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## ARTICLES

### REVIEW AND NEGOTIATION OF THE MORTGAGE LOAN COMMITMENT - PRACTICAL STANDARDS

E. Richard Alhadeff \*

#### I. INTRODUCTION

Commitment letters, agreements to lend money, have become increasingly important as courts begin to hold the parties bound by these letters' terms. The impact of this trend was vividly illustrated in a recent Missouri case in which the lender was found to have breached the terms of a commitment letter, which damaged the borrower in the amount of \$70,000,000.

In light of the possible liability of substantial damages, lenders, as well as borrowers, would be well-advised to treat the negotiation of the commitment letter as critical to the loan transaction.

#### II. A COMMITMENT LETTER AS A FORM OF CONTRACT

A commitment letter is an agreement between two parties, in which one party (the "lender") agrees to loan money to the other (the "borrower"), and the borrower agrees to accept the money from the lender. A commitment letter was once considered an unenforceable statement of an intent to lend money. However, in recent years, courts have begun to recognize that these preliminary loan agreements could actually be binding and enforceable since they contain all of the characteristics of a contract.

In response, many lenders now employ highly detailed and sophisticated commitment letters. Some of the factors to be considered in determining whether the parties have entered into an enforceable agreement are:

- (i) Did the borrower pay a commitment fee?
- (ii) Did the parties manifest an intent to be bound? In this agreement, the specific language used by the parties in the letter is critical. Phrases such as "shall become a binding agreement" and "attached is an executed copy" in preliminary agreements, have been viewed

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as evidence of intent to be bound. A contrasting intent is shown when a party expressly reserves its right to be bound "only upon execution" or "only upon receipt of acceptance."

- (iii) Did the parties agree upon all of the most important economic items and other significant legal issues? For example, was the interest rate "locked in" when the parties entered into the agreement?

In the early stages of the lending industry, many commitments were so-called unilateral contracts that compelled the lender to lend but gave the borrower the right to borrow or lose its commitment fee as the sole remedy. Commitment letters were usually drafted unilaterally. However, as the loans became more complicated, the commitment letters became more bilateral, i.e., the borrower had to borrow as much money as the lender had to lend under the commitment letter.

Some of the factors that have led to the more expansive and complete commitment letter include:

- (i) the increasing complexity of loan transactions;
- (ii) the growing complexity of financed projects. More multi-use and complex-use projects are being developed, requiring greater sophistication in the lending portion of the transaction;
- (iii) during periods of declining interest rates, borrowers are more likely to dishonor their commitment while the lender still desires to enforce the borrower's commitment;
- (iv) commitment fees are no longer nominal. Both parties are therefore under extreme pressure to negotiate the provisions relating to payment and return of the commitment fee; and
- (v) the trend towards greater specificity in the commitment letter to avoid future litigation over provisions not expressed.

Now, with the advent of the complex and complete commitment letter, it has become quite difficult to determine individual fault and each party's underlying motives for the failure when the borrower and lender fail to close a loan.

### III. LITIGATION INVOLVING COMMITMENT LETTERS

The following Florida decisions discuss the circumstances in which the lender and/or the borrower are legally bound to a commitment letter's provisions.

### A. Commitment Fees

Many cases have discussed the nature of the commitment fee and the circumstances in which a lender is entitled to retain the fee if the loan fails to close through no fault of the lender.

In *First Federal Savings and Loan Association of the Palm Beaches v. Sailboat Key, Inc.*,<sup>1</sup> the borrower paid \$70,000 to First Federal Savings and Loan Association of the Palm Beaches as a standby fee for a commitment to provide permanent financing for end loans for a condominium project. The Fourth District Court of Appeal described a series of letters commencing with one dated December 14, 1972, containing the following admonition: “[t]his letter shall not be construed as a firm commitment by the Lender and the parties acknowledge that there shall be no firm commitment until such time as the Lender and the developer enter into a firm mortgage agreement in connection with the above referred to project.”<sup>2</sup> The series of letters concluded with a letter dated December 18, 1973, confirming that the commitment was in full force and effect and accepting the \$70,000 standby fee originally sent to it on September 12th. Since the construction loan never closed, the lender never closed on any of the contemplated mortgage loans. Several years later, the borrower filed suit to recover the standby fee, alleging that it never received a firm mortgage commitment, which was a precondition to the effectiveness of the December 14, 1972 letter. The court concluded that the correspondence taken in its entirety could constitute a firm commitment obligating the lender to make the loan and further stipulated that the lender should have set aside enough funds to meet its commitments. Therefore, the court concluded that the lender was entitled to keep its standby fee.

