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PROFESSIONALS

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Welcome to another issue of the *Commercial Lending Bulletin*, a newsletter published monthly by the Commercial Lending Group at Lerch, Early & Brewer as a service to our clients. Here, you will find articles written by our attorneys covering a variety of current legal issues as they affect lending law. We publish the *Bulletin* as part of our ongoing efforts to provide our clients with responsive service and practical advice when needed.

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In This Issue:**Maryland Foreclosure Law Update**

A number of changes were made regarding Maryland Residential Deeds of Trust and Mortgages, as well as several changes to the Maryland foreclosure laws.

Dispute Over Amount Due Does Not Prohibit Judgment on Liability in Favor of Lender

A District Court in New York recently ruled against a borrower and its guarantors when there was no question of material fact regarding the promissory note, its execution and subsequent default, even though there was some dispute over the exact amount due.

Both Good Faith and Good Price Required to Avoid Possibility of Fraudulent Transfer

A Federal Court recently determined that a judgment creditor had provided enough evidence to show that a debtor's transfer was made with intent to defraud, and thus denied the debtor's motion for summary judgment of creditor's fraudulent transfer claim.

"Notwithstanding..." Limits Guaranty to Future Debts Only

The US District Court for the Eastern District of New York has determined that language contained within a guaranty which states that the guaranty is only effective for future debt approved by Guarantor may be enforced.

Save the Date!

Lerch, Early & Brewer will be hosting a seminar titled "Like Kind Exchanges of Real Property" on Tuesday, May 13, 2008.

Maryland Foreclosure Law Update

EFFECTIVE APRIL 4, 2008, THE FOLLOWING CHANGES WERE MADE REGARDING MARYLAND RESIDENTIAL DEEDS OF TRUST AND MORTGAGES, AS WELL AS SEVERAL CHANGES TO THE MARYLAND FORECLOSURE LAWS. THE FORECLOSURE PROCESS REFORM BILL WAS DESIGNED TO ADDRESS THE CURRENT MORTGAGE DEFAULT AND SUBPRIME LOAN SITUATIONS AND ESTABLISHES MANY NEW CRITERIA FOR LENDERS TO FOLLOW WHEN PROCEEDING IN A FORECLOSURE.



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Information for Deeds of Trust and Mortgages:

For purposes of these new laws, residential property is defined as real property improved by four or fewer single family dwelling units. All mortgages, deeds of trust or other instruments securing a mortgage loan on residential property shall require the name and license number of the mortgage originator and the name and license number of the mortgage lender on the face of the instrument. If either the mortgage originator or mortgage lender is exempt from licensing requirements, an affidavit from the mortgage originator or mortgage lender must accompany the mortgage or deed of trust explaining the exemption. The legislation does not exempt commercial transactions where residential property is pledged as collateral for the loan.

Prior to filing to foreclose, a lender must wait the greater of 90 days from the homeowner's default or 45 days after sending a uniform Notice of Intent to Foreclose to the homeowner by certified and first class mail.



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Default should be defined in the mortgage instrument and, in most cases, occurs the day after payment was due. The Commissioner of Financial Regulation has prescribed a uniform Notice of Intent to Foreclose that all lenders must use. Lenders are additionally required to send a copy of the Notice to the Commissioner of Financial Regulation. A copy of this form can be found at: <http://dflr.state.md.us/finance/foreclosurelaw.htm>

An order to docket or complaint to foreclose must now include:

1. Affidavit stating the date of the default and the nature of the default and the date and fact that the Notice of Intent to Foreclose was sent;
2. Original or certified copy of the mortgage or deed of trust;
3. Statement of the debt remaining supported by affidavit;
4. Copy of the debt instrument and an affidavit of ownership;
5. Original or certified copy of the assignment of the mortgage if applicable;
6. The mortgage lender and originator's license number if applicable;
7. Affidavit that the defendant is not in the military;
8. Copy of the uniform Notice of Intent to Foreclose; and
9. Issuance of a Uniform Notice to defendant that complies with statute

After the foreclosure action has been filed:

1. The lender must send a written notice no later than 2 days after the action to foreclose is docketed to advise the record owners that an action to foreclose has been docketed.
2. The Notice of Intent to Foreclose must be personally served on the owner of the property. Alternate service is allowed in the case of failed attempts at personal service. After at least 2 good faith attempts at personal service on separate days, the plaintiff may file an affidavit with the Court describing the attempts and effect service by mailing, both certified and first class mail AND posting on the property.

