

LERCH EARLY &amp; BREWER

# Commercial Lending Bulletin

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## OUR 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.

This newsletter is sent via email in HTML format. If you wish to print a copy of the newsletter, you may access a .pdf version by following the "Printer-Friendly version" link below.

We appreciate any feedback and invite you to contact us with any questions. If you do not want to receive any further newsletters from us, follow the link at the bottom of this email to be removed from our list of recipients.

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### In This Issue:

#### **Recoupment Costs Disallowed – Consumer Borrower Has Right To Prepay Loan Without Penalty**

The Maryland Court of Appeals recently ruled that lending institutions are prohibited from recapturing closing costs on "no-fee" mortgages that are subsequently prepaid by the borrower. Lenders who offer these types of mortgages will now have to absorb the closing costs on prepaid mortgages, regardless of whether the loan documents signed at closing contain language to the contrary.

#### **Guarantor Unable to Escape Liability for Debts After Entity Change**

A New York court determined that a guarantor-principal of one entity is also liable for the debts of a subsequent entity of which he was also a principal, because he did not properly notify the creditor of the entity change.

#### **Notice Compliance Necessary to Avoid Presumption of Commercial Unreasonableness**

The Florida Court of Appeals found that for a sale of repossessed collateral to occur in a commercially reasonable manner, proper notice of the sale is one of the requirements.

#### **Practice Tip - Documents Under Seal**

As a follow up to last month's newsletter practice tip about documents under seal, the Daily Washington Law Reporter reported a case, *Murray v. Wells Fargo Mortgage* (D.D.C.A. No. 06-CV-1383, July 17, 2008), which held that the mere recitation on the signature page that "we have hereunto set our hands and seal" was insufficient to create a document under seal and that the law requires that there either be an actual seal or some typed, printed or handwritten symbol as a substitute for the seal intending to operate as a seal.

#### **Recoupment Costs Disallowed – Consumer Borrower Has Right To Prepay Loan Without Penalty**

THE MARYLAND COURT OF APPEALS RECENTLY RULED THAT LENDING INSTITUTIONS ARE PROHIBITED FROM RECAPTURING CLOSING COSTS ON "NO-FEE" MORTGAGES THAT ARE SUBSEQUENTLY PREPAID BY THE BORROWER. LENDERS WHO OFFER THESE TYPES OF MORTGAGES WILL NOW HAVE TO ABSORB THE CLOSING COSTS ON PREPAID MORTGAGES,



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**REGARDLESS OF WHETHER THE LOAN DOCUMENTS SIGNED AT CLOSING CONTAIN LANGUAGE TO THE CONTRARY.**

In *Bednar v. Provident Bank of Maryland, Inc.*, the Court reviewed Provident's practice of collecting closing costs from Borrowers who prepaid their no-fee mortgages. A no-fee mortgage is one in which the lender does not charge the borrower traditional costs such as those for appraisal fees, title searches or recordation fees, among others. In *Bednar*, the Borrower signed a "Closing Costs Waiver Certificate" at the closing of his second mortgage loan on his residence that provided that Provident would waive closing costs on the loan if *Bednar* maintained his loan with Provident for at least three years from the date of settlement.

Two years later, *Bednar* refinanced his home and fully prepaid the Provident loan. Because *Bednar* did not keep the loan open for at least three years, Provident added the closing costs that were incurred at settlement to the total payoff amount.

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*Bednar* filed a class action suit in state court against Provident alleging, among other things, that its practice of collecting the closing costs upon the mortgage prepayment was a violation of the Maryland Credit Grantor Closed End Credit Provisions (CLEC). The CLEC provides that a consumer borrower may prepay a loan in full at any time, and that a lender may not impose any charges in connection with the prepayment of a loan by a consumer borrower.

Provident argued that the closing costs were not prepayment charges; instead they were deferred payments that were charged and disclosed to the Borrower at the time of the loan closing. Provident claimed that the charges did not violate the CLEC and that they could not be classified as a prepayment charge because they arose at the time of the closing, not at the time of the prepayment of the loan. Provident also relied on letters issued by Maryland's Office of Commissioner of Financial Regulation, which approved the practice of charging closing costs on prepaid loans. The lower court agreed with Provident, finding that Provident was merely recapturing closing costs on the transaction, and not charging newly incurred prepayment charges.

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In its ruling, the Court explained that the charges were not deferred payments because they were only imposed when the borrower pre-paid the loan in full. Since Provident only imposed the costs on the borrower if the borrower prepaid the loan, the Court classified the costs as prepayment charges, which were prohibited under the CLEC.

