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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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Fee Limitation in Modification Agreement Found Not To Alter Fee Provisions in Loan Agreement

A BORROWER WAS REQUIRED TO PAY APPRAISAL FEES IN THE AMOUNT OF \$73,000 DESPITE HAVING EXECUTED A LOAN MODIFICATION AGREEMENT THAT LIMITED ITS COSTS TO \$15,000.

In this case, the California Court of Appeals held that the cap on fees applied only to the loan modification and did not alter the provision in the original agreement which provided that the

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borrower was responsible for all fees and costs of the loan.

On October 30, 1995, Hardage Hotels I LLC obtained a \$91 million loan from Nomura Asset Capital Corp., and pledged a portion of its hotel properties as collateral. The loan agreement contained customary language requiring Hardage to bear certain costs related to the loan, including “all fees, costs and expenses... on an initial and ongoing basis [of] any special services [and for]... appraisals.”

The loan was subsequently assigned to LaSalle Bank, N.A. In March of 2003, in response to notice from Hardage that it would not be able to meet its obligations under the loan, LaSalle, through the loan’s “special servicer” Criimi Mae Servs. Ltd. Partnership, entered into a loan modification agreement with Hardage.

The modification agreement contained an article entitled “Conditions Precedent” which provided that on or prior to the effective date, “Borrower shall pay to Lender... an amount equal to all costs, fees and expenses (including attorney’s fees and expenses) of Lender incurred or to be incurred in connection with this Agreement... not to exceed \$15,000.”

After the execution of the loan modification, Criimi Mae obtained appraisals of the collateralized hotel properties, and the company that controlled Hardage’s “cash collateral account” (a bank account specifically established under the loan agreement to pay Hardage’s fees and expenses relating to the loan) reimbursed Criimi Mae \$73,000 for the appraisal costs. In response, Hardage filed a complaint for breach of contract, conversion and breach of fiduciary duty, alleging that Criimi Mae unlawfully withdrew the \$73,000. The trial court ruled in favor of Criimi Mae and Hardage appealed.

Hardage argued that the section related to fees and costs in the loan agreement was inapplicable in that it was designed to cover costs related to the original loan and not to ongoing costs incurred by the loan servicer. Alternatively, it reasoned that even if it was applicable it should be superseded by the loan modification which capped fees and expenses arising out of the modification at \$15,000.

The California Court of Appeals explained that in the attempt to decipher the intent of the parties to a contract, “the language of the contractual provision should not be interpreted in isolation, but rather must be viewed in light of related contractual provisions in the same agreement.”

The appellate court held that the original loan agreement did indeed obligate Hardage to pay for the appraisals, as it explicitly provided that Hardage pay not only “all fees, costs and expenses incurred in connection with... the issuance, sale and delivery of the Note” but also “all fees, costs and expenses of, on an initial and ongoing basis... any special servicer.”

With respect to whether the cap contained in the modification was intended to modify the loan agreement, the Court ruled that it was not. Not only was the section related to fees and costs not referenced anywhere in the modification agreement, the Court noted that an article in the modification agreement entitled “Certain Specific Modifications to the Loan Agreement” would have been the ideal provision in which to address any intended cap on loan agreement fees. In reviewing the agreements as a whole, the Court ruled that the cap contained in the modification was intended solely to apply to the modification, and was not a substantive modification of the loan agreement imposing a \$15,000 cap on all the borrower’s costs.

It is worth noting, however, that even though the Court found in its favor, the lender in this case could have avoided the cost of litigation if the loan modification clearly provided that the borrower was liable for all fees without setting a monetary limit.

This case is cited as *Hardage Hotels I v. Criimi Mae Services. Limited Partnership*, No. D047870 (Cal. Ct. App. 03/20/07).



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Arbitration Clause Does Not Require Separate Consideration

IN NORTH CAROLINA, A COURT HAS FOUND THAT A CONTRACT'S ARBITRATION CLAUSE IS NOT INVALID DUE TO EITHER A LACK OF CONSIDERATION OR THE FACT THAT ONLY ONE PARTY POSSESSED THE RIGHT TO PURSUE ARBITRATION.

