petra funded \$30,000,000 of its \$50,000,000 commitment to Fort Tryon.[164] In June 2008, after funding the \$30,000,000, Petra began experiencing financing difficulties and asked Amalgamated to purchase its remaining commitment.[165] Amalgamated refused to do so.[166] Even though Amalgamated acknowledged that Petra's inability to fund its commitment did not effect Amalgamated's obligation to fund its \$45,000,000 commitment to Fort Tryon, Amalgamated declined to fund properly submitted draw requests after September 30, 2008.[167] Subcontractors that had already provided work on the project began to file mechanic's liens.[168] Fort Tryon was then caught in the unenviable position of having no way to pay its

158. Petra Mortg. Capital Corp. v. Amalgamated Bank, No. 101283/2010, 2014 WL 2607087, at *8 (N.Y. Sup. Ct. June 6, 2014).

159. *Id.* at *3.

160. *Id.*

161. *Id.*

162. *Id.* at *4.

163. *Id.* at *9.

164. *Id.* at *4.

165. *Id.* at *6.

166. *Id.*

167. *Id.* at *5–6.

168. *Id.* at *6.

subcontracts and thus, no way to complete construction of its building so that it could repay the loan.[169]

Following its recitation of the facts, the court examined Fort Tryon's counterclaim for specific performance, ultimately held that Fort Tryon was entitled to specific performance, and ordered Amalgamated to fund its share of the loan.[170] The court's analysis in reaching its conclusion mirrors that of the court in *Destiny*. First, the court noted the general rule that a borrower must look to monetary damages for relief, except, as reasoned in *Destiny*, when recognized exceptions to the general rule exist.[171] Those exceptions include when there is no established market value for the subject matter of the contract and construction mortgages.[172] The court noted that construction mortgages are "an integral part of a contract to sell [or develop] real property," not a "simple contract to lend money."[173] Based on this reasoning, the court concluded that Fort Tryon had "established that a particular parcel of land [was] at issue" and, therefore, Fort Tryon was entitled to specific performance.[174]

IV. WHERE DO WE GO FROM HERE?

With the 2009 *Destiny* and 2014 *Petra Mortgage* decisions leading the way in the state courts of New York, an important course correction has begun in the most important lending state in America. With many of the nation's largest lending institutions based in New York and other large lenders often choosing New York law to govern their loan documents because (1) New York, like the State of Delaware for corporate law, has well established statutes and case law favoring lenders; and (2) New York has no usury ceiling for (a) loans in the amount of $250,000 or more, other than a loan secured primarily by an interest in real property improved by a one- or two-family residence,[175] and (b) loans in the amount of $2,500,000 or more;[176] the effect of the two cases cannot be underestimated.

Though no statistics are readily available, based on the Authors' experience in negotiating numerous loan agreements over the course of the last thirty-plus years, an ever-increasing portion of large construction loan agreements drafted are governed by New York law for the reasons stated above. The selection of New York law is even found frequently when the

169. *Id.*
170. *Id.* at *8.
171. *Id.*
172. *Id.* (citing Destiny USA Holdings, LLC v. Citigroup Glob. Mkts. Realty Corp., 69 A.D.3d 212, 217 (N.Y. App. Div. 2009)).
173. *Id.* (alternation in original) (quoting Bregman v. Meehan, 479 N.Y.S.2d 422, 433 (N.Y. Sup. Ct. 1984)).
174. *Id.*
175. N.Y. GEN. OBLIG. LAW § 5-501(6)(a) (McKinney 2011).
176. *Id.*

construction loan involves projects being built outside of the State of New York. By choosing New York law to govern their loan documents, the lenders are selecting the most lender-friendly jurisdiction to resolve their disputes, and they can charge interest on their loans without worrying about violating the project state's usury laws. In such cases, the lenders make all of the loan documents subject to New York law, other than those provisions in the documents dealing with the creation, perfection, priority, and enforcement of the liens and security interests created pursuant to these documents (the state law provisions). The state law provisions must be governed by the laws of the state in which the project is located and the state in which the borrower is incorporated or organized.