The Court also left open the possibility that imposition of these types of charges may violate the Maryland's Consumer Protection Act, which prohibits unfair or deceptive trade practices. Although the lower court found that Provident did not violate the Consumer Protection Act, that decision was based solely on its finding that Provident did not violate the CLEC. The Court of Appeals did not directly address any alleged Consumer Protection Act violation, and lenders should be aware that they may be at risk of violating the Consumer Protection Act if they try to recoup closing costs on prepaid no-fee loans.

Lenders should also note that any attempt to collect closing costs upon prepayment is now prohibited, even if the borrower agrees to the charge at the settlement. Additionally, the Court of Appeals' decision highlights the uncertainty of relying solely on an administrative agency for approval of new lending practices. The Court explicitly noted that it will reject an agency's interpretation of a financial regulation if the interpretation contradicts the clear language of the regulation. Lenders who are uncertain about the legality of some of their practices should consult their attorneys before instituting new practices or policies.

This case is cited as *Bednar v. Providence Bank of Maryland, Inc.* No. 142 (Md. Ct. App. Dec. 13, 2007)

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**Guarantor Unable to Escape Liability for Debts After Entity Change**

**NEW YORK COURTS HAVE DETERMINED THAT A GUARANTOR-PRINCIPAL OF ONE ENTITY IS ALSO LIABLE FOR THE DEBTS OF A SUBSEQUENT ENTITY, OF WHICH HE WAS ALSO A PRINCIPAL, BECAUSE HE DID NOT PROPERLY NOTIFY THE CREDITOR OF THE ENTITY CHANGE.**

In *Alle Processing Corp. v. First Class Restaurant Corp. d/b/a Haikara Grill*, as Alle entered into a credit agreement with First Class Restaurant Corp., which was then doing business as Haikara Grill at 1016 Second Avenue. The president of First Class, Steven Levy, signed a personal Guaranty for the agreement with Alle.

In April 2004, Fine Dining Associates, a New York corporation, began doing business as Haikara Grill

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at 206 East 63rd Street. Levy was the managing member of Fine Dining. Alle continued providing meat and poultry to Haikara Grill without knowledge of the change in the underlying entity or location. During July 1, 2005 through September 19, 2005 Alle delivered its products to First Class as usual but was not paid. Alle sued First Class and Levy, both of whom denied liability, claiming that First Class stopped doing business on or about June 21, 2005 and that Levy only guaranteed the obligations of First Class, not Fine Dining. Levy further claimed that Alle should have realized it was doing business with another entity because the payment checks issued by First Class were different than the payment checks issued by Fine Dining and the addresses were different. Alle provided evidence that First Class and Levy never advised Alle that Fine Dining was using the name "Haikara Grill" and never requested a new credit agreement or that deliveries be made to Fine Dining.

The Court determined that "mere formalistic changes in the identity of a principal obligor do not discharge the surety." The Court stated that the inquiry should focus on whether the entity change significantly alters the business between the principal obligor and the creditor and whether this alters the undertaking of the surety, in this case Levy, especially the degree of risk assumed by the surety. The Court also found that a guarantor may revoke his guaranty "by notice to the creditor revoking his liability for obligations that may be incurred subsequent to the notice." Here, because both entities operated under the same assumed name, Levy participated in the entity change and essentially retained the same relationship with Alle, and he continued to purchase merchandise on credit, the court found that the initial guaranty made by Levy for First Class extended also to the obligations of Fine Dining. The Court allowed a judgment to be filed against Fine Dining for the debt.

This serves as a reminder to creditors to request periodic updates on the legal status of its borrowers and guarantors when continuing to extend credit in situations such as this.

This case is cited as Alle Processing Corp. v. First Class Restaurant Corp., Slip Copy, 2008 WL 151779 (N.Y.City Civ.Ct.), 2008 N.Y. Slip Op. 50109(U).

## Notice Compliance Necessary to Avoid Presumption of Commercial Unreasonableness

### THE FLORIDA COURT OF APPEALS FOUND THAT FOR A SALE OF REPOSSESSED COLLATERAL TO OCCUR IN A COMMERCIALLY REASONABLE MANNER, PROPER NOTICE OF THE SALE IS ONE OF THE REQUIREMENTS.

Mr. Rooter of Central Florida Inc. leased 3 vehicles from Gelco Corp. under a 60-month lease and John Burley the president of Mr. Rooter signed a personal guaranty of the payments. Less than a year later, Mr. Rooter defaulted on the lease agreement and Gelco filed suit against Mr. Rooter and Burley. The vehicles were surrendered to Gelco after court order and Gelco eventually moved for judgment regarding the damages. In the motion for damages, Gelco stated that after receiving the 3 vehicles, Gelco had disposed of them in a commercially reasonable manner, with a remaining balance due under the lease of \$55,928.80. The only evidence as to the sale's commercial reasonableness was an affidavit by a Gelco employee stating that the vehicles were delivered to an auction service known "in the industry" that sold vehicles for Gelco once a week and that at auction all car dealerships were allowed to inspect the vehicles.