Senior Management, Inc. entered into an agreement with Moneyquest LLC in which Moneyquest agreed to obtain large commercial loans for Senior who would then pay for the costs associated with procuring the loans. The agreement included an arbitration provision which stated that at Moneyquest's option any dispute arising out of this agreement may be referred for arbitration.



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Moneyquest then introduced Senior to an individual who claimed he could obtain loans on behalf of Senior, which elected to pay the individual advance fees for the loans. Senior neither obtained any loans, nor received its advance fees in return. Senior then filed a lawsuit against Moneyquest alleging a fraudulent scheme to collect and steal advance fees. Moneyquest moved to have the claims against it dismissed, or in the alternative, to compel arbitration. Senior argued that the arbitration clause of the agreement was unenforceable because it allowed Moneyquest alone to decide on whether to pursue arbitration and that North Carolina law required mutuality of obligations in arbitration agreements.

The 4th Circuit held that when deciding whether an arbitration clause exists between parties the Court must look to state law. North Carolina law provides that so long as the contract as a whole is supported by adequate consideration, there is no additional requirement that the arbitration clause place obligations to arbitrate on all parties to a contract. Simply put, so long as there is mutuality to the contract as whole, the individual terms of the contract may provide different obligations to each party. The Court further looked at Senior's fraudulent inducement claim as to the arbitration provision and found that Senior's assertions were not valid. In this case, since Moneyquest agreed to secure loans in exchange for nonrefundable processing fees, the agreement was found to be supported by adequate consideration.

Lenders should review their current loan documents and any relevant arbitration clauses, as carefully drafted language can allow the lender—rather the borrower—to decide if and when arbitration can be used to settle a matter, providing lenders with more control in the event a loan goes into default.

The case above is cited as *Senior Management, Inc., et. al. v. Capps, et. al.*, No. 06-2273 (4th Cir. 06/19/07).



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Guarantor Cannot Admit Evidence of Oral Misrepresentation if Contract Terms Are Clear

A U.S. DISTRICT COURT RECENTLY REFUSED TO ALLOW A GUARANTOR TO SUBMIT EVIDENCE OF AN ORAL AGREEMENT BETWEEN A GUARANTOR AND LENDER WHEN THE TERMS OF THE GUARANTY WERE CLEAR AND UNAMBIGUOUS.

In March 1999, American Bank and Trust made a \$25 million loan to Bond International Limited. Prior to executing the loan documents, American Bank suggested that if David Bond personally guarantied the loan, then the lender would reduce the interest rate by .25%. American Bank sent a term sheet to David Bond in February which included the .25% interest rate reduction for the personal guaranty. Mr. Bond asked why the guaranty was needed, and the loan officer responded that the guaranty was needed in order to keep Mr. Bond on the "straight and narrow". Bond signed the term sheet and returned it to American Bank and later accepted the interest rate reduction and signed and delivered a personal guaranty.

The guaranty clearly indicated that David Bond was unconditionally and irrevocably guarantying all of the obligations of the borrower, and the Bank could proceed against David Bond without first proceeding against the borrower. The guaranty further provided that it represented the entire agreement between the parties and there were no other written or oral agreements between David Bond and American Bank.

Upon default by the borrower, American Bank sued the borrower and David Bond for all sums due, eventually filing for summary judgment against both. In his defense against the summary judgment motion, Mr. Bond argued that he understood that the guaranty would only be enforced if there was "material malfeasance" or if Mr. Bond misappropriated the collateral for his personal use. Yet, there was no communication by Mr. Bond to American Bank prior to his execution of the guaranty of his interpretation of its contents. In fact, the only evidence offered by Mr. Bond was that the statement made by the loan officer created a condition precedent to the enforcement of the guaranty—that if Mr. Bond did nothing wrong and the loan went into default, he would not be liable. American Bank countered that even if there was an oral agreement, it would not be admissible under the parole evidence rule, which provides that any oral negotiations or discussions are merged into and superseded by an agreement executed in writing. Unless there is an ambiguity in the written agreement, evidence of oral representations are not admissible. Since the guaranty clearly indicated that it was the entire agreement between the parties and there were no other written or oral agreements between David Bond and American Bank, the Court ruled that evidence of verbal representations prior to the execution of the guaranty were not admissible.