In *Brighton Dev. Corp. v. Barnett Bank of South Florida, N.A.*,<sup>3</sup> the borrower, who had entered into a loan commitment, sued to recover its \$171,000 commitment fee. The agreement between the parties stated that the lender would loan the borrower the funds if certain conditions were met. Specifically, the commitment required the lender to reserve the loan amount for sixty days, after the borrower paid a non-refundable commitment fee. The lender was also required to prepare the loan documents, and the borrower was to return the documents within the sixty-day period. However, the borrower

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<sup>1</sup> 375 So.2d 625 (Fla. 4th DCA 1979), *cert. denied*, 386 So.2d 641 (Fla. 1980).

<sup>2</sup> *Id.* at 626.

<sup>3</sup> 513 So.2d 1103 (Fla. 2d DCA 1987).

could not complete its performance within the sixty days and asked for a one-day extension, which the lender declined. The lender ultimately refused to lend the money and refused to return the commitment fee. The Second District Court of Appeal held that the lender performed its part of the obligation by holding the loan amount for sixty days and by delivering the loan documents to the borrower in a timely fashion. Since the lender did not breach the contract, it was entitled to retain the non-refundable commitment fee.

### *B. Conditions of the Commitment Letter*

Failure to comply with the conditions of the commitment are grounds for the lender to refuse to fund a committed loan. However, problems may arise when the borrower believes that one of the conditions that the lender claims has not been met, was ambiguous.

This situation arose in *Thunderbird, Ltd. v. First Federal Sav. and Loan Ass'n of Jacksonville*.<sup>4</sup> The borrower brought an action against the lender claiming that the lender breached its agreement to participate in funding a loan to the borrower for the purchase and renovation of a resort hotel. The loan commitment specifically stated that the lender would provide a mortgage loan upon satisfaction of certain conditions contained in the commitment, one of which was that the real property "shall have consistently over the preceding four (4) month period generated sufficient income to pay when due all operating expenses, accruals, and other liabilities, with sufficient excess to service the debt herein contemplated."<sup>5</sup>

The borrower's financial statements reflected that it had generated a profit in the months of December, February and March, but a loss in the intervening month of January. The lender took the position that the commitment required a positive cash flow in each of the four months for which financial information was furnished, and refused to close the loan.

The Eleventh Circuit held that the plain meaning of the word "consistently" meant a positive cash flow in each of the four preceding months and therefore, the lender had no obligation to make the loan.

Similarly in *Anuhco, Inc. v. Westinghouse Credit Corp.*,<sup>6</sup> the lender and borrower signed a commitment letter for a loan of \$65,000,000, if twelve "special conditions" were satisfied by the borrower, to the lender's satisfaction.

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<sup>4</sup> 908 F.2d 787 (11th Cir. 1990).

<sup>5</sup> *Id.* at 789.

<sup>6</sup> No. WD 47719, 1994 WL 327752 (Mo. App. W.D. July 12, 1994).

Special condition No. 11 stated: "The May 31, 1988 operating results of Borrower are to be reviewed prior to the closing of WCC's accommodation and found to be in line with projected operating results." Review of the May operating results revealed that the borrower's sales revenues were 12% below its April forecast. On the other hand, the lender's net loss for the month was smaller than the net loss it had forecasted. Disagreement arose whether Special condition No. 11 had been met. The lender decided that the condition had not been met and put the loan "on hold." This resulted in the borrower filing for bankruptcy. Eventually, the borrower filed suit and the jury found that the lender had breached the commitment letter. The borrower was awarded \$70,000,000 in damages.

In *Plantation Key Developers, Inc. v. Colonial Mortgage Company of Indiana, Inc.*,<sup>7</sup> an action was brought by a borrower against a lender based on breach of a contract and fraud. The dispute arose out of a loan arrangement between the lender and the borrower for the purpose of constructing a condominium project. As part of the commitment, the lender agreed to provide funds to the borrower in three parts. First, the lender agreed to provide money at a rate of 9% plus a loan service fee (points) of 3 1/2% of the loan amount. Second, the borrower had an option to extend the commitment for six months "with adjustments in interest and points made if market conditions so demand."

