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PROFESSIONALS

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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.

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**Commercial Lending Group News and Notes**

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**Omission of "Inc." From Financing Statement Cost Creditor Its Perfection**

**A VIRGINIA BANKRUPTCY COURT DETERMINED THAT THE OMISSION OF "INC." FROM A DEBTOR NAME ON A UCC FINANCING STATEMENT IS "SERIOUSLY MISLEADING" AND CAN COST A CREDITOR ITS PERFECTION.**

In *In re Tyringham Holdings, Inc.*, the debtor, Tyringham Holdings, Inc., owed Suna Bros. Inc. for jewelry worth nearly \$311,000.00. Suna had entrusted Tyringham with the jewelry for resale and, according to Article 9 of the UCC, sought to perfect a security interest in the goods by filing a UCC-1 financing statement. Suna filed the financing statement with the correct Virginia state filing office and listed the debtor name as "Tyringham Holdings." The actual, legal name of the debtor, according to their corporate records filed with the Virginia State Corporation Commission, was "Tyringham Holdings, Inc." Suna's filing omitted the word "Inc."

In Tyringham's bankruptcy case, other creditors tried to invalidate Suna's claim, arguing that, pursuant to Article 9, Suna's filing was "seriously misleading" and therefore did not perfect Suna's



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lien against the goods. Article 9 provides that a financing statement must sufficiently provide the debtor's legal name, i.e., must list the same name as indicated on the public record of the debtor's jurisdiction of organization (usually the debtor's articles of organization or incorporation). If the financing statement contains a name other than that listed in the public record, or if the debtor's name does not show up in a search of the state's UCC records using that state's standard search logic, the filing is "seriously misleading" and ineffective to perfect a security interest. Here, although common sense would seem to indicate that mere omission of the "Inc." from the debtor's name is a harmless error, the mistake cost Suna its perfection. "Tyringham Holdings" is not the same name as that listed in Tyringham's articles of incorporation filed with the Virginia State Corporation Commission and a search of the state's UCC records under the debtor's proper legal name did not reveal the financing statement. The Virginia state filing office considers "Inc." to be a significant word and omission of that word will alter any search results. Accordingly, the error was determined to be "seriously misleading" and Suna was determined to be unperfected.

Ironically, UCC searches performed by private search companies did, in fact, reveal the existence of Suna's financing statement. As "Inc." is commonly thought to be a "noise word" and is frequently eliminated from consideration when performing UCC searches, Virginia's search logic is in the process of being revised accordingly. However, this is a good reminder, from our own back yard, for lenders to be extra careful when preparing and filing their UCC financing statements.

This case is cited as *In re Tyringham Holdings, Inc.*, 354 B.R. 363 (Bankr.E.D.Va. 2006).

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### **Bank's Internal Prime Rate Does Not Amount To Ambiguous Language**

#### **THE MICHIGAN COURT OF APPEALS RECENTLY RULED THAT A BORROWER FAILED TO PROVE DAMAGES RESULTING FROM THE LENDER'S FAILURE TO PUBLISH ITS INTERNAL PRIME RATE.**

Miljevich Corp. executed a \$1.4 million promissory note to North Country Bank & Trust which provided that the interest rate on the loan was "one and one-half percent per annum above the prime rate as published from time-to-time by the bank as its prime rate." After the president of Miljevich Corp died, the president's wife became the successor president. In December 1999, the successor president met with the bank officer who negotiated the terms of the loan with her husband to obtain a lower interest rate on the loan. The president did not know the interest rate applicable to the loan and, at the meeting, the bank officer would not disclose the rate to her. After the meeting, North Country's employees never responded to the president's inquiries regarding the internal prime rate.

In September 2003, Miljevich Corp. refinanced the loan and paid the North Country loan in full. Thereafter, Miljevich Corp. filed suit against North Country, alleging that the bank breached the terms of the loan agreement by (i) failing to publish and inform the plaintiff of its internal prime rate, and (ii) overcharging interest on the loan.

The trial court found that the parties' agreement was unambiguous, yet incomplete. The trial court reasoned that because North Country failed to publish its prime rate, as provided in the note, North Country could not apply that rate to the loan. Since the parties' agreement did not mention any other interest rate, the trial court applied what it determined to be a "reasonable" interest rate to the loan: Wall Street Journal Prime plus 1.5 percent. The trial court awarded a judgment to plaintiff in the amount of \$140,326.78. Both parties appealed.

Miljevich Corp. and North Country both contended that the trial court erred in applying its "reasonable" interest rate to the loan. North Country contended that the trial court should have applied an interest rate of NCB prime plus 1.5 percent to the loan, as provided in the loan note. Miljevich Corp. contended that the trial court should have applied an interest rate of simply 1.5 percent to the loan.

The Michigan Court of Appeals stated that the primary goal in the construction or interpretation of any contract is to read the agreement as a whole and attempt to apply the plain language of the contract itself. Further, the Court noted that an unambiguous contract must be enforced according to its terms. In this case, the Court found that the trial court erred, and that the plain language of the contract itself provided that the applicable interest rate would be the NCB prime plus 1.5 percent. Thus, the trial court erred in imposing a different "reasonable" rate.

The Court also ruled that North Country's failure to publish the NCB rate was a breach of the agreement. However, Miljevich Corp. failed to prove that it suffered any damages as a result of North Country's breach of the agreement. Miljevich Corp. asserted that it suffered damages because it was overcharged interest, but the Court ruled the parties negotiated for the interest rate of NCB prime plus 1.5 percent, and the record indicated that is what Miljevich Corp. paid. Thus, Miljevich received



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the benefit of the bargain as set forth in the parties' agreement.