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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.

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

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This case is important to remember not for its ruling, but for its discussion related to exceptions to the parole evidence rule. If the Mr. Bond had been able to prove that prior discussions related to his interpretation of the guaranty did in fact take place, the Court may have ruled in favor of the him, meaning that summary judgment would not have been granted and the case would have continued. As such, it is important to make sure that there is a clear understanding between a borrower, guarantor and a lender before the documents are signed, and that any contradictory statements made prior to loan closing be identified and negated in writing to avoid potential roadblocks to collection in the future.

This case is cited as *American Bank and Trust Co., v. Bond International Limited, et al*, 2007 U.S. Dist. LEXIS 15505 (N.D. Okla March 5, 2007).

Loan Officer Not Liable to Participant

THE APPELLATE COURT OF ILLINOIS HAS DETERMINED THAT A PARTICIPANT BANK WHICH DOES NOT HOLD LEGAL TITLE TO A LOAN CANNOT SUE A SUBSEQUENT PURCHASER OF THE LOAN WHO HAD NO NOTICE OF THE PARTICIPANT'S EQUITABLE INTEREST IN IT.

Ottawa Savings Bank, along with other banks, had purchased a participation interest in a portfolio of loans held by Commercial Loan Corp. Pursuant to the participation agreement, Commercial was to repay the participants if any of the loans were sold or repaid. Subsequently, JDI Loans, Inc. purchased a portfolio of seven loans from Commercial, which included the loans in which Ottawa had participated. Upon the loan sale, Commercial did not repay Ottawa its interest as required by the participation agreement. Commercial subsequently declared bankruptcy and went out of business.

Ottawa and the other participants sued JDI, filing multiple complaints with many different allegations of wrongdoing. Each time, the complaints were dismissed as not properly pled. After the other participants had given up, Ottawa individually filed a second-amended complaint alleging inducement of breach of fiduciary duty. The case law for inducement of breach of fiduciary duty requires a plaintiff to allege that a third party: 1) colluded with a fiduciary in committing a breach of duty; 2) induced or participated in the breach; and 3) obtained benefits resulting from the breach.

Here, Ottawa had no contract with JDI; its case was entirely based on its participation in the loans with Commercial. The Court determined that participants can look only to their lead bank (in Ottawa's case, Commercial) "for satisfaction of claims arising out of the transaction." Specifically, the participation agreement with Commercial stated that Ottawa purchased "an undivided interest in...the right to receive its share...of all collections..." under the loans, not an ownership interest in the loans. Accordingly, Commercial retained legal title to the loans. JDI was not a party to the participation agreements and Commercial did not provide JDI copies of any of the participation agreements prior to the loan sale. Further, Ottawa had not maintained a recorded security interest on the loans which would have made JDI aware of the notice of a legal claim. Therefore, the Court held that JDI had no legal duty to Ottawa. The Court specifically stated that, since Commercial was paid by JDI as agreed, the fact that Commercial "chose not to pay Ottawa is a matter between Ottawa and [Commercial.]"

This case reminds lenders of the importance of understanding who is responsible for satisfying a claim on a transaction, particularly when the lender does not possess an ownership interest or legal title to the property in question. It is cited as *Ottawa Savings Bank v. JDI Loans, Inc.*, 871 N.E.2d 236.

Commercial Lending Group News and Notes

Seminar Alert!

Coming soon, professionals from our group will be conducting a seminar on the impact of tightened credit standards on existing loan transactions. We'll discuss such topics as the workout process, the foreclosure process, and collection litigation and bankruptcy proceedings. Be sure to watch for a more detailed description, as well as a formal invitation to this insightful program, in the next month.

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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