<sup>8</sup> Finally, the agreement provided for another extension of the commitment for six more months with the same interest and points. As consideration for this commitment contract, the borrower paid a \$60,000 non-refundable commitment fee, and agreed to pay an additional \$30,000 each time it chose to exercise the option to finance the second and third phases.

The problem arose when the borrower attempted to exercise its option to finance the second phase of the agreement. At that time, the lender increased the interest rate to 9.75%, and increased the service fee to 9 points. The borrower contended that those rates were inconsistent with the lender's promise to make rate adjustments only in response to "market conditions." At that point, the borrower refused to pay the additional \$30,000 and brought suit against the lender.

The lender claimed that: (1) the borrower's payment of the extension fee was a condition precedent to suit; (2) the quotation and extension fee were dependant covenants; (3) the quotation and the extension fee were concurrent conditions; (4) the borrower's failure to tend to the extension fee was a breach

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<sup>7</sup> 589 F.2d 164 (5th Cir. 1979).

<sup>8</sup> *Id.* at 167.

which excused the lender from performance; and (5) the option lapsed due to the borrower's failure to exercise it.

The jury found that the interest rate and closing fees were not in compliance with the commitment letter and awarded damages to the borrower. The Fifth Circuit affirmed, holding that the agreement entered into between the parties was actually an option contract. The court went on to explain the two elements of an option contract: (1) the underlying contract which is not binding until accepted; and (2) the agreement to hold open to the optionee the opportunity to accept. Further, the consideration for this option contract was the original \$60,000 that the borrower already paid. The court held that the only time the borrower would have to pay the additional \$39,000 was if it actually exercised its option and bound the lender to the quoted rates for the extended period. The Fifth Circuit agreed with the District Court that it was within the province of the jury to decide whether or not the lender's quoted rate of 9.75% and 9 points was in compliance with the lender's obligation to change its rates only if marketing conditions demanded.

In this case, the borrower also brought an action of fraud against the lender, claiming that the lender purposely drafted the commitment agreement in such a way as to escape its obligation under the agreement if it did not have the mortgage money readily available. However, the court, reluctant to label common business decisions as fraud, held that it is not uncommon for lenders to obligate themselves for future loans without having the actual funds in their possession. The court refused to hold that because the lender did not conduct its business in a manner acceptable to the borrower or even to the proverbial reasonable man, the lender had perpetrated a fraud against the borrower.

### *C. When must the conditions be performed?*

In the context of commitment agreements, it is important to analyze whether, when a specific date for performance is provided in the commitment, it renders time of performance an essential term of the contract. Florida courts have held that "it is elementary that the mere breach of an agreement which causes no loss to plaintiff will not sustain a suit by him for damages, much less rescission."<sup>9</sup> Concerning tardy performance that does not cause damage to the complaining party, a Florida appellate court has observed:

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<sup>9</sup> Block v. City of West Palm Beach, 112 F.2d 949, 952 (5th Cir. 1940) (affirming dismissal for failure to state a claim in suit by bondholders against a city for breach of contract when bondholders made no showing of injury from city's breach of promise).

The modern trend of decisions concerning brief delays by one party in performance of a contract or conditions thereunder, in the absence of an express stipulation in the contract that time is of the essence, is to not treat such delays as a failure of a constructive condition discharging the other party unless performance on time was clearly an essential and vital part of the bargain.<sup>10</sup>

In applying this general trend in contract law to land sales agreements, the Second District Court of Appeal explained:

time is not of the essence for the reason that no substantial injury will normally result from the breach of a time term and it is therefore just to enforce the contract with due allowance for any damage rather than to discharge the party aggrieved by the failure to perform strictly on time.<sup>11</sup>

Minor delay has also been held not to be a basis for rescission in the context of construction contracts.<sup>12</sup>

In *Westcap Government Securities, Inc. v. Homestead Air Force Base Federal Credit Union*,<sup>13</sup> a purchaser signed a commitment letter agreeing to "stand by" to purchase \$500,000 of Government National Mortgage Association Mortgaged Backed Securities from a seller at an 8% rate of interest. The commitment letter provided that the delivery of securities was optional for the seller, but if the seller exercised its option, then delivery of the securities "must occur November 20, 1978."<sup>14</sup> The seller paid the purchaser a non-refundable commitment fee of \$2,500 as consideration for the agreement.