Before a foreclosure sale can occur, the lender must:

1. Wait 45 days from the time the defendant was served with the Notice of Intent to Foreclose.
2. Publish a Notice of Sale for three successive weeks in a newspaper of general circulation in the county where the action is pending.
3. Send the homeowner the notice previously required by law, which shall include the time, place and terms of the sale, not earlier than 30 days and not later than 10 days before the date of the sale and shall be sent by certified and first class mail.
4. Accept from the homeowner payment of the funds due to cure the default up to one business day before the sale. The secured party must provide, upon request, the amount necessary to cure the default and reinstate the loan and instruction for delivering the payment.

Lenders should familiarize themselves with these new obligations and institute any immediate changes needed to comply with these requirements. Please note that failure to comply with the terms of the new law will impede your ability to foreclose on a defaulted borrower. Please contact us if you have additional questions with compliance.



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Dispute Over Amount Due Does Not Prohibit Judgment on Liability in Favor of Lender

A DISTRICT COURT IN NEW YORK RECENTLY RULED AGAINST A BORROWER AND ITS GUARANTORS WHEN THERE WAS NO QUESTION OF MATERIAL FACT



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REGARDING THE PROMISSORY NOTE, ITS EXECUTION AND SUBSEQUENT DEFAULT, EVEN THOUGH THERE WAS SOME DISPUTE OVER THE EXACT AMOUNT DUE.

In 2003 Heritage Packaging Corp. entered into a \$500,000 commercial line of credit transaction with Merrill Lynch Business Financial Services. Heritage's principals, Rachel and Solomon Schnitzler, personally guaranteed the loan. In the event of a default, Merrill could declare the principal, interest and other obligations immediately due and payable under the note. On April 21, 2006, Merrill sent Heritage a Demand Notice, stating the line of credit was overdrawn \$908.08 and that certain financial documentation required under the loan documents was outstanding. On July 26, 2006, Merrill sent Heritage a Notice of Default and Demand for Payment for all amounts due under the loan agreement pursuant to the acceleration provision in the note. Heritage failed to comply with either notice. Finally, on August 9, 2006, Merrill filed a complaint against Heritage and the Schnitzlers to recover money owed to Merrill. Merrill then brought a summary judgment motion before the Court, arguing that there was no dispute regarding the execution of the loan or failure to comply with the terms of the loan agreement. Heritage opposed the motion, stating that summary judgment was not appropriate because there was an issue of material fact as to the amount owed and that Merrill had failed to credit Heritage for numerous payments made on the loan.

The District Court stated that summary judgment is an appropriate action when there is no showing of a "material question concerning execution and default of the note in question." The court also found that when an action is being brought against the guaranty, the prima facie (there is evidence sufficient in law to establish a fact unless rebutted) case is established by showing that there is an instrument sued upon and there had been failure to pay. In this case, the Court indicated that instead of raising a material fact to dispute, Heritage challenged Merrill based on the amount outstanding on the loan and that this is not a material fact pertaining to Heritage's liability on the note. Once Heritage admitted that it executed and defaulted on its loan, there was no basis for it to challenge Merrill's summary judgment. When the Schnitzlers admitted they had guaranteed the loan and Heritage had failed to pay, they presented no material issue of fact as to their liability. Therefore, the Court found in favor of Merrill on liability.

A lender should be aware when pursuing remedies upon an event of default whether the lender has complied with both the terms of the loan documents and state law. In this instance the lender issued a Demand Notice, stating the line of credit was overdrawn \$908.08 and that certain financial documentation required under the loan documents was outstanding. On July 26, 2006, Merrill sent Notice of Default and Demand for Payment before suing the borrower and guarantors. Additionally, the lender complied with the terms of the loan agreement and state law regarding how long the borrower and guarantors had to rectify the default. By following the guidelines set forth in their own loan documents, the lender was able to easily win its case in court on liability, even though the exact amount was uncertain.

