LERCH EARLY & BREWER

# Commercial Lending Bulletin

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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:

**Borrower Forced To Sing The Blues Despite Non-Recourse Nature of Loan**
The United States District Court for Massachusetts ruled in favor of a commercial lender on its claim of breach of mortgage agreement and breach of guaranties, and imposed upon the borrower full liability despite the fact that the loan was non–recourse.

**Lender who Mislead Potential Borrower Regarding Loan Amount May Be Liable for Fraud**
The US Court of Appeals for the 3rd Circuit has determined that an apparently intentional misrepresentation of a potential loan amount is enough to allow a fraud claim to be litigated.

**Personal Jurisdiction is Proper Even If Guarantor is a Resident of Another State**
The U.S. District Court for the Northern District of Mississippi found that personal jurisdiction is appropriate where a contract is entered into and performed in Mississippi even though guarantor resided in another state.

**Legislative Alert**
Maryland adopts a tax on transfers of "Controlling Interests" in "Real Property Entities."

**Save the Date!**
Lerch, Early & Brewer will be hosting a seminar for lenders on 504 loans on Wednesday, April 16, 2008.

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## Borrower Forced To Sing The Blues Despite Non-Recourse Nature of Loan

**IN A NINE-DAY BENCH TRIAL IN SEPTEMBER 2006, THE UNITED STATES DISTRICT COURT FOR MASSACHUSETTS RULED IN FAVOR OF A COMMERCIAL LENDER ON ITS CLAIM OF BREACH OF MORTGAGE AGREEMENT AND BREACH OF GUARANTIES, AND IMPOSED UPON THE BORROWER FULL LIABILITY DESPITE THE FACT THAT THE LOAN WAS NON–RECOURSE.**

In 1999, Blue Hills Office Park LLC negotiated and closed a $33 million non-recourse mortgage loan with Credit Suisse First Boston Mortgage Capital LLC, which ultimately assigned the loan to JP Morgan Chase. The loan was personally guaranteed by William Langelier and Gerald Fineberg, and secured by

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a first trust deed on a Canton, Massachusetts office building. The terms of the loan included typical carveouts from the non-recourse provisions, covering acts such as waste, fraud and other recourse triggers.

Blue Hills subsequently defaulted on the loan by failing to make two monthly payments of principal and interest. It also failed to notify the lenders of, or to obtain prior consent for, the settlement of a zoning dispute involving a neighboring building. In fact, Blue Hills had transferred the $2 million settlement payment into an account held by the guarantors' lawyers rather than into one of its own accounts, and did not disclose the settlement or the payment to JP Morgan.

When Blue Hills requested that the lender take the missed payments from the loan reserve, the lender refused. Without giving any notice or opportunity to cure, the lender accelerated the debt, foreclosed on the property, and commenced a deficiency claim of over $10 million.

Blue Hills sued J.P. Morgan and Credit Suisse, claiming that the lenders had breached the terms of the loan, had foreclosed wrongfully and had violated the Massachusetts Consumer Protection Act, among other claims. The lenders countersued, claiming that Blue Hills and two of its principals had breached the loan contract and some of the non-recourse or "bad boy" carveouts, and had violated an implied covenant of good faith and fair dealing. The lenders also claimed that the guarantors had made intentional misrepresentations that violated Massachusetts General Laws and that Fineberg and Langelier breached the guaranty.

The District Court dismissed all of Blue Hills' claims and found in favor of the lenders. Of specific interest to borrowers and lenders, the Court ruled that Blue Hills had failed several key obligations under the loan documents: (i) Blue Hills breached its requirement to have an independent director (the Blue Hills "director" was a former secretary at one of the borrower's law firms and did not participate in the business); (ii) Blue Hills breached the mortgage agreement by not retaining the $2 million settlement but rather funneling-off said funds to beneficiaries of Fineberg and Langelier, an act deemed by the Court to be an improper transfer of the mortgaged property in violation of the mortgage agreement; and (iii) Blue Hills breached the duty not to commingle assets which occurred when the borrowers initially deposited the $2 million settlement into the account held by the guarantors' lawyers.

