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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:**Boilerplate Defeats Allegations of Insufficient Notice and Demand**

Lenders should make sure that the boilerplate language in a contract is drafted properly so they can defend their demands for payment. A Federal judge ruled that the guarantors of a defaulted loan waived their defenses of lack of notice of acceleration and lack of demand for the unpaid balance under their guaranties based upon specific language in the documents.

Avoid Allegations of Lender Misrepresentation or Fraud by Educating Borrower

Lenders may be held liable for misrepresentation or fraud when involved in complicated transactions where the lender has particular expertise, even when the borrower is a sophisticated party. In certain instances, the lender may benefit from educating its borrower to ensure that the borrower understands the total transaction.

Industry Standard Damages May Be Awarded Absent Convincing Alternative

Industry-standard liquidated damages may be awarded unless the borrower can make a compelling argument to the contrary. The Eighth Circuit U.S. Court of Appeals determined that an agreed-upon liquidated damages clause was valid and enforceable.

Federal Estate and Gift Tax Changes Make 2009 an Important Year to Review Estate Plans

Uncertainty about 2010, coupled with increases in the 2009 individual exclusionary amounts, makes this year an especially important time to review and possibly revise your estate plan.



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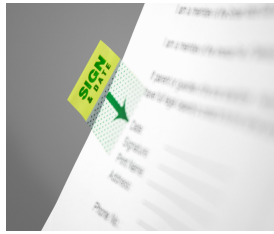
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Boilerplate Defeats Allegations of Insufficient Notice and Demand

Lenders should make sure that the boilerplate language in a contract is drafted properly so they can defend their demands for payment. A Federal judge ruled that the guarantors of a defaulted loan waived their defenses of lack of notice of acceleration and lack of demand for the unpaid balance under their guaranties based upon specific language in the documents.



Media Funding Company, LLC ("Media") agreed to lend \$5 million to BusinessTalkradio.net, Inc. ("BTR"), a company that owns and operates two radio networks and at least three FCC-licensed AM radio stations. Michael Metter was the president and CEO of BTR, and he and others signed personal guaranties of all amounts owed by BTR under the financing agreement. The guaranties required each individual guarantor to pay all sums payable by BTR under the financing agreement "when due, no matter how the same shall

become due." Furthermore, the guaranties were "unconditional" and provided that no action or notice was required to obligate the guarantors to pay the amounts owned by BTR.

In December 2007, BTR entered into a forbearance agreement with Media due to events of default. In April 2008, Media notified BTR of numerous contract violations. In May, BTR provided its lender with Officer Certificates that explained the violations. Two months later, Media sued the guarantors. In October, Media sent a letter to Metter, as president and CEO of BTR, stating that the obligations under the financing agreement had been accelerated due to the existence of events of default.

The guarantors argued that Media had not provided any notice of the acceleration of the outstanding indebtedness to them. However, the New York District Court judge said that notice of the acceleration of the loan was not required under the guaranties. The judge quoted the following specific language contained in the guaranties that allowed Media to accelerate payment without notice: "the Lender may... without notice... accelerate payment or performance of any one or more of the Guaranteed Obligations." He also noted that according to the terms of the guaranty agreements, the guarantors had explicitly waived any notice on the part of Media of either an intention to accelerate or notice of acceleration. Finally, the judge said that even if notice were required, either the filing of the court action or the October 6 letter sent by Media to Michael Metter was sufficient notice.

The guarantors also argued that no demand for an accelerated balance had been made upon anyone. The District Court Judge ruled that the guaranties did not require such a demand. He noted that in the guaranty agreements, the defendants waived "default, demand, presentment for payment, and notice of demand."

Finally, the defendants contended that the alleged amount of the indebtedness was not sufficiently supported. However, the Court disagreed, ruling that Media had provided a detailed breakdown of the balance owed by the defendants. The Court granted summary judgment in favor of Media.

This case is cited as *B.C. Media Funding Co. II et al. v. Lazauskas et al.*, No. 08 CV 6228 (S.D. N.Y. 10/24/08).

Avoid Allegations of Lender Misrepresentation or Fraud by Educating Borrower

Lenders may be held liable for misrepresentation or fraud when involved in complicated transactions where the lender has particular expertise, even when the borrower is a sophisticated party. In certain instances, the lender may benefit from educating its borrower to ensure that the borrower understands the total transaction.

