

LERCH EARLY &amp; BREWER

# Commercial Lending Bulletin

February 2009

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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.

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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### In This Issue:

#### **Insurance Policy Language Defeats Lender's Claim for Loss of Security**

A lender's attempt to make a claim on a policy of commercial insurance was rejected by a Tennessee appellate court which ruled that the clear language of the policy did not protect a security interest in personal property.

#### **Negligence is Not Enough for Liability in Commercial Lending**

A U.S. District Court in Oklahoma found that a person who borrowed money to finance a business was not able to pursue a negligence action against a commercial lender because the loan was for commercial purposes, and the lender could not be held liable for merely negligent actions under Oklahoma law.

#### **Borrower's Claim of Inconvenience Does Not Result In Change of Venue**

A venue clause set forth in the loan documents prevails over motion to change venue.

#### **Senate Stimulus Bill Proposal Includes Funding for 7(a) and 504 Loans**

The American Recovery and Reinvestment Act Senate bill includes funding to stimulate lenders to make small business loans.

#### **Save The Date**

Lerch, Early & Brewer will be hosting a Meet & Greet on February 26th, from 5pm to 7:30pm, for a casual networking reception.

#### **Insurance Policy Language Defeats Lender's Claim for Loss of Security**

**A LENDER'S ATTEMPT TO MAKE A CLAIM ON A POLICY OF COMMERCIAL INSURANCE WAS REJECTED BY A TENNESSEE APPELLATE COURT WHICH RULED THAT THE CLEAR LANGUAGE OF THE POLICY DID NOT PROTECT A SECURITY INTEREST IN PERSONAL PROPERTY.**

PacTech Inc. was in the business of buying and re-selling battery manufacturing and packaging equipment. Arthur H. Black made various loans to PacTech totaling \$680,000, which loans were secured by the battery manufacturing and packaging equipment owned by PacTech. PacTech had an

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insurance policy with Auto-Owners Insurance Co. that included coverage for commercial personal property.

In July 2004, a fire occurred at the building where PacTech stored its battery manufacturing and packaging equipment. After the fire, PacTech submitted a claim for the maximum amount recoverable under the policy. Black also submitted a claim to Auto-Owners pursuant to a clause in the policy providing for payment for certain losses suffered by mortgage holders. However, Auto-Owners maintained that the insurance policy was void and did not provide coverage for the claimed loss, alleging that the fire was intentionally set by PacTech (or its agents) and that PacTech had intentionally misrepresented material facts and circumstances in its proof of loss. The insurance company also refused to pay Black's claim, asserting that his rights under the policy did not exceed those of the named insured.

PacTech filed a complaint for declaratory judgment and damages against Auto-Owner and Black filed an intervening complaint in the suit, seeking a \$680,000 judgment against Auto-Owners. Subsequently, the trial court granted a motion for summary judgment in favor of Black and against Auto-Owners upon finding that the mortgage holders clause in the policy allowed Black, a designated loss payee, to recover notwithstanding any acts by PacTech in conflict with the policy. One of several issues addressed on appeal was whether the trial court erred in granting Black's motion for summary judgment.

The appellate court said that Tennessee recognized essentially two types of clauses in which a loss payee's interest in property was protected in the event that a loss had occurred. First, under a "simple/open clause" the loss payee's rights were no greater than those of the insured. However, the second type of clause, a "standard/union" clause, is intended "to furnish to the mortgagee a reliable security in a definite sum, free from any interference on the part of the mortgagor that would to any extent invalidate or make less adequate that security". The court also stated that specific language is typically included in such clauses to prevent the coverage from being invalidated by the insured's actions or neglect. Although conceding that the clause in its policy was a "union/standard" clause, Auto-Owners argued that it did not apply to personal property and that Black should therefore be relegated to coverage as an "simple/open" mortgagee, able to recover only if the insured recovers.

