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Liability May Be Imposed on Lender for Cancellation of Closing

The 9th Circuit Court of Appeals has determined that a lender may be liable for economic damages caused by its cancellation of a scheduled closing, causing the would-be borrower to seek financing elsewhere at substantially higher rates.

In the case reviewed, GE and Olyaie signed a commitment letter on March 19, 2001 whereby GE agreed to lend Mr. Olyaie, subject to certain terms and conditions, $700,000 to purchase the gas station he operated. During negotiations prior to the execution of the commitment letter, at GE's request, the parties discussed GE obtaining secondary insurance from AIG Insurance in order to mitigate the environmental liability connected to the site. However, this provision was not specifically stated in the commitment letter. Closing was scheduled for April 24, 2001, six days prior to the April 30 closing deadline in Olyaie's sale and purchase agreement. AIG offered the requisite insurance policy at a cost that GE found to be unacceptable. GE, however, did not offer to pass the cost along to Olyaie; never informed Olyaie of the status of the policy; and cancelled closing on the morning of April 24 without providing an explanation.

Despite numerous attempts to contact GE beginning the morning of April 24, Olyaie and his attorney were unable to speak to any of GE's representatives until April 25; but even then received no assurances from them that the loan would close prior to April 30. When Olyaie's attorney told GE's counsel that Olyaie would have to seek alternate financing, GE's response was that he "should do what he has to do." Olyaie then closed with another lender on April 26 at substantially higher rates and sued GE for economic damages arising out of GE's failure to close.

The district court sided with GE and dismissed Olyaie's suit. However, the 9th Circuit Court of Appeals determined that there was merit to Olyaie's complaint. Olyaie claimed that GE "anticipatorily breached" the terms of the commitment letter by creating a situation in which it may not have been able to close even by the April 30 deadline. The Court stated that "given the relative lack of alacrity with which GE Capital responded to Olyaie and its failures of communication, it may have been impossible for it to schedule another signing on or before April 30. Under these circumstances, we hold that there is genuine issue of material fact whether GE Capital put it out of its power to perform by April 30 when it cancelled the April 24 signing with Olyaie." The Court also held that GE may have acted in "an objectively unreasonable manner" by failing to communicate its inability to obtain the environmental insurance in time for Olyaie to assume the extra cost of the insurance and save the deal. By undertaking to perform an obligation for which Olyaie was originally responsible, then failing to do so and further failing to inform Olyaie of the status of the requirement, GE may have breached the implied covenant of good faith and fair dealing.

This case reminds us of the importance of clearly outlining the requirements for closing and the parties responsible for each requirement, as well as keeping all parties updated as to the status of all prerequisites to closing.

This case is cited as *Olyaie v. General Electric Capital Business Asset Funding Corporation, 2007 WL 57562 (9th Cir.(Cal)).*

Merger Clause Bars Fraud Claim

The Georgia Court of Appeals held that a merger clause in a purchase agreement barred claims of fraud based on false oral assurances and failure to disclose.

Florida Commercial Exchange and its principal, David McQuary, entered into a purchase agreement with Donchi, Inc. to buy Donchi's golf course and surrounding property for $2,250,000. The majority of the financing for the purchase was provided by Robdol, Inc., although McQuary was conveying his Florida beach house to Donchi, Inc. in lieu of $300,000. The purchase agreement executed by all parties included a merger clause which provided, "there are no agreements, promises, or understandings between the parties except as specifically set forth herein. No alterations or changes shall be made to the contract except those in writing, signed, initialed and dated by all parties." At the closing, Robdol funded its portion of the purchase, and McQuary executed a warranty deed conveying the beach house. A month later, Donchi learned that the beach house had been foreclosed upon and sold. Donchi sued McQuary, Florida Commercial Exchange and Robdol claiming fraud, breach of contract and unjust enrichment. The trial court dismissed the case against Robdol, and Donchi appealed.