The Court found that the terms of the non-recourse mortgage loan were stated broadly enough that they allowed the lender to claim immediate default without requiring notice or an opportunity to cure. The language of the agreement also enabled the lender to pursue the full amount of the debt, as opposed to limiting recourse to the significantly lesser amount of damages or losses created by the specific breach.

The decision in Blue Hills makes it clear that "non-recourse" loans do not necessarily mean that lenders are without recourse. Indeed, when loan terms are written with broad carveout language, the consequence is often that lenders have broad latitude in pursuing foreclosure and seeking deficiency damages associated with defaults if a borrower or guarantor fails to comply with various non-monetary covenants.

Case cited: Blue Hills Office Park LLC v J.P. Morgan Chase Bank (477 F.Supp 2d 366 (D.Mass. 2007).

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## Lender who Mislead Potential Borrower Regarding Loan Amount May Be Liable for Fraud

**THE US COURT OF APPEALS FOR THE 3RD CIRCUIT HAS DETERMINED THAT AN APPARENTLY INTENTIONAL MISREPRESENTATION OF A POTENTIAL LOAN AMOUNT IS ENOUGH TO ALLOW A FRAUD CLAIM TO BE LITIGATED.**

In Professional Cleaning and Innovative Building Services, Inc. v. Kennedy Funding, Inc., Professional applied to Kennedy for a last-minute loan to purchase real property in Kansas City, Missouri. Professional requested a $1,800,000 loan to be collateralized by the property which was worth, by preliminary estimates, $3,100,000. During an initial conversation, Kennedy promised to loan Professional 60% of the appraised value of the property. Kennedy provided a commitment letter for an unspecified loan amount based on the "as-is market value" of the property, required a non-refundable commitment fee of $54,000 and included a limitation on damages clause limiting any potential recovery to the commitment fee. Concerned that the loan amount would not be high enough to allow them to purchase the property, Professional contacted Kennedy and pressed them for confirmation of the loan amount. Kennedy repeatedly verbally assured Professional that it would loan Professional the money it needed to purchase the property. On the basis of these representations Professional signed the commitment letter and paid the $54,000 commitment fee, as well as $21,000 in other fees. However, the actual loan amount that Kennedy subsequently offered was $1,458,000,

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far below the $1,800,000 that Professional required to purchase the property. When Kennedy refused to return the commitment fee, Professional sued for a violation of the New Jersey Consumer Fraud Act, unconscionability, breach of the covenant of good faith and fair dealing, and breach of contract.

Kennedy claimed that Professional's recovery was limited to the commitment fee of $54,000, which was not enough to qualify for jurisdiction in federal courts, and moved to dismiss the complaint. The District Court agreed with Kennedy and dismissed the complaint purely for lack of jurisdiction. However, on appeal the appellate court held that it was premature to apply the limitation of liability clause contained in the commitment letter to preclude federal jurisdiction. The Court stated that, if the litigation went forward and Professional prevailed, Professional may be allowed to aggregate the commitment fee with the other fees it had already paid pursuant to the commitment letter to meet the $75,000 federal jurisdiction threshold.

In making this determination, the Court preliminarily reviewed Professional's causes of action and determined that Professional might have a successful claim under both the New Jersey Consumer Fraud Act and common-law fraud. Here, Professional claimed that, after being verbally assured that it would receive 60% of the appraised value in loan proceeds, the loan commitment used an alternative formula referencing the "as is market value" and that, when questioned regarding this alternative formula, Kennedy assured Professional it would get the full amount of funding it needed to purchase the property. Professional alleged that Kennedy knowingly misrepresented material facts regarding the formula because, in reality, the "as is market value" discounted the appraised value by 20%, which was then further reduced by 40% to determine the loan amount. This would clearly be less than the $1,800,000 Kennedy knew Professional would need to purchase the property. Since Professional relied on these assurances and paid the commitment fee, then was offered a loan amount significantly less than it needed, the court determined that it was an abuse of discretion not to allow Professional's claims regarding fraud to proceed.