The court declared that the policy was clearly intended to insure commercial property, including machinery and equipment. However, it also ruled that the clause limited Black's rights to recovery for loss of real property only. According to the court, subsection (b) of the clause clearly stated that Auto-Owners would pay for covered loss of, or damage to, buildings or structures to each mortgage holder shown in the Declarations in their order of preference, as the interests appeared. Further, it pointed out that subsection (c) of the clause stated that the mortgage holder had the right to receive loss payment even if the mortgage holder started foreclosure or similar action on the building or structure. The court found no language in the mortgage holder's clause that made it applicable in the event of loss or damage to personal property.

While Black argued that the policy defined the term "building" to include permanently attached machinery and equipment, which could be construed to include large scale industrial equipment associated with battery manufacturing, the court rejected that argument, since no proof was provided that the items securing Black's debt were permanently installed.

The court also held that because the terms in the clause were clear, it was required to construe them in a way that did not extend their ordinary meaning. Based upon a reasonable and logical construction of such terms, and a review of the policy as a whole, the court did not find that the clause extended to coverage of the personal property that secured PacTech's debt.

While the above-case is somewhat fact-specific and contract-specific, it serves as yet another stark reminder to lenders and borrowers alike that they should understand the full scope of insurance coverage contained in its insurance policy.

*(PacTech Inc., et al. v. Auto-Owners Ins. Co., et al., No. E 2007-01480 (Tenn. Ct. App. 09/22/08))*

### **Negligence is Not Enough for Liability in Commercial Lending**

**A U.S. DISTRICT COURT IN OKLAHOMA FOUND THAT A PERSON WHO BORROWED MONEY TO FINANCE A BUSINESS WAS NOT ABLE TO PURSUE A NEGLIGENCE ACTION AGAINST A COMMERCIAL LENDER BECAUSE THE LOAN WAS FOR COMMERCIAL PURPOSES, AND THE LENDER COULD NOT BE HELD LIABLE FOR MERELY NEGLIGENT ACTIONS UNDER OKLAHOMA LAW.**

Judith Knight took out a loan with Bank One Oklahoma NA, which she signed both in her capacity as



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president of Phoenix Central Inc. and as an individual. The loan went into default and the borrowers were sued by Bank One's successor Mooring Capital Fund LLC. Knight filed a counterclaim against Mooring based on the conduct of Bank One under the theories of negligence, negligent misrepresentation, negligent nondisclosure claims and intentional infliction of emotional distress. Mooring moved to dismiss all of the Knight's claims.

The Court found that with the exception of the claim for intentional infliction of emotional distress, all the other counterclaims were based on negligence. Under Oklahoma law the claimant must prove more than mere negligence to impose tort liability on a lender in a commercial loan. Ms. Knight's final claim, for intentional infliction of emotional distress, also failed. To succeed on this claim, one must prove that they have been harmed "by extreme and outrageous conduct intentionally or recklessly" which caused "severe emotional distress". Because Knight failed to allege conduct by Bank One that was either extreme or outrageous and failed to state her severe emotional distress, her claim was denied.

The case above is cited as *Mooring Capital Fund LLC v. Phoenix Central Inc., et al.*, No. 06-0006 (W.D. Okla. 07/02/08)

### **Borrower's Claim of Inconvenience Does Not Result In Change of Venue**

#### **A VENUE CLAUSE SET FORTH IN THE LOAN DOCUMENTS PREVAILS OVER MOTION TO CHANGE VENUE.**

David Bartel owned a California car dealership and entered into a floor plan line of credit from Citibank, which Bartel personally guaranteed. The loan documents provided that any litigation would be filed in California and governed by California law. Citibank's floor plan financing was sold to First Hawaiian Bank in 2005. First Hawaiian increased Bartel's line of credit several times and in October 2006 sent Bartel a commitment letter further increasing the line. The commitment letter required execution of new loan documents by Bartel's company and by Bartel as guarantor and stated in part that the governing law would be the State of Hawaii. The guaranty signed by Bartel included a paragraph directly above his signature that stated that the guaranty was governed under the laws of Hawaii and venue for enforcement of the guaranty would be in Honolulu, Hawaii. In 2007 the car dealership closed and sold its assets. First Hawaiian filed suit in Hawaii against Bartel for breach of the guaranty. Bartel filed a motion to transfer venue.