A lender may have committed fraud by convincing a borrower to enter into a swap agreement as a hedge against interest rate fluctuations instead of giving the borrower its requested fixed rate loan. Indeed, in partially denying the lender's motion to dismiss the borrower's complaint, a Tennessee Court gave the borrower an opportunity to prove that the bank misrepresented the swap agreement's effect in



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A national bank provided a business with financing for a construction project in Tennessee. During the loan negotiations, the borrower asked for a fixed rate of interest. The bank responded by offering an interest rate swap to protect against fluctuations in the interest rate. The borrower acquiesced to the interest rate swap in which it would pay a fixed rate of interest while the bank paid a floating rate of interest under the swap agreement. According to the borrower, a bank representative said that "the only material effect" of the swap agreement would be to fix the interest rate. The construction loan, the swap agreement, and the deeds of trust securing both were executed in March 2002. The loan documents permitted the borrower to prepay the construction loan without penalty or premium at any time and also provided the borrower with periodic opportunities to prepay the loan.

When interest rates dropped in early 2004, the borrower inquired about prepaying the loan and was told by the bank that it would need to pay a "substantial penalty" in order to refinance. As a result, the borrower waited until March 2007, which was its next opportunity to exercise its absolute right to prepay the loan. When the borrower attempted to prepay the loan at that time, the bank refused to accept the payment, refused to cancel the swap agreement, and refused to cancel the liens unless the borrower paid the fees due under the swap agreement.

The borrower filed suit and argued that because the swap agreement and the construction loan were part of a single transaction and because the borrower was allowed to prepay the construction loan without penalty, the bank was in breach of contract by refusing to accept prepayment unless the borrower paid the value of the swap agreement. Alternatively, the borrower argued that if the bank could require the borrower to pay the value of the swap agreement, then the bank was guilty of committing fraud in the loan negotiations.

The Court ruled that while the construction loan and swap agreement constituted one integrated transaction, that alone did not mean that the bank was in breach of the contract, noting that the agreements created their own sets of mutual obligations. Specifically, the Court found that while the borrower was able to prepay the loan at any time, doing so would not free the borrower of its obligations under the swap agreement. The Court explained that although the purpose and practical effect of the swap may have been to provide the borrower with the financial equivalent of fixed-rate financing, the terms of the agreement, taken as a whole, made it clear that the borrower had distinct obligations under the loan portion of the agreement and under the swap portion of the agreement — that is, the borrower had an obligation to repay the note and a separate obligation to make payments under the swap.

Nowhere in the agreement was it suggested that the swap aspect of the transaction would be affected by the prepayment of the note. Moreover, when the borrower attempted to prepay the note and terminate the swap early, the amounts it owed under the terms of the swap were not the result of its prepayment of the note. Instead, they were the result of its obligations under the swap and would have been owed regardless of whether the borrower prepaid the note. In dismissing the borrower's claim for breach of contract, the Court ruled that amounts owed under the terms of the swap did not constitute a penalty or premium assessed as a result of the borrower's prepayment of the note and that the bank was not obligated to remove its lien on the property until the borrower had satisfied its obligations under the swap agreement.

The borrower then argued that if the bank was indeed within its rights to insist that the borrower buy out the bank's interest in the swap agreement, then the bank misrepresented the terms of the loan. Specifically, the borrower alleged that the bank misrepresented that the only material effect of the swap agreement would be to fix the interest rate on the construction loan. The bank asked the Court to dismiss this count as well, arguing that even if the bank had made such a representation, the borrower was knowledgeable regarding commercial loans and, therefore, could not have reasonably relied on such a representation. The Court refused to dismiss, reasoning that although the borrower was indeed sophisticated, nonetheless, the loan "hardly appears to have been a transaction between equals" given (i) the complexity of the swap, (ii) the fact that the bank suggested this complex transaction in response to the borrower's simple request for fixed-rate financing, and (iii) the fact that the bank was far more

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familiar with the technicalities of swap transactions generally. The Court found that the swap agreement was complex and susceptible to being misunderstood. In addition, the fraud allegation went not just to the face of the swap agreement, but to the effect that various instruments had within the greater context of the entirety of the transaction.

