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Our  
Professionals

**Lawrence G. Lerman**  
Chair  
Email  
301-657-0163



**Joel S. Aronson**  
Email  
301-347-1276



**Cindi E. Cohen**  
Email  
301-657-0169

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.

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.

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### In This Issue:

#### **American Recovery Act of 2009 and SBA Lending**

The new stimulus program makes it easier for small businesses to receive SBA funding with increased loan guarantees, elimination of fees, deferred payments and a new secondary market.

#### **Defaulting Lender Escapes Liability for Damages**

When consequential damages caused by the inability to obtain a replacement loan is not foreseeable, the lender is not liable for speculative lost profits or punitive damages for failing to close on a loan absent proof of bad faith or outrageous conduct.

#### **Mistaken Understanding Does Not Save Plaintiff**

A court determined that a guarantor cannot escape liability under the guaranty based on her unilateral mistaken understanding of the terms of the guaranty.

**Tip of the Month:** 15 Days to Fight Foreclosure in Maryland

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### ***The American Recovery Act of 2009 and SBA Lending: Reduces Lender Risk and Increases Opportunities for Small Business Lenders***

**The government stimulus plan now makes it easier and less expensive for small businesses to receive funding guaranteed by the Small Business Administration with new funding and program changes. The American Recovery and Reinvestment Act of 2009 became law early in February of this year. The**



**Arthur F. Lafionatis**  
 Email  
 301-657-0731



**Alison W. Rind**  
 Email  
 301-657-0750



**Arnold D. Spevack**  
 Email  
 301-657-0749



**Vicki R. Canales**  
 Email  
 301-907-2803

bill provides \$730 million to the SBA and makes substantial changes to the SBA 7(a) and 504 programs so they can reach more small businesses. Below is a summary of some of the major revisions to the SBA program.



***New Loan Guarantees***

One of the first changes is that to further encourage private lenders by minimizing risk, the SBA raised its loan guarantee from current levels to as much as 90% for some loans, Only the first \$1.5 million of any 7(a) loan is guaranteed, so there will be limits to the loans which qualify for a 90% guarantee. In order to receive the maximum guarantee, the maximum loan size is \$1,666,666. The 50% guarantee on SBA Express loans remains unchanged.

***Elimination of Fees***

Borrowers could have savings of up to \$25,000 with the elimination of the SBA guarantee fee. SBA has eliminated guarantee fees on 7(a) loans and the third party lender fees and CDC processing fees under the SBA 504 loan program on a temporary basis. The program runs through September 20, 2010; however, it is anticipated that funding for the program will run out sooner. It is projected that funding for the program will remain available at least through December 31, 2009.

***Deferred-Payment Loans & Microloans***

Relief is also in sight for existing borrowers. The Act additionally creates a new SBA loan program to provide \$255 million for deferred-payment loans of up to \$35,000 to viable small businesses that need the money to make payments on an existing, qualifying loan for up to six months. These loans will be 100% guaranteed by SBA. Repayment would not have to begin until twelve months after the loan is fully disbursed. Lenders will make these loans directly. Unfortunately, this program is not available to existing SBA borrowers, however, is available to other small business owners who need assistance in the payment of their non-SBA guaranteed small business loans . As of the print date of this newsletter, the SBA has not released regulations on this program.

The Act also expands the SBA's Microloan program, a program which provides small loans of up to \$35,000, in addition to technical assistance to start up, newly formed or growing businesses. The Act will inject \$50 million in funding to participating Microlenders through September 30, 2010 and adds \$24 million in grants to provide technical assistance to borrowers.

The Act also gives SBA power to the 504 CDC program to refinance existing loans for fixed assets, providing new support for small business expansion; however, this program is not yet implemented. We await regulations.

***Creation of Secondary Market for the Sale of Loans***

The Act allows the SBA to create a secondary market for pools of "First Lien" loans under the 504 program. These "first lien" loans from commercial lenders currently have no SBA guarantee. The Act authorizes SBA to use federal guarantees for pools of these first lien loans so they can be sold to investors in a secondary market. The Act also allows SBA to set up a Secondary Market Lending Authority that would make direct loans to broker-dealers that participate in the secondary market for SBA-guaranteed 7(a) loans. The provided funds would allow broker-dealers to purchase SBA-backed loans from commercial lenders, assemble them in pools and sell them to investors in the secondary loan market. This program will effectively create cash flow for lenders and make the sale of a lender's SBA loan portfolio profitable to the lender. The SBA estimates that it will take another 5-7 weeks for the program to be established.