This case reminds loan officers of the dangers of over-promising. It is cited as Professional Cleaning and Innovative Building Services, Inc. v. Kennedy Funding, Inc., 2007 WL 2249064 (C.A.3 (N.J.)).

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## Personal Jurisdiction Is Proper Even If Guarantor is a Resident of Another State

**MECHANICS BANK, A MISSISSIPPI BANK, LOANED WATER VALLEY POULTRY, INC., A MISSISSIPPI CORPORATION, $700,000.00 ON JUNE 27, 2005. MATTHEW BRUNO, A CALIFORNIA RESIDENT, SIGNED A GUARANTY FOR THE LOAN TO WATER VALLEY POULTRY. BECAUSE WATER VALLEY POULTRY PAID NO PORTION OF THE PRINCIPAL OR INTEREST WHEN THE NOTE MATURED, THE BANK SUED BRUNO ON HIS GUARANTY IN THE U.S. DISTRICT COURT, NORTHERN DISTRICT OF MISSISSIPPI.**

Mechanics Bank filed a motion for summary judgment against Bruno seeking judgment for the principal, accrued interest and costs of collection. Bruno did not contest the motion for summary judgment, but filed a motion to dismiss, challenging the District Court's jurisdiction over his person. Bruno claimed that Mechanics Bank filed the lawsuit in the wrong court and that the District Court lacked the legal authority to hear the Mechanics Bank's claim against him. Mechanics Bank opposed that motion alleging that Bruno had waived any challenge to personal jurisdiction by not timely asserting the defense. The District Court agreed.

The District Court also examined whether Bruno's motion to dismiss should be denied on its merits. Mechanics Bank had argued that Mississippi's long arm statute clearly applied to Bruno and provided for jurisdiction in the state. Bruno, however, argued that California law should apply to Mechanic Bank's case.

The District Court found that it had personal jurisdiction over Bruno. Mississippi law provides that personal jurisdiction is appropriate over any individual who enters into a contract with a Mississippi resident to be performed in the state of Mississippi. Bruno was an officer and shareholder of a Mississippi corporation who traveled to Mississippi to engage in negotiations with a Mississippi bank for that corporation. Bruno also signed a guaranty for the loan that resulted from those negotiations and Bruno should have reasonably foreseen and anticipated being brought before some court in Mississippi if the corporation failed to pay the note.

Accordingly, the District Court denied Bruno's motion to dismiss and granted Mechanics Bank's motion for summary judgment.

While it will not likely deter a borrower or guarantor from defending a lawsuit on the grounds that the court lacks jurisdiction to hear the Bank's case, the note and guaranty should include a provision that

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

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the parties consent to the jurisdiction of specified courts should a dispute arise between the parties.

This case is cited as Mechanics Bank v. Bruno, No. 3:06CV102-JAD (N.D. Miss 09/13/2007).

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## Legislative Alert

In Maryland, real estate investors have been able to transfer ownership of real property without paying transfer taxes by selling the membership interests, limited partnership interests or stock in the entity that owns the real estate taxes. Effective July 1, 2008, all transfers of a controlling interest in an entity that primarily owns Maryland real estate will be taxable to the same extent that a real estate transfer by deed is taxable. The definitions and regulations as to what constitutes a controlling interest in an entity and what constitutes a real property entity are very broad and complex and will be the topic of a future article or seminar once the regulations are finalized. In the meantime, if any of your borrowers are structuring a purchase of real estate as a purchase of membership interest to avoid transfer taxes, advise them that the transaction must be fully closed on or before June 30, 2008 in order to avoid the imposition of transfer taxes.

For further information about the new Maryland tax on transfers of controlling interests, please contact **Larry Lerman**.

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## Save the Date!

**On Wednesday, April 16, Arnie Spevack, Alison Rind, and Joel Aronson will present a breakfast seminar for lenders on 504 loans.  This seminar is ideal for lenders who may have questions or want to learn more about the 504 loan program and 504 workout/foreclosure processes.  Be sure to watch for an official invitation in your email inbox during the coming weeks, or contact Eby Kalantar at ekalantar@lerchearly.com for more details.**

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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**.

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**.

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