The seller exercised its option and notified the purchaser that it was going to deliver the securities. The purchaser then borrowed the necessary funds to pay for the securities and awaited delivery. When the purchaser did not receive delivery of the securities by November 28, 1978, the purchaser wrote the seller a letter terminating the contract, stating:

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<sup>10</sup> National Exhibition Co. v. Ball, 139 So.2d 489, 492 (Fla. 2d DCA 1962).

<sup>11</sup> *Id.*

<sup>12</sup> See also *Larsen v. Miami Gardens Dev. Corp.*, 299 So.2d 50 (Fla. 3d DCA 1974).

<sup>13</sup> 697 F.2d 911 (11th Cir. 1983).

<sup>14</sup> *Id.* at 912.

It is our understanding that delivery was mandatory on or before November 20, 1978. Since this has not been accomplished, we hereby notify you that we do not wish to proceed due to your failure to comply with our agreement. We will retain the \$2,500 as liquidation damages pursuant to your December 1, 1978 [sic] letter.<sup>15</sup>

Although the seller did not present the bonds for payment until November 28, 1978, it still tried to persuade the purchaser to accept them. Having failed at that attempt, the seller was forced to sell the securities at a loss.

The parties disputed the legal significance of the contractual provision that "[d]elivery must occur November 20, 1978." The court held that, although the word "must" strongly suggests that delivery was mandatory on that date, there is no language in the contract suggesting that the time of delivery was an essential element of performance.

In a footnote, the court pointed out that the defendant acknowledged that if it would have been able to make a profit on the securities, it would have accepted them even though they were delivered late. The court reasoned that the obligation of the defendant was to buy the securities and the delayed delivery would not cause any damage to the defendant. The court further held that in the absence of any showing of damages, Florida law does not countenance the purchaser's unilateral termination of its contract to purchase the securities. Further, the purchaser could not keep the \$2,500 commitment fee absent any showing of damages that it might have suffered from the seller's tardy delivery. Even in a contract containing a "time is of the essence" clause, a party must give reasonable notice of intent to terminate when payment is not made at the time provided for in the contract.

#### *D. Good faith and fair dealing*

One of the most difficult issues to resolve when the borrower and lender fail to close is who is at fault and what are the motives of the defaulting party. Underlying the factual issues is the legal issue relating to the obligation of the parties to deal with each other in good faith and fair dealing.

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<sup>15</sup> *Id.*

The Florida courts have not yet addressed this issue with regard to a commitment letter. However, a recent New York decision has analyzed this form of remedy in great detail.

In *Teachers Ins. & Annuity Ass'n v. Butler*,<sup>16</sup> the lender and the borrower entered into a preliminary commitment agreement, dated September 9, 1982, in which the lender agreed to lend the borrower \$20,000,000 for a thirty-five year term at a fixed interest rate of 14.25% per annum. Because the project was under construction, the loan was not intended to be closed and funded for almost two years. The lender and the borrower acknowledged in the commitment letter that the letter constituted a binding contract between them.

In July 1983, the lender sent the borrower the closing documents for the loan. These documents contained a provision to the effect that if the borrower attempted to pay off the mortgage before a certain date, it would have to pay a large prepayment premium. Prior to the closing, all disagreements were worked out between the parties, except as to the prepayment fee clause. On the day of the closing, the borrowers agreed to sign the loan documents, but struck the prepayment provision before doing so, informing the lender that they were unwilling to accept the loan on those terms. The lender then filed suit seeking damages for breach of contract, claiming that the borrower failed to negotiate in good faith the prepayment penalty clause, and that the objection was merely a pretext for the borrower wanting to get out of the loan agreement because interest rates had greatly declined since the date that the commitment commenced. The lender sought as damages the difference between the interest rate anticipated at the time the commitment was entered into (14.25%), and the prevailing rate of interest on the date when the loan should have closed (11.89%). The borrower argued that since the clause was not in the commitment letter, they had a right to refuse to sign any agreement containing the added provision.