***Better Leverage of Capital***

Finally, the Act provides help to SBA-licensed Small Business Investment Companies to better leverage the capital they use to invest in small businesses. The Act sets up maximum levels of funding the SBA can provide to these companies at up to three times the private capital raised by those companies or \$150 million, whichever is less. The Act also raises the percentage any one SBIC can invest in a single small business to 10% of total capital and raises to 25% the percentage of any licensee's dollar investment that must be made in "smaller" businesses.



**Jeremy I. Goldman**  
Email  
301-657-0732



**Shannon N. Mandel**  
Email  
301-907-2815



**Michael D. Smith**  
Email  
301-657-0166

## Our Services

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

As noted, many of these changes will require further guidance from the SBA in order for lenders to fully implement these programs. We hope the SBA will provide the necessary information to so lenders can start matching these programs to eligible business and help spark the economy to the benefit of both the lenders and borrowers.

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## Defaulting Lender Escapes Liability for Damages: Borrower Unable to Prove Entitlement to Special or Punitive Damages

**The US District Court in Arizona has declined to award an investor consequential or punitive damages arising out of economic harm it claimed to suffer when its lender failed to fund its loan.**

In August, 2006, Arizona Precious Metals, Inc. (APM) and Silver King Mining Company of Arizona signed a joint venture agreement wherein Silver King would contribute its mining rights in the Silver King Mine and APM would provide between \$2 million and \$10 million to fund the project. The Silver King Mine had been in operations since the 1870s, but had not been profitable since 1922. APM had planned to obtain funds for the venture from Accept Erste Rohstoff Beteiligungs KG, a German lender, and signed a loan agreement with them on September 5, 2006. Under the agreement, APM borrowed \$2 million from Accept for various projects and allocated \$500,000 for the Silver King Mine. However, at that time Accept did not have the capability to fund the loan and eventually defaulted on the agreement. After repeated attempts to obtain other financing failed, APM sued Accept for breach of contract and fraud in the inducement, requesting \$26,961,043 in lost profits and \$5,000,000 in punitive damages. Later, as a result of being unable to provide the funds required under the joint venture agreement, APM lost its interest in Silver King Mine.

### ***Need to Prove Damages When Substitute Credit Unavailable***

The Court had previously found Accept in default of the loan agreement, so the issue here was simply one of damages. The Court first outlined consequential damages as those "reasonably foreseeable losses that flow from a breach of contract" and are typically measured by the additional interest required under a replacement loan. In lending situations, a lender often has no reason to foresee that substitute credit will become unavailable, so consequential damages are not typically awarded against a lender unless the lender is aware of a specific purpose for the loan, and, among other things, the damages are reasonably probable at the time the loan is documented. Here, although Accept was aware of the purpose of the loan, APM offered insufficient evidence that Accept knew no substitute financing would be available. Further, the Court determined APM's lost profit calculations to be "entirely speculative" due to the mine's unprofitable history and the low percentage of funds APM was receiving from Accept which were allocated for the mine. As a result the Court refused to award lost profits.

### ***Punitive Damages Require an "Evil Mind"***

Regarding the punitive damages claim, the Court noted that punitive damages are not awarded in contract disputes such as this unless "there is an accompanying tort," such as APM's claim of fraud. To award punitive damages, a Plaintiff must prove "by clear and convincing evidence that the defendant engaged in aggravated and outrageous conduct with an 'evil mind.'" While not successful in this instance, the case illustrates the more aggressive tactics that disgruntled borrowers may take in the current lending environment. As such, a lender should be extremely cautious in making commitments to provide financing until it is sure it will be able to meet its obligation assuming a borrower meets its conditions to obtain financing.

This case is cited as *Arizona Precious Metals, Inc. v. Accept Erste Rohstoff Beteiligungs KG, et al., 2008 WL 4138116 (D.Ariz.)*.

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.

## Practice Areas

**Business and Taxation**

**Commercial Lending**

**Community Associations**

**Elder Law**

**Employment and Labor**

**Estate Planning and Probate**

**Family Law**

## Guarantor Uninformed Regarding Deal Terms is Unable to Escape Liability *Lack of Understanding Is Not a Lack of Liability*

**The US District Court in Ohio has determined that a guarantor cannot escape liability under the guaranty based on her mistaken understanding of the terms of the guaranty.**

Christina Corl sued Citizens Bank after they attempted to collect on her guaranty of a debt owed by Simsbury Place LLC, of which her husband was a member. In 2006, Simsbury needed financing to buy land and build a residential condominium complex. The bank issued commitment letters on June 9, 2006 for a \$730,000 acquisition note and a \$5.2 million construction note which required the guarantees of the three individual members of Simsbury and the wife of one of the members. Citizens required her guaranty even though she was not a member because she and her husband, a member, jointly owned their home and other major assets. The initial commitment letter for the construction loan required that at least ten of the condominium units be pre-sold to investors who had already obtained mortgage loan commitments.



