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OUR
PROFESSIONALS

Lawrence G. Lerman
Chair
Email
301-657-0163

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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Commercial Lending Group News and Notes**Affirmative Statements to Third Parties May Create Fiduciary Obligations**

A COURT OF APPEALS DECISION IN KANSAS DETERMINED THAT A BANK MIGHT HAVE CREATED A FIDUCIARY DUTY TO A SUBORDINATED LENDER BY PROMISING TO LOOK INTO IRREGULARITIES IN LOAN ADMINISTRATION.

Linden Place, L.L.C., owner of a residential subdivision in Kansas, contracted with Williams Building & Development Corporation for the sale of several lots in the subdivision and the construction of model homes on the lots. Williams obtained 3 loans from Stanley Bank for the purchase and construction. At the sale, Linden Place agreed to subordinate its interest in the lots to the Stanley Bank loans. Stanley Bank was aware of the subordination. The parties anticipated that once the model homes were sold,



Joel S. Aronson
Email
301-347-1276



Cindi E. Cohen
Email
301-657-0169



Arthur F. Lafionatis
Email
301-657-0731



the proceeds would be used first to repay Stanley Bank, and second to repay Linden Place for the cost of the lots. Although the notes to Stanley Bank indicated that the proceeds would be used to construct the homes, the loan proceeds were apparently diverted by Williams for other purposes. When Linden Place learned of this, it contacted Stanley Bank and was told that Stanley would investigate the matter. Two days later Linden again contacted Stanley and was told that Stanley was handling the situation. Stanley's representative told Linden's representative not to be alarmed because expenditures would be more carefully monitored in the future. When Linden again learned of the diversion of loan proceeds, it contacted Stanley a third time, this time through Stanley's president as well as through its historic point-person. For the third time Linden was told Stanley was looking into it and would report back. The following day, Linden contacted Stanley's president again and was told Stanley had no further comment and was now represented by counsel. Linden sued Stanley for breach of fiduciary duty. The court granted summary judgment in favor of Stanley. Linden appealed.

Alison W. Rind
Email
301-657-0750



The Appellate Court stated that "a fiduciary relationship exists where there has been a special confidence reposed in one who, in equity and good conscience, is bound to act in good faith and with due regard to the interests of the one reposing the confidence." Here, while there is certainly no contractual or formal relationship between Stanley and Linden, the Court found that the parties' course of dealings regarding Williams may have created a fiduciary relationship which Stanley then breached. Linden did not have access to information regarding Williams' use of Stanley Bank loan proceeds and had no way to verify any malfeasance by Williams or do anything about it. When confronted with information regarding possible malfeasance under the Stanley loan which could jeopardize its own interests, Linden contacted Stanley to inform it of the matter and make sure the situation was being handled properly. Three times Linden was informed by Stanley that Stanley would look into it and get back to Linden. More specifically, Linden was told "not to be alarmed" and that Stanley would monitor expenditures under the loan more carefully in the future. By promising to look into the situation, the Court determined that Stanley may have created a fiduciary relationship between itself and Linden and that the case should have been allowed to proceed past the summary judgment stage.

Arnold D. Spevack
Email
301-657-0749



Although it is premature to characterize this as a fiduciary relationship, banks should be careful not to make promises of this nature to other lenders or third parties, or risk similar litigation.

The case is cited as *Linden Place, LLC v. Stanley Bank*, 167 P.3d 374.

Contracts with Conflicting Obligations Not Per Se Ambiguous

DESPITE THE EXISTENCE OF AN "AS IS" PROVISION IN A CLOSING CONTRACT, A MARYLAND STATE APPELLATE COURT HELD THAT THE PURCHASER OF A RESTAURANT WAS ENTITLED TO DEDUCT FROM THE PURCHASE PRICE THE COST OF REPAIRS NEEDED TO BRING THE ESTABLISHMENT UP TO CODE BECAUSE OF A CONTRARY PROVISION IN THE ASSET PURCHASE AGREEMENT.

Vicki R. Canales
Email
301-907-2803



The Court held that while the management contract had an "as is" provision, nonetheless, the fact that the asset purchase agreement provided that the seller was liable for costs associated with making sure the restaurant was up to code at the time of closing left no ambiguity as to the responsibility of the seller therefor.