The court awarded the requested damages to the lender, finding that "closing documents for commercial real estate loans historically contain provisions necessary to implement the express terms of the commitment letters, but which are not contained in the commitment letters."<sup>17</sup> Moreover, the parties had a "duty to negotiate in good faith to close the loan transaction [and to] negotiate the terms of provisions."<sup>18</sup> The court determined that the borrower

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<sup>16</sup> 626 F. Supp. 1229 (S.D.N.Y. 1986), *stay granted*, 813 F.2d 61 (2d Cir. 1986), *appeal dismissed*, 816 F.2d 670 (2d Cir. 1987).

<sup>17</sup> *Id.* at 1234.

<sup>18</sup> *Id.*

asked for a reduction of the interest rate to 12% a few weeks prior to the closing and that the borrower did not deny communicating with other lenders for alternative loans. The court found these facts reinforced the claim that the borrower had not negotiated in good faith.

#### IV. REMEDIES AVAILABLE FOR BREACH OF A COMMITMENT AGREEMENT

##### A. Monetary Damages

The damages that are recoverable for breach of contract are those which naturally result from the breach, as the ordinary consequences which, under the circumstances, may be presumed to have been contemplated by the parties to the contract as the probable result of its breach.<sup>19</sup> Further, where a contract unambiguously indicates that the loan is for a specific purpose, parol evidence is not admissible to vary the terms of the contract.<sup>20</sup>

In the recent case of *Anuhco, Inc. v. Westinghouse Credit Corp.*,<sup>21</sup> the borrower brought suit for breach of contract, alleging that the lender had anticipatorily breached a conditional loan commitment. The jury returned a verdict in the sum of \$70,000,000. The lender appealed claiming, among other things, that the borrower did not present sufficient evidence to establish that the claimed injury, forcing the borrower into bankruptcy, was reasonably foreseeable as the probable result of the lender's decision not to provide credit. The Missouri Appeals Court disagreed. It found that the subsequent bankruptcy was reasonably foreseeable because the lender knew (1) that the borrower's current line of credit was threatened and in default; (2) that the borrower needed cash to maintain essential insurance coverage; (3) that alternative and lending sources were not feasible; and (4) that the borrower would have to issue a press release stating that the loan had not closed, and that this would negatively affect its business.

In *A.M.R. Enterprises, Inc. v. United Postal Sav. Ass'n*,<sup>22</sup> the borrower brought suit against a lender for breach of a commitment to loan money pursuant to a commitment letter. The commitment required the borrower to

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<sup>19</sup> First Nat'l Ins. Agency, Inc. v. Leesburg Transfer & Storage, Inc., 139 So.2d 476 (Fla. 2d DCA 1962).

<sup>20</sup> Indemnity Ins. Co. DuPont, 292 F.2d 569, 574 (5th Cir. 1961).

<sup>21</sup> 883 S.W.2d 910 (Mo. App. 1994).

<sup>22</sup> 567 F.2d 1277 (5th Cir. 1978).

deliver a title insurance policy free of exceptions to the lender. The commitment was issued on January 3, 1974, and by August 29, 1974, the borrower was not able to deliver title in the manner required. The lender then notified the borrower that it was cancelling the commitment. The court concluded that because the commitment letter did not expressly limit the duration of the lender's obligation, this unresolved issue of fact precluded the entry of a summary judgment. Although the lender was successful in limiting its potential damages, it could have avoided the potential for liability completely had it included a date certain for the satisfaction of the conditions. Compare this case to *Brighton Dev. Corp. v. Barnett Bank of South Florida, N.A.*<sup>23</sup> The borrower, contending that the loan was for construction of condominiums as well as for purchase of the land, sought recovery of the money it had expended in attempting to comply with the conditions of the commitment letter, and for the cost of the property that it lost through mortgage foreclosure.<sup>24</sup> The court found that the commitment entered into by the lender was solely for the construction loan and therefore it denied recovery for moneys expended in connection with the mortgage on the property because those expenses were not "proper elements of damages as they were not proximately caused by [the lender's] breach of its contractual obligation, were not incurred in compliance with the terms of the commitment letter and further were not reasonably foreseeable by [the lender] or in contemplation of the parties at the time the contract was made."<sup>25</sup> Further, the circuit court found that the commitment letter completely stated the agreement of the parties and that the terms of the commitment could not be supplemented with parol evidence. Specifically, the commitment letter stated that the lender would be lending money for a construction loan. Everything in the agreement indicated that the parties intended the loan for construction purposes. Since the foreclosure was not foreseeable or contemplated, the court held that the lender was not liable for damages resulting from the foreclosure.<sup>26</sup>

In *Levenson v. Barnett Bank of Miami*,<sup>27</sup> the borrowers entered into a contract with the lender for a \$6,000,000 loan to be disbursed two and one half

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<sup>23</sup> 513 So.2d 1103 (Fla. 2d DCA 1987) (a one day delay in performance was sufficient to cause the plaintiff to forfeit its commitment fee).

