

Verdicts & Settlements

Subdivision developer sued after defaulting on loans

\$20.3 million award

In 2001, a developer sought financing for a 291-acre parcel of land on which he proposed to develop an 18-hole golf course and a large residential subdivision. As several of the required permits for the project had not issued, conventional bank financing was not feasible.

Through an intermediary, the developer was introduced to representatives of a private equity group about a short-term loan to begin the development process. After much negotiation, a closing on the loan was held in August 2001. The developer, through a newly formed entity, agreed to borrow \$6.7 million from a limited partnership and affiliate of the equity group. The loan term was 12 months and the interest rate set at 21 percent, compounded monthly to reflect the substantial risk associated with the loan. The loan also featured additional interest components.

Months before the loan closing, the limited partnership filed a usury notification form with the Attorney General's Office in compliance with G.L.c. 271, §49(d). Due to an administrative oversight, the usury notice was filed several business days before the limited partnership was legally formed with the secretary of state. In addition, where the limited partnership did not possess its own bank account, the loan was funded by a second limited partnership pursuant to an intra-corporate loan arrangement.

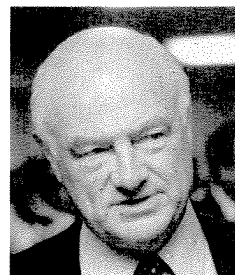
At the maturity date, the borrower failed to tender payment and a default notice is-

sued. Through counsel, the parties negotiated a forbearance agreement whereby the borrower provided a broad and comprehensive release to the lender. In 2003, and after a subsequent default, the limited partnership agreed to loan the entity an additional \$3.3 million to fund certain construction at the project. The original term promissory note was amended to reflect the additional loan amount.

Construction finally commenced, and by October 2004 the borrower had paid off \$4.8 million pursuant to the \$10 million principal loan amount owed. By this time, the developer required an additional \$6 million in financing to construct the golf course. The developer ultimately obtained financing for the golf course through a bank, although the loan was contingent on the limited partnership subordinating its first mortgage position to and the equity group guaranteeing the bank loan. In connection with the loan closing, the borrower provided the limited partnership with another full release.

After further construction delays, the entity and the developer fell into default of both the limited partnership and bank loans, and default notices issued. Thereafter, the parties again negotiated and executed a forbearance agreement, which again provided broad and comprehensive release language.

The developer failed to live up to the terms of the forbearance terms, and a further default was declared. Ultimately, the limited partnership filed suit and conducted a foreclosure sale at the property. The bor-



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rower defended the action (and asserted substantial third-party claims and counter-claims) alleging violations of the usury statute, fraud, "lender liability," violations of G.L.c. 93A, breach of the covenant of good faith and fair dealing, and wrongful foreclosure for alleged misconduct occurring both before and after the execution of the various releases.

The third-party claims included allegations that many of the people, entities and limited partners associated with the equity group were required to file usury notification forms in compliance with G.L.c. 271, §49(d), given their indirect participation in the underlying, usurious loans.

In addition, the borrower specifically contended that, because the money utilized to fund the loan was not advanced directly by the limited partnership to the borrowers, the limited partnership was required to file a usury notification form. The developer and entity also argued that because the limited partnership had filed its usury notice before its formal formation, the limited partnership's usury notification was defective and invalid. The developer and entity contended that the releases were procured

through fraud and were inadequate to release a usury claim.

In its findings of fact and conclusions of the law, the court rejected the developer and entity's usury defense. In particular, the court found that the limited partnership was the entity's lender, despite the fact that the funds technically did not flow from the limited partnership to the entity. The court found that individuals and entities that had indirectly participated in the loan were not required to file usury notices. The court also found insufficient evidence to pierce the corporate veil based on the limited partnership's lack of a bank account.

The court also concluded that, although the limited partnership's formation documents were not filed with the secretary of state until a few days following its usury filing, the usury filing had been adopted and ratified by the limited partnership. Moreover, the court found that the limited partnership's usury filing was consistent

with the usury statute's remedial purpose, which provides safe harbor to those who notify the attorney general of a usurious loan prior to the advancement of loan funds.

The court also upheld the validity of the release language contained within the forbearance agreements. This ruling supplemented a prior decision made in connection with pretrial proceedings, which held that a party could not, as a matter of public policy, release a usury claim.

The court rejected each of the borrower's defenses and claims, including its wrongful foreclosure claim, which contended that the lender was required to disclose to potential bidders at the foreclosure sale the existence of unrecorded, junior purchase and sale agreements for parcels of land within the subdivision.

In rejecting each claim and finding that the lender had not defrauded the borrower or breached the covenant of good faith

and fair dealing, the court enforced the promissory notes according to their terms and awarded the limited partnership damages in the amount of \$20.7 million, including an award of \$389,647 in legal fees.

Type of action: Contract

Injuries alleged: Breach of contract

Name of case: LR5-A Limited Partnership v. Meadow Creek, et al.

Court/case no.: Superior Court, No. 2006-2804-BLS1

Tried before judge or jury: Judge

Name of judge: Ralph D. Gants

Amount of award: \$20.3 million

Date: Jan. 16, 2009

Attorneys: David H. Rich and J. Owen Todd, Todd & Weld, Boston (for the plaintiff)