The case above is cited as: Merrill Lynch Business Fin. Servs. Inc. v. Heritage Packing Corp., et al., No. CV-06-3951(E.D.N.Y. 09/25/07)

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Both Good Faith and Good Price Required to Avoid Possibility of Fraudulent Transfer

A FEDERAL COURT RECENTLY DETERMINED THAT A JUDGMENT CREDITOR HAD PROVIDED ENOUGH EVIDENCE TO SHOW THAT A DEBTOR'S TRANSFER WAS MADE WITH INTENT TO DEFRAUD, AND THUS DENIED THE DEBTOR'S MOTION FOR SUMMARY JUDGMENT OF CREDITOR'S FRAUDULENT TRANSFER CLAIM. ALTHOUGH THE COURT RULED THAT THE DEBTOR HAD RECEIVED REASONABLY EQUIVALENT VALUE FOR ITS SALE, THE COURT RULED THAT THERE WAS NONETHELESS A GENUINE ISSUE OF MATERIAL FACT AS TO WHETHER THE TRANSFER WAS MADE IN GOOD FAITH.

Permasteelisa CS Corporation entered into a contract with The Airlite Company to install architectural louvers, which allow air flow while filtering-out dirt, debris and water, in a 38-floor commercial building in New York City. Shortly after the louvers were installed, the owner of the building reported problems with rattling noises. In September of 2003, Permasteelisa notified Airlite of the complaints and requested that Airlite correct the problem. Airlite did nothing, and was at that point in financial distress. Norman Murray, Airlite's president, decided to sell Airlite's assets so that he could avoid foreclosure on a large loan.

In the summer of 2004, Greenheck Fan Corp. and Airlite reached an agreement for a sale of the assets. Subsequently, Greenheck established The Airlite Company, LLC, a subsidiary, for the purpose of continuing Airlite's business operations. The subsidiary purchased most of Airlite's

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assets for a total of \$1,572,460.

Permasteelisa, which knew nothing of Airlite's financial difficulties or of the negotiations with Greenheck, undertook repairs on the architectural louvers at its own expense, expecting to recoup the costs from Airlite. On July 26, 2004, Permasteelisa filed a breach of warranty suit against Airlite in the U.S. District Court, Southern District of New York to recover the costs it had incurred.

Just days thereafter on August 2, 2004, Airlite finalized its asset purchase agreement with the subsidiary, which also agreed to hire Murray as a sales director and to increase his salary, and also hired more than 20 other key employees of Airlite. Having sold its brand name to the Greenheck subsidiary, Airlite immediately changed its name to Floh Corp., and immediately after consummation of the sale used \$1,380,780.87 of the \$1,572,460 cash payment to satisfy Airlite's outstanding secured debt. Permasteelisa was not reimbursed.

It was not until a year later, in August 2005, when Permasteelisa deposed Murray in the underlying action, that Permasteelisa learned of the existence of the asset purchase agreement. Permasteelisa moved for summary judgment in that action and, on April 3, 2006, it received a judgment against Floh Corp. in the amount of \$707,666. However, the judgment was not satisfied.

On July 26, 2006, Permasteelisa filed a lawsuit against Greenheck's Airlite subsidiary and Murray, alleging a fraudulent conveyance of assets from Airlite to the Greenheck subsidiary to avoid Permasteelisa's judgment, in violation of Ohio's Uniform Fraudulent Transfer Act. The subsidiary and Murray moved for summary judgment.

To succeed on its claim under the Uniform Fraudulent Transfer Act, the U.S. District Court, Southern District of Ohio said that Permasteelisa was required to establish by clear and convincing evidence the existence of a conveyance made with actual intent to defraud, hinder or delay present or future creditors. The court said that the party alleging fraud may demonstrate actual fraud by producing evidence of indicators or "badges of fraud." Thus, for example, in the event that a plaintiff shows enough indicators of fraud, the court may infer that the transfer was made with actual intent to defraud. The burden would then shift to the defendant to prove that the transfer was not fraudulent but rather made in good faith and that the transferee paid reasonably equivalent value.

The subsidiary and Murray argued that even if Permasteelisa could establish a presumption of fraud, the defendants were nevertheless entitled to summary judgment based on the fact that the subsidiary paid reasonably equivalent value for Airlite's assets. To prove this, the defendants produced an expert, who testified that the asset purchase agreement was an arm's length transaction, and that the subsidiary purchased Airlite's assets for a fair price. Permasteelisa did not dispute the expert testimony. However, it argued that the defendants failed to prove good faith, and the court agreed.

The District Court observed that the Uniform Fraudulent Transfer Act requires proof that reasonably equivalent value was paid and proof of good faith. In addition, the court said that common sense dictated that a transferee should not be able to avoid liability simply by paying a reasonably equivalent value for the assets.

