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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:****Oral Modification Claim Proceeds Despite "No Oral Modification" Clause**

The presence of a clause prohibiting oral modifications may not necessarily mean that a contract cannot be orally modified, according to a recent decision by the U.S. District Court for the Southern District of New York.

**Individual Lender of Lending Consortium Cannot Take Action In The Event of Default**

Parties in a lending consortium should explicitly spell out whether one lender can act individually to enforce its rights under the loan documents.

**Guarantor Not Liable For Undecided Portions of Lender's Pending Litigation With Third Party**

The US District Court for the Eastern District of Pennsylvania has determined that a guarantor is liable for a deficiency judgment for the borrower's debt, but is not liable for contingent liabilities not yet incurred by a lender.

**Did You Know:** Real Estate Transactions

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**Oral Modification Claim Proceeds Despite "No Oral Modification" Clause**

**THE PRESENCE OF A CLAUSE PROHIBITING ORAL MODIFICATIONS MAY NOT NECESSARILY MEAN THAT A CONTRACT CANNOT BE ORALLY MODIFIED, ACCORDING TO A RECENT DECISION BY THE U.S. DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK.**

The presence of a clause prohibiting oral modifications may not necessarily mean that a contract cannot be orally modified, according to a recent decision by the U.S. District Court for the Southern District of New York. The Court refused to dismiss a lawsuit filed by a potential borrower against its would-be lender based on a claim that the lender had orally modified the letter of intent, in spite of a clause within the letter prohibiting oral modifications. Additionally, the case raises important issues



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concerning breach of contract, fraud and other claims that all lenders should be mindful of when dealing with borrowers.

Carbon Capital, Inc. issued a letter of intent on August 4, 2003 to provide a mezzanine loan to Randolph Equities, LLC in the amount of \$10.8 million for the purchase of real property in Florida. The parties executed a commitment letter on September 10, 2003 stating Carbon could terminate the agreement at any time prior to closing and prohibiting oral modifications of their agreement. Closing was scheduled for October 14, 2003, and Randolph claims that Carbon orally agreed not to terminate the commitment letter before closing. Thereafter, Carbon began experiencing internal problems and began taking measures to negate its obligations under the commitment letter. Finally, on October 9, 2003 Carbon informed Randolph they would not proceed with the loan. Because of this, Randolph was unable to purchase the property. Randolph filed suit for breach of contract, fraud, intentional interference with prospective business advantage and estoppel. Carbon filed a motion to dismiss, which was denied.



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In its denial, the Court stated that, with regard to the breach of contract claim, if a party's conduct implies a contract modification, conduct can be enough to stop that party from "invoking the statutory or contractual requirement of a writing." Here, the Court was willing to deny the motion to dismiss based on Randolph's allegations that the parties' course of dealings, evidenced an intent to close the deal.

Regarding Randolph's claim of interference with prospective business advantage, New York law requires a plaintiff to allege i) business relations with a third party; ii) defendant's interference with those business relations; iii) that defendant used dishonest means; and iv) injury to the relationship. The Court found that these elements were met given that Randolph's purchase of the property fell through due to lack of financing, and that Carbon misrepresented their intentions to follow through with the deal. The Court also found sufficient grounds to allow the estoppel claim to proceed, given the fact that Randolph relied upon Carbon's promises and representations and was ultimately unable to purchase the property.



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Lastly, the Court stated that in order to prove fraud, under New York law, a plaintiff must allege i) a material false representation made by defendant; ii) defendant intended to use the representation to defraud plaintiff; iii) plaintiff's reasonable reliance on the representation; and iv) plaintiff's damages as a result of the reliance. Randolph's principal had expressed concerns about dealing with Carbon due to its questionable relationship with its affiliates, which Carbon's representative had sought to downplay by falsely claiming that Carbon and its affiliates "regularly worked together, partnered on numerous similar transactions, and already had a deal firmly in place." Because Randolph alleged that these false claims induced them to enter into a contract which they would not otherwise have, the Court found that Randolph's claim could proceed.

It is important to remember that the Court's decision merely means that Randolph can proceed with its litigation, not necessarily that it will be successful in its suit. However, the fact that Randolph can proceed with its case based on allegations of this nature not only reminds lenders to document all required deal terms, it also reminds eager underwriters of the dangers of making statements that could later be construed as over-promising and exaggeration.

This case is cited as *Randolph Equities, LLC v. Carbon Capital, Inc.*, 2007 WL 914234 (S.D.N.Y.).



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## **Individual Lender of Lending Consortium Cannot Take Action In The Event of Default**

### **PARTIES IN A LENDING CONSORTIUM SHOULD EXPLICITLY SPELL OUT WHETHER ONE LENDER CAN ACT INDIVIDUALLY TO ENFORCE ITS RIGHTS UNDER THE LOAN DOCUMENTS.**

As lending consortiums—groups of lending institutions funding a single loan—become more common, lenders should be aware of the risks of participating in them. One of those risks is that a majority of institutions involved in a deal may make a decision that is not within the interests of an individual lender. In such cases—as we will see below—the rights of the individual lender can be severely hampered.

On February 26, 1998, a lending syndicate, originally comprised of 13 institutions, invested in the construction of Aladdin Gaming, LLC to develop a casino in Las Vegas, Nevada. The lenders advanced \$410 million through the Bank of Nova Scotia, the Administrative Agent. A credit agreement and a keep well agreement from the parent of the borrower were the primary loan documents governing



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the loan.