<sup>24</sup> The property at the time was encumbered with three mortgages in addition to the purchase money mortgage. Because the lender did not provide the funding, the borrower defaulted on the mortgages and the property went into foreclosure.

<sup>25</sup> *A.M.R Enterprises, Inc.*, 567 F.2d at 1281.

<sup>26</sup> *Id.* at 1282.

<sup>27</sup> 330 So.2d 192 (Fla. 3d DCA 1976).

years after the parties entered into the commitment. The borrowers paid an initial commitment fee of \$30,000 and also paid an additional \$60,000 fee by an irrevocable letter of credit.<sup>28</sup> It was agreed upon by the parties that the \$60,000 would be returned to the borrower if the loan closed, or otherwise the \$60,000 would be retained by the lender. Ultimately, the loan did not go through, and the borrower sued to recover the \$60,000 fee, claiming that: (1) the lender did not earmark funds for use in the event the borrowers met the conditions of the commitment; and (2) the lender would have been unable to actually deliver the \$6,000,000 loan if the conditions of the commitment were met.

The trial court struck as irrelevant all evidence concerning the lender's earmarking of the funds necessary to make the loan and the lender's ultimate ability to make the loan. The appellate court agreed that the earmarking of funds is not an essential ingredient to a commitment to make a loan and therefore found that with respect to the initial payment of \$30,000, such evidence was in fact irrelevant and was properly stricken.

However, with respect to the additional \$60,000, because this amount was to be returned to the borrower if the loan closed, the court concluded that the fact that the lender was not able to make the loan was relevant. If the lender could not make the loan when requested by the borrower, the lender would not be entitled to the \$60,000. The court further concluded that the initial \$30,000 fee was an amount necessary to charge to protect the lender from the expenses and time consumed by its employees in determining that the loan to the borrower was proper under its rules and regulations and good business practice. But with regard to the additional \$60,000, the court found that it was compensation for the lender holding itself in readiness to make the loan or as a liquidated damage provision in the event the borrower failed to proceed with the business transaction. Therefore, the court concluded that the trial court erred when it did not allow into evidence facts concerning whether or not the lender was in fact able to make the loan at the time required.

### *B. Specific Performance*

The equitable remedy of specific performance has been applied to protect various contractual rights. Specific performance is a proper remedy for breach

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<sup>28</sup> This fee was labeled by the lender as part of the commitment fee and labeled by the borrower as a standby fee.

of contract only where an action at law for compensatory damages is inadequate to do complete justice between the parties.<sup>29</sup>

Specific performance is an appropriate remedy when the value of non-real property is uncertain, or not readily ascertainable in the open market, or if the damages from the breach of contract are too uncertain or indefinite to be fixed.<sup>30</sup>

In *American Bancshares*,<sup>31</sup> the lender ("American") brought an action against another lender ("Empire") seeking specific performance on an agreement that required Empire to purchase a construction mortgage loan from American. American contended that when it notified Empire to comply with the agreement to purchase the construction mortgage loan, Empire defaulted on the agreement. Although the trial court awarded American specific performance, the Fifth Circuit reversed. It held that damages could be monetarily ascertained and therefore a decree of specific performance was inappropriate.

Although this case involves a dispute between two lenders, typically the borrower is the party seeking specific performance of a loan commitment.<sup>32</sup> Specific performance seems to be granted in those instances where the borrower has substantially complied with the requirements of the commitment letter and could have difficulty replacing the loan which the lender is seeking to avoid.

