FRANDZEL

QUARTERLY PROPHETS

LEGAL TRENDS & DEVELOPMENTS AFFECTING THE FINANCIAL AND BUSINESS COMMUNITIES

FALL 2015| VOL. 9, NO. 2

EDITOR'S INTRODUCTION In August 2015, after more than three and a half decades located in the Mid-Wilshire/Beverly Hills area, the firm is excited to announce that it has moved its headquarters to brand new office space in downtown Los Angeles. As downtown continues to reinvent itself, we believe that this is the place to be. We hope that you will come by and visit soon.

Not to be outdone, Quarterly Prophets is likewise excited to unveil its new look and feel. This edition includes articles authored by both transactional and litigation professionals on diverse business and finance issues, including ADA compliance at bank branches, the potential consequences of financing statement termination errors by lenders, and how to handle borrowers who argue that default rate interest is excessive and unreasonable.

SIMPLE MISTAKES

Can mean big consequences

By LOREN R. GORDON

Sophisticated professionals working in banking and other financial industries are accustomed to the demands, stresses and pressures that often accompany positions dealing with big dollars. However, in the fog of war, it is easy to overlook something that on its face bears little import, but in reality is of material significance, and within these industries, a simple oversight can be catastrophic. Such was the case for JPMorgan Chase Bank, N.A. (JPMorgan or the Bank) when the bank and its legal counsel failed to recognize that they were authorizing the filing of a UCC-3 termination with the effect of terminating the bank's security interests for a $1.5 billion credit facility. There is much to learn from their story.

In 2001, General Motors (GM) obtained approximately $300 million in financing from a syndicate of lenders, including JPMorgan (the "Synthetic Lease Financing"). The Synthetic Lease Financing was secured by liens on multiple pieces of real estate. JPMorgan served as administrative agent for the Synthetic Lease Financing. UCC-1 financing statements were filed identifying JPMorgan as the secured party.

In 2006, GM obtained a term loan for approximately $1.5 billion (Term Loan) from JPMorgan, acting again as administrative agent for a different syndicate of lenders. The Term Loan and the Synthetic Lease Financing were two separate credit facilities and had no relation to one another, except that both involved GM and JPMorgan. The Term Loan was secured by a large number of GM's assets, including all of GM's equipment and fixtures at

Please turn to Page 6

Inside this issue

Don’t let borrower blather bamboozle you about default interest

By MICHAEL GERARD FLETCHER and CHRISTOPHER D. CROWELL

Trends in commercial lending come and go. A current trend is for borrowers in default to claim that default interest charged by their lenders is unreasonable and should be reduced or eliminated entirely. These arguments presuppose that default interest clauses in loan documents are subject to scrutiny as liquidated damages provisions. (Liquidated damages are damages whose amount the parties designate in their contract as compensation for a specific breach, thus saving both parties the difficulty and expense of calculating and proving actual damages upon such breach.) The presupposition is, however, false. Established jurisprudence does not consider default interest to be liquidated damages, thereby undermining such borrower claims. As such, there is no good reason for lenders to engage in a debate with defaulted borrowers about the reasonableness of default rate interest.

In California, generally speaking, "a provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made." Cal. Civ. Code § 1671(b). "A liquidated damages clause will generally be considered unreasonable, and hence unenforceable under section 1671(b), if it bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach" at the time they entered into the contract. *Ridgley v. Topa Thrift & Loan Assn.*, 17 Cal. 4th 970, 977 (1998).

The debtor trying to wriggle free from default interest wants to provoke a discussion about quantifying something that is inherently difficult to quantify: namely, the lender’s costs from a loan default. The issue is not that those costs are not real; they undoubtedly are. There are the costs of maintaining workout and special assets departments staffed with specialized personnel; there are costs associated with additional regulatory scrutiny; and there are risks to an institution’s capital and cash flow reflected in charge offs, loan loss reserves, and loans on non-accrual status.

But attempting to quantify those costs for a particular loan (to establish that the loan’s default interest provision represents a reasonable approximation of damages when the loan was made) can devolve into a costly and unpredictable battle involving interest rate and banking industry experts, with someone in a black robe charged with sorting through the competing testimony and deciding whether this or that particular interest rate is or is not reasonable.

Fortunately, there is a better way. Borrowers in default never want to talk about what the law in California regarding default interest actually is, it being infinitely easier simply to assume that the law of liquidated damages applies and assert that the default interest provision is unreasonable. Lenders on the other side of disputes regarding default interest, however, need to be aware of an often overlooked and forgotten case. True, *Thompson v. Gorner,* 104 Cal. 168 (1894), was decided by the California Supreme Court 121 years ago. But, 121 years ago, the California Supreme Court, came to a conclusion that a provision for default interest on an obligation that is fully due and payable is not a liquidated damages provision.