The right of the borrower to sue the lender for either an at-law remedy of damages or the equitable remedies of injunctive relief and specific performance is separate from the state law provisions governing enforcement of the mortgage or deed of trust lien. Accordingly, in a construction loan that is governed by New York law (except for the state law provisions), lenders, thinking they will be protected by the laws of the most lender-friendly jurisdiction in America, have, in this instance, subjected themselves to the very pro-borrower precedent of allowing injunctive relief and specific performance. Therefore, if the construction loan documents are governed by New York law, a significant step toward replacing the remedy of at-law damages with injunctive relief and specific performance has already taken place.

Even in states that have not yet expressly followed the *Destiny* and *Petra Mortgage* holdings, it is the Authors' opinion that it is only a matter of time. The logic and real-world reasoning of these cases serve as pathfinders for other state courts adjudicating defaulting lenders in construction lending. Case law in states such as Texas, where significant new large construction is currently occurring in multiple large cities, has independently moved closer and closer to the *Destiny* and *Petra Mortgage* holdings.[177] Hence, it is just a matter of time until all states hopefully adopt this view.

A. Suggested Provision

Just as the doctrines of injunctive relief and specific performance were interwoven in *Rogers* with the historical legal doctrine of mutuality of remedies, the remedy of specific performance has also carried with it a general belief that the remedy, for it to be granted, must be expressly written into the agreement the aggrieved party wishes to enforce. This belief has

177. *See, e.g.*, Claflin v. Hillock Homes, Inc., 645 S.W.2d 629, 635–36 (Tex. App.—Austin 1983, writ ref'd n.r.e.) (forcing appellant to pay the appellee the price of the home); *see* Clear Channel Commc'ns, Inc. v. Citigroup Glob. Mkts., Inc., No. 2008Cl04864, 2008 WL 2164150 (225th Dist. Ct., Bexar County, Tex. Apr. 18, 2008) (granting a temporary restraining order enjoining the defendants from refusing to fund under the commitment letter).

evolved from a combination of two old legal philosophies. First, since specific performance was for decades used primarily to enforce real estate purchase contracts, the rules governing real estate contracts were used to govern the right to seek specific performance. The centuries-old Act for the Prevention of Fraud and Perjuries,[178] enacted in England in 1677, commonly known today as the Statute of Frauds, requires, among other things, that "any contract [f]or the sale of lands, tenements or hereditaments, or any interest in or concerning them . . . shall be in writing."[179] Second, in addition to the requirement that the real estate contract be in writing, courts have also held the view that equitable remedies "require[] that a contract be more definite than is necessary at law for enforcement . . . [and] the parties must know with reasonable certainty what is expected of them."[180] Accordingly, transactional attorneys have been taught for years that if you want specific performance as a remedy, make sure you draft it into the contract. However, the Authors could not find any express law on point that actually requires that specific performance be specifically drafted into the contract. Additionally, in the cases discussed above, the courts granted specific performance even though many of the contracts in question did not contain injunctive relief or specific performance as enunciated remedies.

However, one should never take anything for granted, and the Authors suggest that borrowers attempt to negotiate their construction loan agreements to include the following provision or similar wording that incorporates the required elements discussed in the above cases:

> <u>Borrower's Additional Equitable Rights Against Defaulting Lender</u>. Notwithstanding anything to the contrary contained in this Agreement or any other Loan Document, the Administrative Agent, each Lender, and the Borrower acknowledge and agree that each Lender's funding obligations outlined in this Agreement and the other Loan Documents amount to a contract of a unique nature between the Borrower and each Lender, that the Borrower is relying on each Lender to fulfill its funding obligations under this Agreement and the other Loan Documents, that the Borrower will enter into significant construction agreements and materials purchase orders based on such reliance and that the failure of any Lender to fulfill all of its funding obligations under this Agreement and the other Loan Documents will cause irreparable injury to the Borrower for which the payment of money damages shall not be a sufficient remedy. Therefore, in addition to all other remedies available to the Borrower, Administrative Agent and each Lender expressly agree that the Borrower shall have the right to seek injunctive relief, specific performance, and all other remedies in equity and at law to compel any Defaulting Lender to fulfill its obligations under this Agreement and all other Loan Documents, including but not limited to,

178. Statute of Frauds Act 1677, 29 Car. 2 c. 3, § 4.
179. PERILLO, *supra* note 42, § 19-1, at 673 (first alteration in original).
180. *Id.* § 16-8, at 589.

> immediately funding to the Borrower the Defaulting Lender's proportionate share of any Advance which Borrower has requested in compliance with the terms of this Agreement. If the Borrower seeks to enjoin a Defaulting Lender from failing to fund, Administrative Agent and each Lender expressly agree to waive any undertaking or posting by Borrower of a bond.

Including such a clause will negate the negative inference that the parties intended to look only to damages and not equitable remedies.[181] While this may not be absolutely binding on a court, it will certainly give the court an additional basis to adopt equitable remedies if previous court decisions in its jurisdiction have not yet done so.[182]

In addition, the last sentence of the paragraph contains a waiver of the requirement that the borrower post a bond if it is successful in obtaining an injunction against the defaulting lender. This is important because many, if not most, states require that a bond, usually in the amount of 10% of the amount in controversy, be posted by the aggrieved party for the benefit of the party against whom the injunction is sought.[183] The requirement that the borrower post a bond protects the alleged defaulting lender regarding its costs and other potential damages suffered by the defaulting lender in the event the borrower is not, at the final court hearing, successful in convincing the court of the borrower's position.

In the example of a large construction project with the defaulting lender still obligated to fund $20 million, it would be extremely unfair if the borrower had to post a $2 million bond with the court to force the defaulting lender to honor its obligations. Fortunately, the bond may be waived by the agreement of the parties, and each borrower's counsel should check their local laws to make sure no additional "magic words" are needed.

B. Why Lenders Should Agree to Adding the Suggested Provision

Lenders do not like to insert clauses in their agreements that restrict their rights or grant the borrower additional remedies against them. Accordingly, the initial reaction of the lenders' attorneys drafting and negotiating the construction loan documents will be to reject the suggested provision. At first blush, the lenders' attorneys will immediately refuse, saying they have never seen such a clause in their many years of closing construction loans; and they are correct. But that is because this is a new development in the law. The *Destiny* and *Petra Mortgage* holdings are less than seven years old,

---

181. Theodore Eisenberg & Geoffrey P. Miller, *Damages Versus Specific Performance: Lessons from Commercial Contracts* (NYU L. & Econ Working Papers, 2013), http://lsr.nellco.org/nyu_lewp/334.

182. *Id.*

183. PERILLO, *supra* note 42, § 16-8, at 589.

a relative blink of an eye in the hundreds of years of English and American common law.[184]

However, the borrower's attorney must persist and convince the lender group that the provision is actually to the benefit of the non-defaulting lenders. Each lender should be just as fearful of defaulting lenders as the borrower. In a large construction loan in which a defaulting lender's failure to fund results in the non-completion of the project, foreclosure of the property, and return of cents on the dollar to the non-defaulting lenders, the defaulting lender can cost each of the non-defaulting lenders tens of millions of dollars.[185]

Also, even though large lending institutions employ legions of attorneys, they do not like to sue each other. It is somewhat of a professional courtesy amongst banks in the large-lender club. They will instead work behind the scenes, demanding that the defaulting lender fund. But if such unofficial cajoling is not effective, then they too are limited to utilizing the traditional at-law remedy and must wait for the project to collapse to determine their damages before they can sue.