The court found that Permasteelisa had presented evidence from which a reasonable jury could find a lack of good faith. The plaintiff claimed that subsidiary's representatives knew of the pending claim against Airlite prior to the date the asset purchase agreement was executed. Additionally, there was proof that the asset purchase agreement guaranteed future employment for Murray. Thus, the District Court held that genuine issues of material fact precluded the granting of summary judgment.

It is interesting to note that the District Court observed that under Ohio's Uniform Fraudulent Transfer Act which prohibits the fraudulent transfer of assets, an "asset" was defined as "property of the debtor" exclusive of "property to the extent it is encumbered by a valid lien." However, the court held that since the defendant received more in proceeds from the asset sale than it needed to repay the liens on them, the transfer in Permasteelisa was subject to the Uniform Fraudulent Transfer Act.

In addition to issues related to fraudulent transfers, this case highlights the importance of up to date litigation searches and thorough representations and warranties related to pending and threatened litigation.

The case above is cited as: Permasteelisa CS Corp. v. The Airlite Co., et al., No. 2:06-cv-569 (S.D. Ohio 12/31/07).

"Notwithstanding..." Limits Guaranty to Future Debt Only

THE US DISTRICT COURT FOR THE EASTERN DISTRICT OF NEW YORK HAS DETERMINED THAT LANGUAGE CONTAINED WITHIN A GUARANTY WHICH STATES THAT THE GUARANTY IS ONLY EFFECTIVE FOR FUTURE DEBT APPROVED BY GUARANTOR MAY BE ENFORCED.

In April of 2001, Rimpex, a wholly owned subsidiary of Voicenet, owed Symbol Technologies \$162,788.40. Symbol sued Voicenet for breach of guaranty and Rimpex for breach of contract and money owed. Voicenet acknowledged the debt and proposed a payment plan to retire it. Later that month, in order to re-establish a line of credit with Symbol for Rimpex, Voicenet signed a guaranty which guaranteed to Symbol payment of money "now, or at any time hereafter" owed to Symbol from Rimpex. The guaranty further contained a provision that read "notwithstanding anything contained elsewhere in this guarantee, the guarantor will only be liable under this Guarantee...for goods supplied on credit by Symbol...to Rimpex...with the prior written approval of the Guarantor." After execution of the guaranty, Symbol made further shipments of goods to Rimpex but was not paid. In November, 2003 Symbol filed a complaint against Voicenet as Guarantor for this breach.

Voicenet moved for judgment in its favor claiming that Symbol could not prove Voicenet had approved Rimpex's orders, which was a condition precedent to its liability under the guaranty. Symbol claimed that correspondence between itself and Voicenet prior to execution of the guaranty evidenced Voicenet's consent to the guarantee of debts both before and after execution of the guarantee. Symbol stated it would not have continued to extend credit to Rimpex without confirmation that its existing debt would be paid. The Court disagreed, pointing to the provision within the guaranty stating "Notwithstanding any other provision in this contract...guarantor will only be liable...for goods supplied...with prior written approval of the Guarantor." The Court stated that the use of the word "notwithstanding" means this provision takes precedence over and negates any contrary provision. The Court further pointed to an email from Symbol discussing a payment plan for the old debt as evidence that the old debt was not guaranteed by Voicenet. The Court concluded that Voicenet was not liable for Rimpex's debt incurred prior to execution of the guaranty. The Court further concluded that the parties had raised a valid issue of fact over whether Voicenet had, in fact, through its correspondence with Symbol, provided prior written approval of the sale of products to Rimpex. That issue was set aside for future determination.

The case is a reminder to those drafting, negotiating and reviewing documents to make sure that the actual intent of the parties is accurately reflected within the documents. Any carve out or qualifying language must be particularly scrutinized to avoid possible denial of liability in future actions.

The case above is cited as: Symbol Technologies, Inc. v. Voicenet (Aust.) Ltd., 2008 WL 89626 (E.D.N.Y.).

Save the Date!

On Tuesday, May 13, Lawrence G. Lerman will present a breakfast seminar titled "Like Kind Exchanges of Real Property. Be sure to check your email inbox for the official invitation to the event, which will be held in the offices of Lerch, Early & Brewer. You may also contact Eby Kalantar at ekalantar@lercheearly.com for more details.

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We publish this newsletter as a service to our clients as a means to make them aware of certain aspects of the law. As always, we would like to hear feedback from our readers regarding the content of the newsletter. If there are items or topics you would like to see covered in future issues, or you have a suggestion concerning the newsletter itself, you may send them to Paddy Shakin at ptshakin@lercheearly.com.

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