According to *Thompson*, default interest provisions simply represent an alternative course of performance under the contract. In

---

Michael Gerard Fletcher’s practice emphasizes commercial, real estate, and bankruptcy litigation; major debt workout negotiations and restructuring, and documentation of commercial, personal property and real estate-secured, and construction credits.

Christopher D. Crowell’s practice focuses on bankruptcy law. He has substantial experience representing secured and unsecured creditors, trustees, lessors and lessees, debtors and asset purchasers in all aspects of bankruptcy cases and related proceedings.

other words, default interest provisions give the borrower a choice: repay the obligation when due or be liable for the specified higher rate of interest. While treating default interest in this manner may seem odd at first blush, *Thompson* is grounded on a bedrock principle of Anglo-American contract law.

That principle is that there is no moral approbation for defaulting on a contract; choosing to perform does not make one a good person, and choosing to breach does not make one a bad person. Instead, each party to a contract at all times has the option to perform or to breach and accept the consequences. Thus, in *Thompson*, the California Supreme Court put the onus where it clearly belongs: on the borrower in default, by indicating that the borrower had simply made a choice of alternative performance under the contract, and was therefore liable for default interest.

While treating default interest in this manner may seem odd at first blush, *Thompson* is grounded on a bedrock principle of Anglo-American contract law.

This might seem like a quaint and antiquated way of looking at the world, one that is better left to the sensibilities of people alive in 1894, but one would be wrong to come to that conclusion. Seventy-nine years after announcing the *Thompson* rule, the California Supreme Court in *Garrett v. Coast & Southern Fed. Sav. & Loan Assn.,* 9 Cal. 3d 731 (1973), affirmed that *Thompson* is still good law. At issue in *Garrett* was the validity of a provision assessing late charges on loan installment payments calculated as a percentage of the entire unpaid loan balance. *Garrett* distinguished the late charges from the default interest at issue in *Thompson*, held that the late charges were liquidated damages, and invalidated them as unreasonable.

The Supreme Court in *Garrett* could have swept *Thompson* away as an outdated way of looking at the world. Instead, the Supreme Court doubled down on *Thompson*. The Court upheld the notion that default interest on a fully matured loan obligation was not liquidated damages but rather, in the words of *Thompson*, simply an alternative means of performing under the contract.

Thus, as far as the California Supreme Court is concerned, there is a huge distinction between imposition of a higher default interest rate on a matured loan obligation and the assessment of charges for the failure to make timely loan installment payments. California courts will view the latter as liquidated damages and focus on whether they represent a reasonable estimation of the lender's damages viewed from the time of loan origination. By contrast, there should be no need to defend a decision to implement default interest on a matured loan obligation under notions of reasonableness, since the law of liquidated damages does not apply.

What, then, should one do? One of the first steps in dealing with any defaulted loan is to perform a thorough and complete review of the underlying loan documents to determine what they say about defaults and default interest. What are the enumerated events of default? Is the imposition of default interest immediate and automatic upon default or only at the option of the lender? Are there notice or cure provisions to satisfy before default interest may be implemented?

Next, consider giving written notice of the default or defaults even if the loan documents do not expressly require such notice. The notice can simply recite the existence of the defaults and the fact that the default has resulted in the acceleration of the entire loan balance (assuming the loan documents provide for same). Setting a deadline for payment in full in the notice is good practice even if there is no applicable cure period in the loan documents. (Of course, there are times when emergency situations and threats to collateral prevent setting such deadlines and require immediate legal action.) The goal is to move the obligation as rapidly as possible to being fully matured, either because it has matured by its terms or because there has been a properly-noticed acceleration of the maturity date, so as to avoid having to defend post-maturity default interest under the rubric of liquidated damages.

Conclusion

Don't be bamboozled by blather from your defaulted borrowers about default interest. Lenders in California have rock-solid claims for the recovery of post-maturity default interest without having to engage in any discussion about whether the default interest rate is or is not "reasonable." There are default interest rates that could be so high as to be unconscionable but that is a vastly different proposition than whether an interest rate represents a reasonable estimate of a lender's costs and expenses resulting from a borrower's default.