The Court stated that when deciding a motion to change venue, the Court must consider and weigh the location where the agreements were negotiated and executed, the state that is most familiar with the governing law, and the plaintiff's choice of forum, as well as other factors including the parties' contacts with the forum and the costs of litigation in two opposing forums. The Court also stated the forum selection clause was a significant factor in determining the correct forum.

Bartel offered several arguments for changing the venue to California. He stated the venue should be changed because he, the defendant, lived in California. Second, Bartel argued that California was favored because of the convenience of witnesses, including, his former lender, his former partner, his bookkeeper and accountant who were all located there. The Court stated that without information on the substance or relevance of the witnesses' testimony, this was unpersuasive and it was unclear how evidence from these witnesses would be relevant to the current dispute. Bartel argued that Hawaii had no relationship to the litigation, an argument that likewise the Court found unconvincing. The Court claimed that regardless of where the money was loaned, Hawaii did have an interest in seeing that local banks were able to collect on defaulted loans and the loan, originally made in California, was transferred to a Hawaiian bank, which increased the available credit line. Finally, Bartel claimed that all the parties, documents and witnesses were located in California and therefore a California forum was justified. The Court noted that the documents were signed and witnessed by First Hawaiian, in Hawaii.

Forum selection and governing law clauses are some of the most important aspects of standard loan documents. A lender must determine the appropriate law not only for the governing its documents, but also for enforcement of the documents, should the need arise. Likewise, this case shows that simply picking a forum that is convenient to the lender may not be enough. The Court was willing to consider several factors when determining the appropriate forum. This is particularly true if it is not apparent why a lender has chosen a particular state for choice of law or venue. When challenged a lender must be prepared to defend its choice of law and forum provisions under the standards set forth here, realizing that a challenge, while ultimately unsuccessful, may be costly and time-consuming.

The case above is cited as *First Hawaiian Bank v. Bartel*, No. 08-00177 (D. Hawaii 09/22/08)

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

## PRACTICE AREAS

**Business and Taxation**

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**Elder Law**

**Employment and Labor**

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**Family Law**

**Health Care**

**Land Use and Zoning**

**Litigation**

**Real Estate Transactions**

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## Senate Stimulus Bill Proposal Includes Funding for 7(a) and 504 Loans

### THE AMERICAN RECOVERY AND REINVESTMENT ACT SENATE BILL INCLUDES FUNDING TO STIMULATE LENDERS TO MAKE SMALL BUSINESS LOANS.

The stimulus bill includes \$515 million to temporarily eliminate fees associated with making 7(a) loans. By reducing the lender's fees, the bill hopes to get lenders back into the 7(a) lending market. Last year alone, there were 30,000 less SBA 7(a) loans than were made in 2006, and from the beginning of this fiscal year, 7(a) loans are down more than 56%. The bill also includes \$100 million for the temporary waiver of fees associated with making 504 (real estate and long term equipment financing) loans. 504 loans are already down 42% for the current fiscal year. This bill hopes to create more than \$15 billion in small business 7(a) loans and \$5 billion in small business 504 loans. Also included in the bill is funding for the SBA's microloan program, which provides very small loans to small businesses and \$24 million for complementary counseling.

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## Save The Date

### LERCH, EARLY & BREWER WILL BE HOSTING A MEET & GREET ON FEBRUARY 26TH, FROM 5PM TO 7:30PM, FOR A CASUAL NETWORKING RECEPTION.

The event will be held at the offices of Lerch, Early & Brewer. Appetizers and drinks will be provided. Please be sure to RSVP to Bill Melchior at [wgmelchior@lercheearly.com](mailto:wgmelchior@lercheearly.com) as space is limited.

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## 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 Bill Melchior at [wgmelchior@lercheearly.com](mailto:wgmelchior@lercheearly.com).

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