Eric Anderson, the managing member of Anderson Adventures LLC sought to purchase Fins, a restaurant owned by Sam & Murphy, Inc. On June 22, 2005, the parties entered into an asset purchase agreement, which stated that all of the restaurant's equipment was to be "purchased on an 'as is' basis without warranty... however, at the Closing of this sale, all equipment shall be in working condition and shall comply with all applicable codes and regulations."

Attached to the asset purchase agreement and signed by the parties was a restaurant management agreement which provided that Anderson would manage the restaurant for a period prior to closing. Pursuant to the management agreement, S&M represented that there was sufficient equipment in order to operate the restaurant and the management agreement stated that Eric Anderson had an opportunity to inspect the premises and was accepting it on an "as is" basis.

Jeremy I. Goldman
Email
301-657-0732

On June 27, 2005, Anderson took over management of Fins. Subsequently, the Maryland Department of Health and Mental Hygiene issued a report indicating that there were several conditions at the restaurant that violated the health code. Reacting to same, Anderson wrote a letter to S&M stating that "any and all costs incurred in order to bring these conditions into code compliance will be reduced from the selling price of the business."

On Nov. 7, 2005, S&M sold the restaurant to Anderson. At that time, Anderson declined to tender the



Shannon N. Mandel
 Email
 301-907-2815

full purchase price of the restaurant and filed a petition for the appointment of a receiver for S&M The petition stated that the approximate balance of the purchase price for Fins was \$50,000.00 and that Anderson held back \$40,000.00 for adjustments to the purchase price related to repairs made to bring the property up to code. Anderson then paid the sum of \$10,000, the amount it felt was due on the purchase price, into the registry of the court.

S&M filed pleadings stating that Anderson was not entitled to "set off" any sums due, and that it should be made to deposit the full \$50,000 into the court registry. The trial court ruled that the asset purchase agreement and the management agreement created an ambiguity concerning which party was responsible for repairs made to the restaurant after June 27, 2005. Since the rule in Maryland is that ambiguities must be construed against the drafter, and it had been Anderson that drafted the agreements, the court found that the "as is" provision in the management agreement precluded Anderson Adventures from deducting anything from the purchase price. Anderson Adventures appealed.



Michael D. Smith
 Email
 301-657-0166

Anderson Adventures contended that the court erroneously relied upon the "as is" provision in the management agreement and argued that the management agreement did not address the purchase of sale of the restaurant assets at all, but rather related solely to the interim period in which Anderson was to manage the restaurant before owning the same. Anderson maintained that the express warranties in the asset purchase agreement controlled the purchase and sale of the assets.

The Maryland Court of Special Appeals explained that "[a]mbiguity arises if, to a reasonable person, the language used is susceptible of more than one meaning or is of doubtful meaning." A contract is not ambiguous, however, merely because the parties do not agree as to its meaning, the Judge added.

The Court held that when read together, the two agreements did not create an ambiguity concerning a responsibility for the maintenance and repair of the restaurant and equipment prior to closing. First, pursuant to the management agreement, S&M was responsible for any repairs necessary to make the equipment "sufficient" for the operation of the restaurant during Anderson's management. Furthermore, under the asset purchase agreement, S&M was responsible for the repair and replacement of any equipment not in working condition or not in compliance with applicable codes and regulations at the time of closing. Therefore, the Court held that Anderson properly withheld from the purchase price the amount paid for the repairs necessary to bring the restaurant up to code. The judgment was vacated and remanded for the trial court to determine which of the disputed expenditures were for repairs.

This case serves as a reminder that when multiple agreements are drafted for a single transaction, they must be consistent so as to avoid any possibility of ambiguity.

The case cited is *Anderson Adventures, LLC v. Sam & Murphy, Inc.*, 176 MD.App. 164, 932 A.2d 1186 (No. 1343 (Md. Ct. Spec. App. 09/21/07))

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A Loan From A Shareholder To A Corporation Does Not Create Personal Liability On Its Majority Shareholder

THE FLORIDA DISTRICT COURT OF APPEALS HELD THAT THE MAJORITY SHAREHOLDER WHO WAS AN OFFICER OF A CORPORATION WAS NOT PERSONALLY LIABLE FOR A LOAN OWED BY THE CORPORATION TO ANOTHER SHAREHOLDER.