No stone unturned: Bank branches and ADA compliance

By **LAWRENCE S. GROSBERG and TRICIA L. LEGITTINO**

Living in the litigious time that we do, we have all become defensive in our day-to-day business. In an effort to ward off lawsuits, banks have become more sophisticated in their policies and procedures. However, in this frenzy to make sure they are as bullet proof as possible, banks seem to be ignoring their compliance with the American with Disabilities Act (ADA) at both the branch and corporate levels. The recent increase in the number of lawsuits against banks for non-compliance with even the most fundamental ADA requirements is startling. More and more banks are being sued for various violations of the ADA Accessibility Guidelines (ADAAG) and Title 24 of the California Code of Regulations, including, but not limited to suits based on a lack of handicapped van accessible parking, lack of curb breaks and access ramps, inadequately marked parking spaces and insufficient handicapped access to ATM machines. While the ADAAG requirements can be daunting, the failure to make branches ADA compliant for both customers and employees can result in multiple lawsuits. This article will address some of the key areas that have arisen in ADA-related bank cases in recent years.

ATM machines

At least one ATM per location must be ADA accessible. If there are ATMs inside and outside the bank, each is considered to be a different location and there must be at least one accessible ATM inside and outside. Accessible ATMs must have voice guidance and must include Braille instructions that explain how to initiate voice instructions. Failure to follow federal and state guidelines have resulted in the filing of lawsuits across the country. How then, can a bank avoid these problems? Usually, the first step toward a full compliance strategy is to develop a realistic timeline to assess and correct violations. Banks may decide to survey a number of locations to identify necessary renovations. Once the survey is completed, renovations should then be undertaken to comply with ADA regulations for those particular sites. This process should be repeated until all branches are fully compliant. This pro-active approach is far better than a reactive strategy which leaves the bank open to court awarded damages and/or expensive settlements.

Parking lots

One of the major compliance issues facing banks are the ADA parking requirements. Under the 2010 ADA standards for accessible parking, ADA parking spaces must be at least eight feet wide. Access aisles must be at least five feet wide, and marked (painted) with hash marks. Additionally, accessible parking spaces must be identified by signs that include the International Symbol of Accessibility. The amount of accessible and van accessible parking spaces is determined by the total number of spaces present at each parking lot.

Vending machines

For those banks that provide vending machines for their employees there are other ADA requirements. The newest ADA standards, effective March 15, 2012, require the reach range to be no higher than forty-eight inches, and no lower than fifteen inches.

Compliance strategies

The best way to make sure a bank is in compliance with federal and state ADA requirements is to have an inspection by a Certified Access Specialist (CASp). During the 2007-08 legislative session, the California Chamber of Commerce and other business groups worked with legislators to enact SB1608 which designed to promote and increase compliance with ADA laws. The major provisions of that legislation became effective in 2009. The centerpiece of SB1608 is the

---

Lawrence S. Grosberg is a shareholder with the firm and specializes in employment law, business law and business litigation.

Tricia L. Legittino is a partner of the firm and one of the firm's lead trial lawyers. She has represented brokers and individual investors in securities litigation as well as representing lenders and businesses in commercial litigation.

creation of the Certified Access program. A CASp is a person who has been tested and certified by the state as an expert in disability access laws. SB1608 sets up a process whereby business owners, including banks, could voluntarily hire a CASp to inspect their buildings and property to ensure compliance with disability standards and obtain an inspection report as proof they did so.

If the access specialist determines that corrections are needed in order for the site to be brought into full compliance and the corrections are then made, the bank is entitled to a confidential written report identifying changes that needed to be made, and which were in fact, made. Once the work has been completed the bank should keep the confidential inspection report in a safe place because if the bank is ever sued they must have a CASp inspection report to be eligible to request a 90-day stay of a lawsuit and an Early Evaluation Conference (EEC). If the bank does not have a report, they are barred from this benefit. The EEC is a court-run conference between the parties, at which both parties have an opportunity to explore whether the lawsuit can be avoided

Banks whose structures and premises have received an inspection report by a CASp may request a sign (Disability Access Inspection Certificate) signifying that they have been CASp inspected. The window sign will send a message that the bank has taken proactive steps to comply with the disability access laws and thus will be less likely to be targeted by lawyers seeking to earn quick money. The importance of SB1608 is also illustrated by the fact that that it helps ensure that damages may be claimed only when the plaintiff personally encounters a violation or was deterred from gaining access on a particular occasion. SB1608 clarifies the fact that a denial of full and equal access to a facility constitutes only one violation per distinct facility for purposes of damage, and that damages could not be recovered for each and every offense that may have existed at a particular facility.

Usually, the first step toward a full compliance strategy is to develop a realistic timeline to assess and correct violations

In addition, SB1608 makes it clear that a plaintiff cannot recover for violations that may have existed at a facility but which never caused harm or injury to the plaintiff, either in the form of an encounter or deterrence on a particular occasion. SB1608 also states that a court could consider, among other relevant factors, reasonable written settlement offers made and rejected by either party in determining the amount of attorney's fees that could be awarded at the conclusion of the case.