However, the commitment letter was later amended by a handwritten note acknowledging that the pre-printed unit sales contract contained a clause that if a buyer did not have sufficient financing within a thirty day period, the contract would be terminated and the buyer's deposit would be returned with interest. This handwritten language was added to the construction loan agreement that was signed by Corl. Further, the purchase agreements for the pre-sold units allowed the contracts to be terminated and the deposits returned to the buyers if they could not obtain purchase money financing.

Although Corl signed the loan documents at closing in June, 2006, she claims she did not learn of these provisions allowing for return of the deposits until after she was asked to make payments under the guaranty. As the project neared completion and the buyers were asked to close, all but ten buyers were unable to obtain purchase money financing and Citizens returned the deposits plus interest in accordance with the terms of the contracts. Simsbury was then unable to make its required loan payments and defaulted on its loans. Then, after the completed project was appraised in February, 2008, Citizens demanded that Simsbury make up a \$1,680,070 loan deficiency balance. In March, 2008, Corl filed a complaint against Citizens for fraud or mistake and requested a permanent injunction against collection on the guaranty.

The Court found that Corl's complaint failed for lack of compliance with the particulars of the rule for pleadings regarding fraud and mistake. Such a complaint must state the "time, place and content of the alleged misrepresentation on which she relied; the fraudulent scheme; the fraudulent intent of the [other party]; and the injury resulting from the fraud." Here, Corl failed to specify such particulars of the fraudulent inducement and did not demonstrate that Citizens intended to defraud her. The Court specifically pointed to the fact that the decision to change the requirements regarding the buyers' purchase money financing came from her co-guarantors, not the bank. Further, in order to prove her claim for fraudulent inducement, Ohio law requires a demonstration of a false representation regarding material fact, knowledge of the falsity, intent to induce reliance on the misrepresentation and injury resulting therefrom. Again, the Court determined that, based on these facts, Corl failed to present evidence that the bank made false representations or intended to mislead her.

Alternatively, Corl asked the Court to rescind the guaranty based on the doctrine of mistake, although she failed to specify whether the mistake was unilateral or mutual. However, Ohio law provides that a "unilateral mistake by the guarantor as to the nature of the underlying transaction or by the creditor as to the capacity in which the guarantor signed may not be the basis for relief from the guaranty contract" unless the creditor knew or should have known of the guarantor's unilateral mistake. Again, Corl failed to provide evidence sufficient for the Court to find that Citizens knew or had reason to know of any misunderstanding between the parties. Further, in order to rescind the contract based on mutual mistake, Corl would have had to show the existence of a contract, a material mutual mistake by the



parties, and a lack of negligence in discovering the mistake. Again, she failed to provide any evidence to convince the Court of mutual mistake. The Court also disagreed with Corl that her lack of understanding of the terms of the loan agreement amounted to a material alteration of the loan which would discharge her liability.

Because Corl was unable to prove any of her claims the Court refused to discharge her liability under the guaranty.

This case is cited as *Corl v. Citizens Bank, 2008 WL 2622984 (S.D.Ohio)*.

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### Tip of the Month: 15 Days to Fight Foreclosure in Maryland



Maryland's Court of Appeals has adopted new foreclosure rules that will require lenders to notify certain parties when a foreclosure action has been filed against residential property.

The new rules require lenders to notify the homeowner, any borrower or guarantor of a loan, and any occupant of the subject property, that a foreclosure proceeding against residential property has been filed. As a means of reducing the number of last-minute motions to stay foreclosure proceedings, a new Rule 14-211 allows any interested party, including tenants and occupants, a 15-day period, from the date such notice was received, to raise legal defenses to the foreclosure sale in a motion to stay/dismiss with the circuit court. The legal defenses include challenges to the validity of the loan or right to accelerate, or a collateral proceeding that involves the property. If the motion is not filed within the prescribed time, the party must state a particular reason for the delay. The new rules also allow for limited discovery and eliminate the requirement for posting a bond for the entire amount of the debt.

The new notice requirements supplement the rules adopted by the General Assembly and Rules Committee last year. The Court of Appeals voted to make the changes effective May 1, 2009.

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### We'd 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, please send them to Anne Core at [ascore@lerchearly.com](mailto:ascore@lerchearly.com), or via phone at 301-961-6096.

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SUITE 460 | 3 BETHESDA METRO CENTER | BETHESDA MD 20814-5367

TEL: 301.986.1300 | [www.lerchearly.com](http://www.lerchearly.com)

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