LERCH EARLY & BREWER

Commercial Lending Bulletin

Welcome to the inaugural electronic 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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Pending Lawsuit is Material Adverse Condition

THE 6TH CIRCUIT COURT OF APPEALS HELD THAT A LENDER COULD WITHDRAW AN OFFER OF FINANCING UPON LEARNING THAT THE BORROWER WAS BEING SUED BECAUSE THE LAWSUIT CONSTITUTED A "MATERIAL ADVERSE CONDITION."

In July and August, 2003, Merchants Bank and Trust issued two commitment letters to Kena Properties, LLC, to refinance seven investment properties and provide a revolving line of credit. Both letters contained the following statement: "This commitment may be deemed null and void if there are any material adverse conditions with respect to Borrower that occur before the closing." In September 2003, Merchants learned a lawsuit, alleging complex mortgage fraud and naming Kena as a defendant, had been filed in US District Court. On September 15, 2003, Merchants' and

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Kena's attorneys held a conference call to discuss the lawsuit at which time Kena was informed that Merchants would "not be moving forward on anything until [the mortgage fraud case] is resolved." Kena then sued Merchants for breach of contract.

Kena argued that the pending lawsuit did not constitute "any material adverse conditions" and that the phrase was not defined and was, therefore, ambiguous. The Court disagreed. While Kena claimed that Merchants failed to investigate the merits of the pending suit, the Court found neither the commitment letter nor Ohio law require that a lender owes a borrower a duty to perform its own due diligence. Further, the Court found that a lack of definition of "material adverse condition" does not make a term ambiguous. In this case, "common, undefined words, appearing in a written instrument will be given their ordinary meaning unless manifest absurdity results." In this instance, the Court found that the phrase meant "a significant disadvantageous situation arising in the life or existence of a borrower under the agreement" and as such, the pending lawsuit met this definition. The Court thus found in favor of Merchants and dismissed the case.

This case illustrates the need for all commitment letters to include language that allows the lender to opt out should the borrower experience any significant change between the time of application for a loan and the date of the loan closing.

The case above is cited as *Kena Properties, LLC et al v. Merchants Bank & Trust, No. 06-3688 (6th Cir. 02/20/07).*

Parol Evidence Inadmissible if No Fraud Found

THE US DISTRICT COURT FOR THE NORTHERN DISTRICT OF OKLAHOMA DETERMINED THAT A GUARANTY IS ENFORCEABLE IF IT IS UNAMBIGUOUS ON ITS FACE AND THERE IS NO EVIDENCE OF FRAUD.

In *American Bank and Trust Co. v. Bond International Limited, et. al.*, American Bank loaned $25 million to Bond International Limited and its affiliates. The lender agreed to a quarter percent reduction of the interest rate for the loan if David K. Bond, a principal of the company, executed a personal guaranty agreement. In discussions regarding the loan terms, American's loan officer allegedly told Bond that the personal guaranty was to keep Bond on the "straight and narrow." Bond agreed to the personal guaranty and the parties signed loan documents, including the guaranty, on March 23, 2003. When Bond International Limited defaulted on the loan, American began pursuing Bond for repayment under the guaranty. Bond resisted payment under the guaranty, claiming that he had understood from negotiations prior to signing loan documents, specifically the "straight and narrow" comment, that the guaranty would only be enforced if he "committed material malfeasance or misappropriated significant collateral for his personal use." Since he had not committed such malfeasance or misappropriations, he claimed that the guaranty should not be enforced.

The Court found for American, citing the Oklahoma parol evidence rule that "pre-contract negotiations and oral discussions are merged into and superseded by the terms of an executed writing." Although parol evidence is admissible when the contract is ambiguous, the Court found that was not the case here. In the guaranty at issue, the document contained no reference to the "straight and narrow" comment, nor did it limit the guaranty acts of malfeasance or misappropriations. Further, it contained a clause stating that the written guaranty, as signed, contained the entire agreement between Bond and American, and that there were no other oral or written agreements with respect to the guaranty. Because Bond could not prove that he was fraudulently induced to sign the guaranty, the Court refused to allow him to escape liability.

This case stands as a reminder to contracting parties to clearly put all relevant promises, conditions and terms in writing. It is cited as *American Bank and Trust Co. v. Bond Intern. Ltd., 2007 WL 724642 (N.D. Okla.).*

"Valid Business Interest" Defeats Claim of Infliction of Injury Without Justification

THE MISSOURI APPELLATE COURT OVERTURNED A JURY AWARD, FINDING THAT A LENDER'S VALID BUSINESS INTEREST DEFEATED THE CLAIM BY A BORROWER THAT THE LENDER INTENTIONALLY FILED ITS NOTICE OF FORECLOSURE TO CAUSE INJURY TO THE BORROWER WITHOUT JUSTIFICATION.

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OUR SERVICES

Providing lenders with only the highest and most knowledgeable levels of lending counsel in all phases of commercial lending transactions.

Representing both borrowers and lenders in complex real estate and development transactions.