The terms of the credit agreement authorized the Administrative Agent to act on the lenders' behalf pursuant to the loan documents, and "in the absence of other written instructions from the required lenders...to exercise such powers...as are specifically delegated to or required for the administrative agent by the [terms of the loan documents]." The term "required lenders" was defined as those lenders holding at least 66.66% of the outstanding principal and the participation interests in the loan. The credit agreement also stated that after the Administrative Agent provided the borrower notice of any event of default, the Administrative Agent could "exercise any or all rights and remedies at law or in equity," including the right to recover judgment on the keep-well agreement, at the direction of the required lenders.

In July 2000, Sommer Trust agreed to become a sponsor under the keep-well agreement. Just after September 11, 2001, Aladdin sought bankruptcy protection. Afterwards, Beal Savings Bank acquired a 4.5% interest in the bank debt. On September 30, 2002, the Administrative Agent and all of the lenders, except Beal, entered into a settlement agreement directing the Administrative Agent to forbear from enforcing the keep-well agreement. Beal was the only lender that sought to enforce the keep-well agreement.

Beal unilaterally filed a claim to recover \$90 million from the Trust under the keep-well agreement. The Trust argued that only the Administrative Agent acting at the behest of a supermajority of the lenders could enforce the agreements. The trial court granted the Trust's motion to dismiss and the appellate court affirmed.

The New York Court of Appeals found that neither the credit agreement nor the keep-well agreement contained any explicit provision stating that a lender may or may not take individual action in the event of default. The Court then observed that the keep-well agreement stated that it was executed pursuant to the credit agreement, and must be interpreted in accordance with the terms of the credit agreement. The Court found that "[t]he specific, unambiguous language of several provisions, read in the context of the agreements as a whole" revealed that the lenders intended to act collectively in the event of the Aladdin's default and to preclude an individual lender from enforcing the agreements.

In order to avoid confusion (and costly litigation), parties in a lending consortium or participation should explicitly spell out whether one lender can act individually to enforce its rights under the loan documents.

This case is cited as *Beal Savings Bank v. Viola Sommer, et al.*, No. 26 (N.Y. Ct. App. 03/22/07).

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## **Guarantor Not Liable For Undecided Portions of Lender's Pending Litigation With Third Party**

**THE US DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA HAS DETERMINED THAT A GUARANTOR IS LIABLE FOR A DEFICIENCY JUDGMENT FOR THE BORROWER'S DEBT, BUT IS NOT LIABLE FOR CONTINGENT LIABILITIES NOT YET INCURRED BY A LENDER.**

On June 12, 2001 US Bancorp loaned DCC II Aircraft Corporation, Inc. \$4.3 million to purchase an airplane. In connection with the loan, Andrew N. Yao signed a guaranty in which he guaranteed DCC's obligations to US Bancorp. Pursuant to their agreement, US Bancorp could recover and sell the airplane in an event of default. In May, 2004, US Bancorp declared DCC in default and in September of that year, sent a letter to DCC and Yao notifying them of the default and acceleration of the loan. US Bancorp filed this action against DCC to recover under the principal obligation and against Yao to recover under the guaranty. In the meantime, unbeknownst to US Bancorp, DCC had leased the plane to Lanmar Marine and Aviation, Inc., so when US Bancorp attempted to recover the plane, they could not. Lanmar first asserted a mechanic's lien over the plane, then agreed to release it to US Bancorp after US Bancorp posted two surety bonds. Lanmar then sued US Bancorp to recover \$276,119.54 for losses sustained under the lease, which litigation remains ongoing. US Bancorp hired a third party, Jet Aviation, to recover, refurbish and sell the airplane. Jet Aviation was able to obtain \$1.75 million for the plane.

While Yao does not dispute his liability under the guaranty for the full amount of DCC's obligations to US Bancorp, he disputes the amount of damages. US Bancorp claims \$2,335,041 in damages as of June 30, 2005. This figure includes an offset of \$1.75 million, which was the price Jet Aviation was able to recover from selling the plane. Yao argued that the sale of the plane by Jet Aviation was not

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commercially reasonable and therefore, the amount of damages he owes should be less.

Jet Aviation had advertised the plane in five trade periodicals, on its website and in various mailers. They received seven offers for the plane and accepted the highest offer, at \$1,750,000. However, Yao provided an expert that stated the plane was worth \$1.7 to \$1.8 million dollars wholesale and \$2.5 million dollars if put in best condition prior to sale. He also provided an appraisal stating the plane was worth \$3.05 million. The Court refused to consider the appraisal, which was not accompanied by an affidavit swearing to its truthfulness and was not admissible as evidence of value. Absent the appraisal, the Court stated there was no evidence that the sale of the plane was commercially unreasonable, and refused to recalculate the amount of damages.

Yao also claimed he should not have to pay the \$276,119.54 at dispute in the Lanmar/US Bancorp litigation. Here, the Court agreed with him because nothing in his guaranty required him to guaranty "potential liabilities or costs that have yet to be incurred." Since the Lanmar litigation has not yet been "judicially determined," the Court agreed that this figure should not be included in the damages calculation.

This case reminds us of the importance of fixing the liability of a guarantor before litigation to recover is commenced if the need for multiple lawsuits is to be avoided, as well as the importance of conducting a commercially reasonable sale of collateral. It is cited as *U.S. Bancorp Equipment Finance, Inc. v. DCC II Aircraft Corporation, Inc.*, 2006 WL 4381496 (E.D.Pa.).

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