In summary, by having a CASp inspection of the bank's branches now and correcting deficiencies before litigation is commenced, banks will save not only on legal fees, but will also reduce the risk of negative publicity and brand damage that noncompliance with ADA requirements can cause.

FRANDZEL

QUARTERLY PROPHETS

IS A NEWSLETTER PUBLISHED BY FRANDZEL, ROBINS, BLOOM & CSATO, LC
1000 Wilshire Boulevard, 19th Floor, Los Angeles, Calif. 90017-2427

Phone:	(323) 852-1000
Facsimile:	(323) 651-2577
Executive editor	Patricia Y. Trendacosta
Managing editor	Bob Benjy

Please email additions or changes to the Quarterly Prophets mailing list to epang@frandzel.com.

Simple mistake, big consequences

Continued from Page 1

forty-two facilities throughout the United States.

In 2008, GM advised its counsel that it intended to pay off the Synthetic Lease Financing, and GM requested that its counsel begin preparing the documentation necessary to terminate the same. In connection with documenting the termination, a paralegal who was unfamiliar with the transaction or the purpose of the termination was tasked with performing a search for UCC-1 financing statements that had been filed against GM. The paralegal's search disclosed three UCC-1 financing statements filed in the State of Delaware; the first two related to the Synthetic Lease Financing, but the third related to the $1.5 billion Term Loan. The paralegal prepared UCC-3 Termination Statements for all three UCC-1 financing statements, which were then ultimately circulated to JPMorgan for review and approval. Neither the paralegal nor anyone else representing GM, or for that matter, JPMorgan, realized that only the first two of the UCC-1s were related to the Synthetic Lease Financing, and that the third related instead to the Term Loan.

JPMorgan's counsel apparently approved the UCC-3 termination statements and authorized their filing through his e-mail communications approving the Synthetic Lease Financing termination documents, and by joining in an escrow instruction whereby GM and JPMorgan, among others, authorized the escrow company handling the payoff and termination of the Synthetic Lease Financing to deliver the UCC-3 termination statements to GM's counsel for filing once the payoff was made by GM. Ultimately, GM made the payoff and its counsel filed all three UCC-3 termination statements.

It was not until GM filed for bankruptcy in 2009 that anyone realized a mistake had occurred. JPMorgan later notified the Committee of Unsecured Creditors in GM's bankruptcy (Committee) that the UCC-3 termination statement for the Term Loan had been filed inadvertently, and that it had intended to terminate only liens related to the Synthetic Lease Financing. Shortly thereafter, the Committee filed an adversary action against JPMorgan in bankruptcy court asking for the court's determination that, notwithstanding that JPMorgan did not intend to terminate its security interest for the Term Loan, the UCC-3 termination statement is nonetheless effective because JPMorgan had authorized its filing. The Committee and JPMorgan both moved for summary judgment, and the Bankruptcy Court granted summary judgment in favor of JPMorgan, holding that "a filed record is effective only to the extent its filing is authorized…" and "JPMorgan did not grant actual authority to terminate the…Term Loan UCC-1." *Official Comm. of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank, N.A. (In re Motors Liquidation Co.),* 486 B.R. 596, at 620 and 623 (Bankr.S.D.N.Y 2013).

The Committee appealed to the United States Court of Appeals for the Second Circuit (Court of Appeals). The Court of Appeals opinion states "presents two closely related questions. First, what precisely must a secured lender of record authorize for a UCC-3 termination statement to be effective: 'Must the secured lender authorize the termination of the particular security interest that the UCC-3 identifies for termination, or is it enough that the secured lender authorize the act of filing a UCC-3 statement that has that effect?' Second, '[d]id JPMorgan grant to [GM's counsel] the relevant authority—that is, alternatively, authority either to terminate the [ ] Term Loan UCC-1 or to file the UCC-3 statement that identified that interest for termination?' ." *Official Comm. of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank, N.A. (In re: Motors Liquidation Co.),* 777 F.3d 100, 104 (2d Cir. 2015) (internal citations omitted).