Burley filed an opposition to Gelco's motion for damages stating that he had not received proper statutory notice of the disposition of the vehicles prior to their sale pursuant to Florida's UCC. Burley asserted that had he known of the sale he would have objected or gone to the sale and purchased the vehicles himself because their sale price was 1/3 of the market price. At trial, the Court found that notice of sale was insufficient because it did not indicate the specific date, time or place of the sale, but the Court did find that Gelco met its burden of proof and established that it disposed of the vehicles in a commercially reasonable manner. Burley appealed.

On appeal, Burley argued that Gelco's failure to provide him with the notice required by Florida's UCC raised a presumption that the sale was conducted in a commercially unreasonable manner. Therefore, Burley concluded, the trial court erred in finding for Gelco.

Article 9 of the UCC states that a secured party's sale of collateral must be made in a "commercially reasonable" manner. On appeal, the Court interpreted this to mean that "every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable." The Court also found that if a debtor places the creditor's compliance in issue, it becomes the creditor's burden of establishing that the disposition was conducted in accordance with the statute. Burley placed Gelco's compliance at issue when he argued successfully at trial that Gelco's notice was inadequate. The showing of insufficient notice gave rise to the presumption that the subsequent sale was commercially unreasonable, something that could not be decided by the trial court on motion, but an issue of fact to be decided at trial.

necessary resources to deal constructively with problem loans and the implementation of creative loan work-out arrangements.

Additionally, the Court looked at the evidence in support of the Gelco's claim of a commercially reasonable sale. The only evidence was the affidavit from the Gelco employee, which merely explained what usually occurs at such sales, but gave no details relating to this particular transaction that could be used to determine that the vehicles were disposed of in accordance with Article 9. Thus, the affidavit was insufficient evidence to show that Gelco had disposed of the vehicles in conformity with reasonable commercial practices. The verdict in favor of Gelco was reversed and the case was remanded to the trial court.

**PRACTICE AREAS**

Business and Taxation

This is another example of a creditor or lender getting into costly litigation by simply not following outlined procedure. Article 9 states that every aspect of disposition must be occur in a commercially reasonable manner and requires that the creditor give the debtor notice of a sale. A prudent creditor will review its procedures with respect to disposition of repossessed property and make sure notices are clear and detailed. Failure to provide adequate notice entitles debtors for further recourse in court and delays the ability to collect. Don't be in such a hurry once you've acquired repossessed collateral that you miss a step and jeopardize your ability to seek full restitution.

Commercial Lending

The case above is cited as *Burley v. Gelco Corp.*, No. 5Do6-1995 (Fla. Ct. App. 02/29/08)

Community Associations

Elder Law

**Practice Tip - Documents Under Seal**

Employment and Labor

**AS A FOLLOW UP TO LAST MONTH'S NEWSLETTER PRACTICE TIP ABOUT DOCUMENTS UNDER SEAL, THE DAILY WASHINGTON LAW REPORTER REPORTED A CASE, MURRAY V. WELLS FARGO MORTGAGE (D.D.C.A. NO. 06-CV-1383, JULY 17, 2008), WHICH HELD THAT THE MERE RECITATION ON THE SIGNATURE PAGE THAT "WE HAVE HEREUNTO SET OUR HANDS AND SEAL" WAS INSUFFICIENT TO CREATE A DOCUMENT UNDER SEAL AND THAT THE LAW REQUIRES THAT THERE EITHER BE AN ACTUAL SEAL OR SOME TYPED, PRINTED OR HANDWRITTEN SYMBOL AS A SUBSTITUTE FOR THE SEAL INTENDING TO OPERATE AS A SEAL.**

Estate Planning and Probate

Lenders should review their forms to make sure the actual signature line includes the word "seal," otherwise, the shorter statute of limitations period may apply.

Family Law

Health Care

Land Use and Zoning

Litigation

**We Would Like To Hear From You**

Real Estate Transactions

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 Bill Melchior at [wgmelchior@lercheearly.com](mailto:wgmelchior@lercheearly.com).



Additionally, a number of the Firm's other departments periodically issue highly informative newsletters on a variety of other subjects, including Real Estate, Community Associations, and Employment and Labor. If you would like to view one or more of these newsletters, you may access them through our website, [www.lercheearly.com](http://www.lercheearly.com).

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