Stanley Priskie and Ralph Missry were both shareholders in EXA, Inc., a publicly traded company. Priskie asked Missry to loan EXA \$20,000.00. Missry made the loan and although there was no written documentation of the transaction, neither man disputes that there was such a loan. In May 2004, Missry filed suit against Priskie and EXA for \$20,000.00 alleging that Priskie and EXA were the same, and therefore Priskie was personally liable for the unpaid loan. The trial court awarded Missry \$25,000.00 and also found Priskie was personally liable.

The Appeals Court disagreed with the finding that Priskie was personally liable. Generally, actions taken by officers and shareholders of a corporation on the behalf of the corporation are protected by the corporate veil and no personal liability is attributed to those actions. In order to pierce the corporate veil and obtain personal liability, three factors must be shown: 1) the shareholder "dominated and controlled the corporate to such an extent that the corporation's independent existence was in fact non-existent; 2) the corporate form must have been used fraudulently or for an improper purpose; and 3) the fraudulent or improper use of the corporate form cause the injury to the claimant."

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In this case, Missry presented no evidence of improper or fraudulent conduct on the part of EXA or Priskie. There was no dispute that the funds Missry loaned were used by EXA and not for any improper personal purpose. Prior to the loan, Priskie had been personally funding EXA and the loan provided him with some relief from that financial pressure by allowing the corporation to repay some of his shareholder loans. Missry argued that Priskie planned to pay him back out of income from personal investment and such a plan proves Priskie's personal liability. The Court notes, however, that all payments made to Missry were from EXA and Priskie acknowledged that his intention was to take personal investment capital out of his personal accounts and place it in EXAs in order to issue a check from EXA. Finally, Missry argued that Priskie's actions were not authorized by EXA. The Court noted that while there was no initial corporate resolution authorizing EXA to borrow money from Missry or to make repayment, EXA's board of directors later acknowledged the issuance of checks from EXA to Missry and affirmed they were appropriately issued. This subsequent ratification was deemed to cure any improper action. As a result, the Court found that Missry failed to present evidence that would allow the court to pierce the corporate veil and hold Priskie personally liable.

Lenders should consider what potential personal liability it seeks from each major shareholder or officer when making a loan, and then require express guaranties to document this liability. In the absence of a personal guaranty, the lender must show all three above cited factors in order to pierce the corporate veil and hold an individual personally liable. Since this is often difficult to prove, the lender should review the corporate structure and be sure to require guaranties of any individuals from which it may seek personal liability.

The case above is cited as *Priskie, et. al., v. Missry*, No. 4D06-2710 (Fla. Dist. Ct. App. 07/05/07)

Tip of the Month: Pitfalls In Purchasing Loan Documents To Minimize Recordation Taxes

In Maryland and other jurisdictions, it is a common practice, when a new lender refinances an existing loan, to amend and restate the loan documents from the existing lender in order to minimize the recordation taxes. In such a case, the recordation taxes will only be based on the difference between the new loan amount and the outstanding principal balance of the existing loan.

The proper way to document a purchase of existing loan documents is to require an assignment of the loan documents and an endorsement of the promissory note payable to the new lender. While it is not necessary under Maryland law, often an assignment of the deed of trust is also recorded prior to recording the amended and restated deed of trust.

These formalities should not be taken lightly. Two lenders foreclosing on property in Ohio had their foreclosure actions dismissed because they could not prove to the court that they were the holders of the promissory notes secured by the deeds of trust being foreclosed. Apparently, the notes and loan documents were assigned to the new lender, but the lender could not produce the assignment documents or the allonge to the promissory note which contained the endorsement of the note payable to the new lender. Additionally, in these cases, the lender did not amend and restate the deed of trust so that there was no document recorded among the Land Records evidencing the new lender.

The obvious lesson is that when purchasing loan documents, the endorsement to the promissory note and the assignment of the loan documents should be handled as carefully as one would handle an original promissory note.

Commercial Lending Group News and Notes

Did you know that a financing statement naming the "XYZ Company" as a debtor when its actual legal name is "XYZ Company, Inc." will be defective and the creditor's lien will not survive a challenge by a bankruptcy trustee? Look out for a Virginia case cited in our next newsletter which discusses the issue.

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.

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 view one or more of these newsletters, you may access them through our website, www.lerchearly.com.

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

TEL: 301.986.1300 | www.lerchearly.com

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