By including the borrower's suggested provision, the non-defaulting lenders give the borrower a remedy that protects the non-defaulting lenders just as much as the borrower. It is absolutely in the non-defaulting lenders' best interest that the borrower gets into court quickly to force the defaulting lender to resume its funding and keep construction on schedule.

Of course some lenders might profess to be offended by the borrower's suggested provision, but the borrower needs to look its relationship lender/administrative agent in the eye and say: "If you are going to fund in accordance with your written agreement, what are you worried about? I have faith that your bank will always honor its obligations or I would not have brought my project to you to create the lending syndicate and act as administrative agent. It is the other syndicate lenders that we must worry about and this provision will protect us both."

The relationship lender/administrative agent will answer that the suggested provision will hinder signing other lenders to join the lending syndicate. However, the borrower should counter that any lender who resists the suggested provision cannot be counted on. And the last thing the borrower and lenders want in the syndicate is a lender who cannot be counted on.

In a very recent negotiation of a large construction loan led by a top national bank, we negotiated back and forth with the lender's counsel covering all of the above points. Though the lender did not agree to insert the suggested provision, the lender's attorney did appreciate the precarious

---

184. *See* Destiny USA Holdings, LLC v. Citigroup Glob. Mkts. Realty Corp., 69 A.D.3d 212, 212 (NY. App. Div. 2009); Petra Mortg. Capital Corp. v. Amalgamated Bank, No. 101283/2010, 2014 WL 2607087, at *1 (N.Y. Sup. Ct. June 6, 2014).

185. *See* 1 LENDER LIABILITY LAW AND LITIGATION § 21.02 (Matthew Bender ed., 2015).

position the borrower found itself in when there was a defaulting lender and the danger that exists to the non-defaulting lenders. Hence, to their credit, they offered a take-it-or-leave-it compromise that each of the non-defaulting lenders would fund the immediately succeeding sixty days of defaulting lender advances so long as such advances did not exceed their agreed initial funding commitment.

While this is exceedingly helpful to keep construction funds flowing for sixty days and give the borrower two months to find an alternative lender or new equity source, it does not solve the suicidal problem of the loan documents requiring that the outgoing defaulting lender be paid off at par. As explained earlier, without building into the loan documents a significantly discounted purchase price for the defaulting lender's share of the loan, it is unreasonable to expect that a white-knight replacement lender will step in to a turbulent loan situation and purchase the defaulting lender's position without a discount. This major gap is so obvious that the *Destiny* court even took judicial notice that expecting a white-knight replacement lender to step in as a cure was unreasonable.[186]

What the proposal does provide, however, is sixty days of continued funding while the borrower runs into court to obtain injunctive relief and specific performance. So for that purpose, the take-it-or-leave-it offer of our lender was accepted. Better that than nothing. However, this compromise is a flawed answer. The best answer is to include the borrower's suggested provision to make clear in all instances that the defaulting lender is subject to equitable remedies.

V. CONCLUSION

When the Authors first began investigating the issue of defaulting lenders in syndicated construction loans, almost all of the attorneys we turned to for advice were of the mindset that only traditional contract damages were available in an action to enforce a loan agreement to lend money. Because statutes and codes usually do not answer real estate construction lending questions, they, like ourselves, had been taught the ins-and-outs of loan document negotiation through experience, including the truism that equitable remedies are not available.

That may have been the common law view in the past, but the evolution of American case law, especially the 2009 *Destiny* and 2014 *Petra Mortgage* holdings in New York, show that the law is moving beyond these archaic concepts.[187] These two cases, along with others discussed above appearing in a number of states, have opened the door to allowing equitable remedies against defaulting lenders in construction loan transactions.

186. *Destiny*, 69 A.D.3d at 222–23.
187. *Id.* at 216–17; *Petra*, 2014 WL 2607087, at *7.