The Court of Appeals noted that the party alleging fraudulent inducement in entering a contract has two options: (1) affirm the contract and sue for damages from fraud or breach or (2) rescind the contract and sue in tort for fraud. Because Donchi did not rescind the contract in its claims, the purchase agreement was read with the understanding that it was being affirmed and Donchi was suing for damages. Donchi's claims are based on two arguments: (1) fraud from oral assurances, and (2) fraud from failure to disclose.

As to the first claim, the Court found that the merger clause in the purchase agreement was applicable and that it on its face barred Donchi's claim that Robdol committed fraud by making false oral statements with regards to mortgage of the beach house. Robdol argued that fraud voided the merger clause provision, however, the Court stated that this would only be the case if there was mutual mistake involved, which was not the case here. Donchi's second argument is that Robdol committed fraud by failing to disclose the fact that the beach house was being foreclosed upon. The Court found that concealment of material facts is only fraud in the instance that the opposing party could not discover the concealed facts through ordinary care. In this instance, Donchi admitted that it did not check on the status of the mortgage and did not try to record its warranty deed prior to learning of the foreclosure.

This case illustrates importance of a thorough due diligence examination for all loan and purchase transactions. In the above case, a simple title search would have alerted the seller to the status of the current mortgage and the potential of foreclosure. Lenders should use ordinary care and confirm all information provided by the potential borrowers.

This case is cited as *Donchi, Inc. v. Robdol, LLC, et. al., 2007 Ga. App. LEXIS 2, 2007 (Court of Appeals of Georgia, January 2007).*

California Appellate Court Allows Suspended Corporation To Defend Action

A recent case from California highlights the importance of verifying corporate records when a lending institution is involved in litigation with an entity.

This action involves a breach of promissory note and breach of written guaranty and was filed by The Cadle Company against World Wide Rattan, Inc., World Wide Hospitality Furniture, Inc., and Isaac Gonshor. Cadle alleged that Gonshor, acting on behalf of Rattan as its president, executed a written loan and security agreement for a line of credit with Cadle's predecessor in interest, Columbia National Bank, and signed a continuing guaranty in connection with the loan, personally guarantying all of Rattan's debt to the Columbia National Bank. Also, Gonshor executed a change in terms agreement with the Bank to refinance Rattan's remaining debt.

After sending several acceleration letters to Gonshor and Rattan, Cadle filed an action against Rattan after receiving no response to its letters. An answer was filed on behalf of World Wide Hospitality Furniture, Inc., a defunct California corporation.

At trial, Cadle moved to preclude World Wide Rattan, Inc. and World Wide Hospitality Furniture, Inc. from defending the action, asserting it had conducted a search of the records of the Secretary of State of California and found that their corporate powers had been suspended for failure to file statutorily required information statements. The trial court precluded the two corporations from defending the action, which left the guarantor to defend the action alone. Subsequently, judgment was entered against each corporation and the guarantor. The defendants filed an appeal arguing, among other things, that the trial court erred in not granting a continuance to allow the suspended corporations to secure a reviver, and that a partial reversal of the judgment is required to allow the corporation to present a defense.

The Appeals Court agreed that although neither Hospitality nor Rattan had a right to defend or participate in the lawsuit during the suspension of their corporate powers, disallowing the corporations to defend the action was too harsh a penalty and an abuse of discretion by the lower court. The Court noted that the purpose of the statutes depriving a suspended entity of privileges enjoyed as a going concern, including the right to defend in litigation and capacity to sue, was to motivate delinquent corporations to pay back taxes or file missing statements, and not to be punitive. The Court also noted that had the corporations notified the Court of its revived status, they should have been allowed to continue to defend the actions as all actions of the suspended corporations before or after judgment would have been validated by revival.

This case illustrates the importance of the observance of state requirements affecting corporate status. Although the California court ruled that a simple continuance would be sufficient to allow the defendant entities to revive their corporate powers, it acknowledged that the suspension of corporate powers could pose an obstacle for an entity involved in litigation.

This case is cited as *The Cadle Co. v World Wide Hospitality, Inc. No. SC079132 (CA. Ct. App. 10/21/06).*

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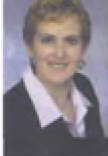

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