Advising and counseling in the structuring, documenting and closing of asset-based loans, and in the perfection of the lender's security interest.

Providing counsel to bank and non-bank lenders in closing government guaranteed loans under the 7(a), 504, B&I and "piggyback" loan programs.

Marcin, Inc. was in default on several promissory notes which were assigned to LPP Mortgage Ltd. When Marcin learned of the assignment, it contacted LPP to initiate settlement discussions. As part of the negotiations, LPP requested personal and corporate financial information. After a year of negotiations, Marcin offered to settle for a lump sum payment of roughly $50,000 on the claim, which totaled more than $700,000. LPP rejected this offer from Marcin, as well as Marcin's next offer of payment of $100,000 paid out over the course of 30 years. After rejecting the second offer and without further communication with Marcin, LPP published notice of foreclosure on the real property serving as collateral on the loan.

Marcin contacted LPP when it learned of the publication, and the parties agreed that LPP would refrain from pursuing the foreclosure if Marcin made a better settlement offer. After future negotiations, the parties were unable to settle. LPP then filed suit to collect the debt and Marcin filed a counter-claim for "prima facie tort" against LPP, alleging that LPP intentionally inflicted harm on Marcin by publishing the note of foreclosure without justification. LPP received a verdict in the amount of $778,754.51 based on its claims under the note. Marcin, however, received a jury verdict on its tort claim for a total of $700,000 in compensatory and punitive damages, which LPP appealed.

In Missouri, in order to prevail in a case of "prima facie tort," the party bringing the claim must establish, among other things, an absence of or insufficient justification for the defendant's act. Marcin argued that LPP's actions, which included requesting "extensive financial information" prior to publishing the notice, failing to reject its last settlement offer, and withdrawing its publication notice after a third settlement offer and then filing suit without rejecting another settlement offer, demonstrated the lack of justification in proceeding with the collection action. The Court disagreed. At the time of publication of the notice of foreclosure, Marcin had been in default on the loan for five years. The notes included a power of sale clause which gave LPP the right to pursue non-judicial foreclosure in the event of default, which required publication of a notice of foreclosure. The Court found that in Missouri a "valid business interest will generally provide sufficient justification to defeat a claim for prima facie tort." Here, LPP's actions were attempts to collect on the defaulted note, not motivated by some other purpose. Thus, the Court reversed the judgment in favor Marcin.

While it seems hard to believe that a lender could be found liable for its actions to collect a debt, the jury awarded the borrower extensive damages merely because the lender took action to foreclose after a default under the borrower's debt. This case reminds us of the importance of including jury waiver clauses in each of a lender's loan documents. Even though juries are instructed as to the rules of law, in tort claims, a lender is left to the emotions of the jury panel. Given the factual background of this case, it was unlikely that the trial judge would have ruled in favor of the borrower and the lender could have avoided a costly appeal.

The case above is cited as *LPP Mortgage, Ltd. V. Marcin, Inc., et. al., No. WD66551 (Mo. Ct. App. 03/06/07).*

Tip of the Month: Notary Acknowledgements

Virginia has recently enacted legislation effective July 1, 2007 that requires all notary acknowledgements to be on the same page as the signature for which they are providing the notary acknowledgement. As a practical matter, this means that those preparing documents for recordation in the Commonwealth of Virginia must revise their forms to make sure the "notary block" is on the same page as the applicable "signature block." In addition, the notary's seal must be in a photographically reproduceable format. Practically speaking, this means one must either use a notary stamp instead of an embossed seal or must use carbon paper or some other means of darkening the embossed seal. Failure to comply with these requirements will not alter the legality of the document, but will prevent the document from being recorded in Commonwealth of Virginia.

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

PRACTICE AREAS

- Business and Taxation
- Commercial Lending
- Community Associations
- Elder Law
- Employment and Labor
- Estate Planning and Probate
- Family Law
- Health Care
- Land Use and Zoning
- Litigation
- Real Estate Transactions

Commercial Lending Group News and Notes

Lerch, Early & Brewer Attorneys Present 504 Seminar
On Tuesday, May 22, 2007, and again on Tuesday, June 5, **Alison Rind** and **Arnie Spevack** presented a seminar in our offices entitled "Closing a 504 Loan – Taking the Mystery Out of the 504 Process". The presentation focused on the ins and outs of the 504 loan process, including the various government regulations that must be followed. The seminar was attended by lenders from numerous banks and lending agencies throughout the region. A copy of the presentation which was given can be accessed by **clicking here**.

If you are not currently on our invitee list for seminars and other events, please contact Benjamin Harris at **bjharris@lerchearly.com**.

We Would Like To Hear From You

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 Ben Harris at **BJHarris@lerchearly.com**, or via phone at 301-961-6096.

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 receive one or more of these newsletters, you may access them through our website, **www.lerchearly.com**. To be added to the mailing list of any of the above-mentioned practice groups, simply send an email to Mr. Harris at **BJHarris@lerchearly.com**.

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