Standard Damages May Be Awarded Absent Convincing Alternative

Industry-standard liquidated damages may be awarded unless the borrower can make a compelling argument to the contrary. The Eighth Circuit U.S. Court of Appeals determined that an agreed-upon liquidated damages clause was valid and enforceable.

Ladco Properties XVII obtained a \$12.59 million loan commitment from Jefferson-Pilot Life Insurance Company in January, 2005. Ladco's attorney reviewed the commitment letter and negotiated several of its terms before the parties signed it. One of the negotiated terms was a liquidated damages clause in which Ladco agreed to pay Jefferson a deposit of three percent of the loan amount upon execution of the commitment letter. The clause further stated that if the loan did not close by the anticipated date, then the deposit would be retained by Jefferson as damages and applied toward its expenses.

Ladco acknowledged that Jefferson would be unable to provide an actual determination of its expenses and that the three percent was a reasonable estimate. Ladco then failed to meet its obligations under the commitment and Jefferson kept the deposit in accordance with the commitment letter. Ladco then sued for a return of the deposit, arguing that it was an unenforceable penalty because it was not a reasonable estimate of their damages. The District Court agreed with Jefferson that the deposit fell within industry standards, that it was reasonable and that the parties were both sophisticated businesses with equal bargaining power. Ladco appealed.

On appeal, the Court again agreed with Jefferson. The Court stated that liquidated damages clauses are used to discourage breach of contract and to avoid controversy over the actual damages resulting from the breach. The clauses will be upheld if they "represent an estimate of actual damages likely to result from the breach" and will not be upheld if they are a fixed amount acting as a penalty. Under North Carolina law, by which the commitment letter was governed, the provisions will be "enforceable and will not be considered a penalty where (i) the damages are speculative or difficult to ascertain, and (ii) the amount stipulated is a reasonable estimate of probable damages or...is reasonably proportionate to the damages actually caused by the breach."

Here, Ladco claimed that the percentage was not a reasonable estimate of probable damages or reasonably proportionate to the damages actually caused. However, the Court pointed to the fact that three percent falls within industry standards and that two of the three loan officers who had presented offers to Ladco had used the three percent standard. Further, the Court agreed with the Lower Court that both Ladco and Jefferson were "experienced with this type of transaction and exercised equal bargaining power in the negotiation." The Court pointed to the fact that both were "sophisticated parties with commercial real estate experience" and a lack of evidence to support any inequities in bargaining power. In addition, Ladco had engaged a professional mortgage broker in the deal and an attorney had negotiated the loan commitment on Ladco's behalf before its execution.

This case is cited as *Ladco Properties XVII v. Jefferson-Pilot Life Insurance Company*, 531 F.3d 718.

Federal Estate and Gift Tax Changes Make 2009 an Important Year to Review Estate Plans



Uncertainty about 2010, coupled with increases in the 2009 individual exclusionary amounts, makes this year an especially important time to review and possibly revise your estate plan.

Family Law

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On January 1, 2009, the federal estate tax exclusionary amount per U.S. citizen increased from \$2 million to \$3.5 million. The top marginal rate at which the federal estate tax is imposed remains at 45 percent. Under current federal law, the \$3.5 million exclusionary amount and 45 percent rate are effective only in 2009. In 2010 – absent a change in law – the federal estate tax disappears, only to return in 2011 at a top marginal rate of 55 percent and with a \$1 million exclusion per U.S. citizen or resident alien. Many prognosticators expect temporary or permanent legislative changes to avoid this scenario, but the outcome remains unknown.

The increased \$3.5 million federal estate tax exclusionary amount does not eliminate the need for estate tax planning for people whose estates might be under \$3.5 million. Depending on where you live, state estate tax planning might now be a priority. In Maryland and Washington, DC, for example, the state estate tax exclusionary amount per resident remains at \$1 million. Certain tax planning techniques are available to mitigate the impact or defer the payment of state estate taxes, but state law determines which techniques are available.

Consider reviewing your estate plan with your attorney. If you have no estate plan, consider putting one in place. Regardless of the impact of federal and state estate taxes, it pays to have a plan in place to provide for your family and loved ones in the event of your demise. Visit www.lerchearly.com/estates for more information.

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