The Court appeared to be mostly concerned with the trial court's imposition of a "reasonable" interest rate since that decision essentially negated the parties' freedom to enter into contracts. While Miljevich Corp. suffered no damage as a result of the failure of North Country to disclose its internal prime rate, had it proved damages, the liability to North Country would have greatly outweighed any justification for not disclosing its internal prime rate to its customers.

This case can be cited as (*Miljevich Corp. v. North Country Bank & Trust*, No. 268356 (Mich. Ct. App. 08/16/07).)

**Relative Value of Alternatives Confirms Prepayment Fee Is Enforceable**

**A BORROWER'S ATTEMPT TO HAVE THE PREPAYMENT FEE UNDER A PROMISSORY NOTE DECLARED TO BE AN UNENFORCEABLE PENALTY WAS DENIED. A CIRCUIT COURT, AFTER COMPARING THE RELATIVE VALUES OF PAYING OFF THE LOAN EARLY WITH THE PREPAYMENT FEE VERSUS PAYING OFF THE LOAN PURSUANT TO ITS TERMS, RULED THAT THE NATURE OF THE CLAUSE WAS NOT PUNITIVE.**

River East Plaza LLC, a real estate developer, worked with another party to develop a large retail store. In 1999, River East purchased the other developer's share of the project for \$12.7 million. Variable Annuity Life Insurance Co. ("VALIC") provided a loan to River East to finance the purchase.

VALIC's form promissory note contained a "yield maintenance" prepayment clause, a common provision required by lenders in order to ensure that prepayment of the loan does not deprive the lender of the yield that it bargained for over the life of the loan. The promissory note contained the following formula for calculating the amount of the yield maintenance fee in the event of a prepayment: the parties would look at the outstanding principal as of the date of prepayment along with scheduled loan payments from that date to maturity. They would then determine the prevailing interest rate on United States Treasury bonds maturing closest to the loan's maturity date of January 2020. Using these three amounts, the yield maintenance clause calculated the difference between the scheduled payments and potential interest if the prepaid principal were invested in Treasuries. That amount was compared to an amount equal to one percent of the outstanding principal. The lesser of those two numbers was the yield maintenance fee. After River East's attempt to delete the yield maintenance provision from the promissory note was rejected, the parties went forward with the closing.

In July 2003, River East sold the property and prepaid the loan. There was, however, a dispute between the parties with respect to the size and enforceability of the prepayment penalty. River East ultimately paid the penalty under protest, and brought suit against VALIC. After the District Court entered judgment in favor of River East on ruling that the prepayment fee was unenforceable under Illinois law, VALIC appealed.

In performing its analysis, the 7th U.S. Circuit Court of Appeals noted that Illinois case law adopted the Restatement of Contract's prohibition against the enforcement of penalty clauses. In other words, in Illinois, certain liquidated damages clauses may be deemed by the court to be unenforceable penalty clauses rather than enforceable prepayment fees. Therefore, the question was whether the clause in the instant case was punitive in nature.

The Court explained that penalties are distinct from alternative forms of performing the obligations under the contract, and cited a comment to the Restatement, which says "a court will look to the substance of the agreement to determine whether...the parties have attempted to disguise a provision for a penalty that is unenforceable.... In determining whether a contract is one for alternative performances, the relative value of the alternatives may be decisive."

The Court noted that River East borrowed \$12.7 million from VALIC at an interest rate 8.02%. Had River East paid as scheduled, over the course of 20 years it would have paid a total of approximately \$16.4 million in interest to VALIC. When River East prepaid the loan in July 2003, the outstanding principal remained over \$12 million, and River East had to that point paid approximately \$3.45 million in interest. River East's prepayment fee was approximately \$3.9 million.

Looking at the relative value of the alternatives, the Court did not agree that VALIC used the prepayment clause to disguise a penalty that should be deemed unenforceable. The Court found that by electing to prepay the loan River East avoided paying \$13 million due between 2003 and the maturity date of the loan. In fact, the Court commented that River East had actually benefited from the prepayment despite the prepayment fee. The Court stated, "This hardly seems to be a clause

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whose "sole purpose is to secure performance of the contact," and reversed the judgment of the District Court with respect to this count of River East's complaint.

To help to ensure enforcement, a cost/benefit analysis should be conducted by a lender at the time it introduces a requirement of a prepayment fee to determine if its prepayment provisions compensate the lender for its lost interest expectation or else it could be viewed as punitive.

The case cited is *River East Plaza, L.L.C. v. The Variable Annuity Life Ins. Co.*, 498 F.3d 718 (No. 06-3856 (7th Cir. 08/22/07)).

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## Commercial Lending Group News and Notes

On March 18, 2008, Lerch, Early & Brewer will be hosting a seminar titled "Implementing Montgomery County's New Growth Policy: Issues & Answers." Speakers at the seminar will include representatives from the Montgomery County Planning Board, Montgomery County Public Schools, and other local organizations. For more information about the event and available space to attend, please contact [ekalantar@lerchearly.com](mailto:ekalantar@lerchearly.com), or simply click [here](#) for the downloadable PDF.

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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 Paddy Shakin at [ptshakin@lerchearly.com](mailto:ptshakin@lerchearly.com).

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