The Court of Appeals certified the first question to the Delaware Supreme Court, since it involved an issue of first impression and presented a significant issue of Delaware state law. The Delaware Supreme Court answered that "if the secured party of record authorizes the filing of a UCC-3 termination statement, then that filing is effective regardless of whether the secured party subjectively intends or understands the effect of that filing." *Id.* at 104. Accepting the Delaware Supreme Court's answer as to the first question, the Court of Appeals turned to the second question and found that "JPMorgan and [their counsel's] repeated manifestations to [GM's counsel] show that JP Morgan and its counsel knew that, upon the closing of the Synthetic Lease

Loren R. Gordon's practice emphasizes major debt workout negotiations, restructuring, real estate-secured credits, and construction credits, as well as loan and real property sales.

transaction, [GM's counsel] was going to file the termination statement that identified the Term Loan UCC-1 for termination and that JPMorgan reviewed and assented to the filing of that statement. Nothing more is needed." *Id.* at 105. As such, Court of Appeals reversed the bankruptcy court's summary judgment for JPMorgan and instructed that partial summary judgment be entered in favor of the Committee. *Id.*

The nature of the financial services industry is such that one cannot give an approval or an authorization and not fully read and understand what it is they have approved or authorized. On this issue, Delaware Supreme Court stated that "[t]he secured party is the master of its own termination statement; it works no unfairness to expect the secured party to review a termination statement carefully and only file the statement once it is sure the statement is correct. If parties could be relieved from the legal consequences of their mistaken filings, they would have little incentive to ensure the accuracy of the information contained in their UCC filings." *Official Comm. of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank, N.A.,* 103 A.3d 1010, 1016 (Del. S. Ct. 2015).

The filing of a UCC-3 termination statement for the $1.5 Billion Term Loan in the JPMorgan case could have been easily avoided if the attorneys and parties on either side had taken a few minutes to review the original UCC-1 financing statement being terminated, or noted that the filing number of the original UCC-1 financing statement referenced in the UCC-3 termination statement indicated that it had been filed in 2006 (five years after the Synthetic Lease Financing closed). To error is human. However, the JPMorgan case stands for the proposition that it does not matter what you intended to do; it only matters what you did. This is a harsh reality, but one that in the end provides more security for those transacting in commerce and relying upon the validity of financing statements and other filed documents, and it is a reminder that care and attention should be paid to every aspect of a financial transaction, because you never know what might happen if something slips through the cracks.

Names in the news

THOMAS M. ROBINS III was a panelist on the sham guaranty doctrine at the SAMA Conference in La Jolla.

STEVEN N. BLOOM has been selected to serve as chair of the Financial Institutions Committee of the Business Law Section of the State Bar of California. In addition, he has been selected as chair of the 2016 Evening to Foster Dreams for CASA of Los Angeles.

ANDREW K. ALPER spoke at the National Equipment Finance Assn. Conference on October 9, 2015, regarding new developments in bankruptcy. In addition, he was recently named one of the 25 most influential lawyers in the equipment finance and leasing industry by the *Leasing News*. Mr. Alper has also been appointed to the Equipment Leasing and Finance Association's Legal Committee.

CRAIG A. WELIN chaired the 4th Annual Educational Summit for Asset Managers in CMBS Special Servicing and Bank Special Assets Departments, put on by CRE Finance Council's High Yield Distressed Realty Assets group in Dallas. Mr. Welin was also a panelist on a restructuring case study panel for the CREFC High Yield Distressed Realty Assets group's East Coast Conference in New York City.

LOREN R. GORDON has been selected to serve as co-vice chair of the Commercial Transactions Committee of the Business Law Section of the State Bar of California.

BRIAN BLOOM has been admitted to the Commercial Transactions Committee of the Business Law Section of the State Bar.

EMAIL DIRECTORY | username@frandzel.com

Andrew K. Alper	aalper
Marshall J. August	maugust
Brad R. Becker	bbecker
Bob Benjy	bbenjy
Brian Bloom	bbloom
Steven N. Bloom	sbloom
Christopher D. Crowell	ccrowell
Peter Csato	pcsato
Michael G. Fletcher	mfletcher
Hal D. Goldflam	hgoldflam
Loren R. Gordon	lgordon
Lawrence S. Grosberg	lgrosberg
Tricia L. Legittino	tlegittino
Hemal K. Master	hmaster
Albert Moon	amoon
Bruce D. Poltrock	bpoltrock
Carol A. Robertson	crobertson
Thomas M. Robins III	trobins
Damon Rubin	drubin
Kenneth N. Russak	krussak
Stephen M. Skacevic	sskacevic
Patricia Y. Trendacosta	ptrendacosta
Reed Waddell	rwaddell
Craig A. Welin	cwelin

FRANDZEL
QUARTERLY PROPHETS

LEGAL NEWSLETTER
Frandzel Robins Bloom & Csato, L.C.
1000 Wilshire Boulevard, 19th Floor
Los Angeles, Calif. 90017-2427
(323) 852-1000

Presort Std.
U.S. Postage
PAID
Permit #1
Ontario, CA