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Orix Public Finance, LLC v. Lake County, Minn.

United States District Court, D. Minnesota - December 5, 2013 - Slip Copy - 2013 WL 6328865

The Broadband Initiatives Program, available through the Rural Utilities Service ("RUS"), a division of the United States Department of Agriculture, assists rural communities with broadband project funding

In early 2010, Lake County submitted an RUS application for a $56,413,705 loan and a $9,955,359 grant. The application stated that the County would satisfy the local matching fund requirement by issuing $3.5 million in revenue bonds, to be repaid solely from subscription fees paid by users of the broadband network.

RUS notified Lake County that its application had been approved, subject to the County's satisfaction of RUS conditions contained in the Loan/Grant and Security Agreement between Lake County and RUS ("LGSA").

Once the County received its award letter from RUS, it began to seek funding for the requisite $3.5 million in local matching funds. Plaintiff ORIX Public Finance, LLC ("ORIX") expressed its desire to purchase the revenue bonds.

The initial drafts of the bond purchase agreement ("BPA") provided that the County would issue the revenue bonds to ORIX at 12% interest and gave ORIX a security interest and right to receive revenue from the Project pari passu with the rights held by RUS. RUS refused to approve the pari passu funding. Because it could not obtain pari passu funding and the bonds would be subordinate to RUS's payment rights, ORIX required more favorable economic terms, including a 15% interest rate and a standby letter of credit from the Project's contractor that would replenish the debt service reserve in the amount of $1.5 million if there was a draw on the debt service reserve. These changes increased the size of the bond from $3,500,000 to $5,630,000.

RUS stated that the BPA was unacceptable to RUS for many reasons including: the 15% interest rate was too high; the amount of the bond was more than the $3.5 million identified in the County's application; the amount of the bonds threatened the financial viability of the Project; the BPA would not close until after RUS funding; and the BPA called for payments through the general contractor by way of a line of credit, which RUS believed would give ORIX priority.

After RUS stated that it would deny the loan if the County proceeded with the BPA, the County decided that it could not fund the Project through revenue bonds. On February 8, 2011, the Lake County Board authorized using $3.5 million of County reserves to meet the local match requirement.

On February 23, 2011, Skala sent ORIX a letter which stated that Lake County was not in a position to perform the BPA. As of September 2012, the County and RUS had commenced the Project, and RUS has approved the first advance of the RUS loan and grant.

ORIX sued the Lake County, alleging that the BPA was an existing and enforceable contract and that Defendants anticipatorily and materially breached it by refusing to perform before performance was due. Additionally or alternatively, ORIX argued that it was entitled to a termination fee under the BPA.

The court concluded that, because RUS rejected the BPA, the frustration of purpose doctrine applied, and ORIX's claim that Lake County breached the BPA must be rejected. The fact that RUS did not formally reject the BPA, which would have required RUS to pull the award from the County altogether, is not dispositive. It is enough that, in substance, RUS rejected the BPA.

"Here, the undisputed evidence is that the entire purpose of the BPA was to provide gap financing to enable the County to qualify for the RUS loan and grant to build the Project, the proceeds of which were to be used to repay the bonds. Once RUS stated that it would not approve the loan and grant and would end the Project if the County proceeded with the BPA, there was no purpose whatsoever for the BPA for either party. From the County's point of view, it would be issuing bonds to fund nothing because there would be no Project. (And in fact, it would not be able to legally issue bonds without a public purpose.) From ORIX's point of view, it would be purchasing bonds that had no chance of repayment because repayment was going to come from the revenue raised by the Project and no Project would exist. ORIX's in-house counsel testified multiple times that if RUS pulled out of the Project, ORIX would not close on the BPA. It would be absurd and futile to enforce the BPA in the face of RUS's rejection of the BPA."

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