Although Florida courts have not addressed this issue, other jurisdictions have found that borrowers may have a remedy for specific performance. In the New Jersey case of *Selective Builders, Inc. v. Hudson City Sav. Bank*,<sup>33</sup> the borrower signed a loan commitment letter with the lender to replace the construction financing for an apartment complex. As a condition of closing, the construction had to be completed by a certain date. The lender argued that the loan commitment was not enforceable because the construction was only 95% complete. The court held that although the improvements were not complete, they were still in compliance with the commitment and the bank's failure to complete the loan constituted a default.<sup>34</sup> The court further determined that specific performance was the appropriate remedy for three reasons. First, the borrowers had been trying, without success, to arrange substitute financing

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<sup>29</sup> See generally, 71 Am. Jur. 2d, Specific Performance §8.

<sup>30</sup> American Bancshares Mortgage Co., Inc. v. Empire Home Loans, Inc., 568 F.2d 1124 (5th Cir. 1978).

<sup>31</sup> *Id.*

<sup>32</sup> See generally, Specific Performance of Agreement to Lend or Borrow Money, 82 A.L.R. 3d 1116.

<sup>33</sup> 349 A.2d 564 (N.J. Super. Ct. Ch. Div. 1975).

<sup>34</sup> *Id.* at 567.

since the time the closing was scheduled to occur. Second, an award of damages would not have made the borrower whole. Third, it would have been difficult to calculate the actual monetary damage.

One might argue that the lender should also be entitled to seek specific performance of loan commitments. Given a lender's desire to share in the benefits derived by the borrower from a given project, a lender might not be in a position to derive similar benefits from another project and the damage to the lender from the loss of the loan may be difficult to determine. Consequently, the lender may wish to seek specific performance for its commitment. However, no cases have been found which grant a lender specific performance of an agreement. The courts assume that a lender can find another borrower for the money. Further, it is rare that a lender would want to lend money to someone who does not want to borrow the money. Moreover, the lender's damages can usually be estimated because the amount that the borrower was supposed to borrow, the interest rate under the agreement are known, and the current interest rate at which the lender must loan the money is known.

## V. LIMITING LENDER LIABILITY

Once a lender has made a commitment to lend, whether written or oral, and the borrower has fulfilled the conditions precedent, the lender must comply with the commitment. In recent years, the number of lender liability lawsuits has grown dramatically. This is due, in part, to the increase in creative financing by lenders and the creative theories of lender liability. This new creativity has resulted in many large judgments against lenders.<sup>35</sup> These large judgments have substantially increased the cost of lending money. Lenders, in turn, pass on these additional costs to borrowers. The Florida legislature has recognized that a lender's relationship with a borrower should be close, so that the lender can properly determine the needs of the borrower and the soundness of the borrower's financial plans.<sup>36</sup> Lenders often orally advise borrowers. However, because the courts began to recognize lender liability claims based on oral representations, and because borrowers often misunderstood lenders' advice, lenders started to limit their oral communications to borrowers. In response to this situation, state legislatures tried to placate worried lending

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<sup>35</sup> See Jerry M. Gewirtz, *Impact of Florida Statute § 687.0304 on Lender Liability Actions*, Fla. B.J., June 1992, at 82.

<sup>36</sup> See generally Jeffrey A. Tochner, *Limiting Lender Liability in Florida: The Application of a Statute of Frauds to Credit Agreements*, 44 Fla. L. Rev. 807 (Fall 1992).

institutions and to facilitate open communications in credit transactions by enacting a particularized statute of frauds that would limit lender liability.<sup>37</sup> With the enactment of this statute of frauds, it became more difficult for borrower's counsel to successfully allege creative causes of action against the lender since the statute limits borrowers' claims to those derived from written commitment agreements. While prior claims against lenders would usually include allegations of breach of an oral communication to lend, breach of an oral agreement to refinance an existing loan, and breach of an oral agreement to forbear from enforcing contractual remedies, these causes of action are now prohibited by the new statute of frauds.

Section 687.0304(2) of the Florida Statutes provides that for a borrower to maintain an action on a credit agreement, the statute requires that the agreement: (1) be in writing; (2) express consideration; (3) set forth the terms and conditions; and (4) include the signature of both the creditor and the debtor. The statute defines a credit agreement as "an agreement to lend or forbear repayment of money, goods, or things in action, to otherwise extend credit, or to make any other financial accommodation."<sup>38</sup>

Although it seems that the statute favors the lender, the statute could be viewed as benefitting borrowers as well. By requiring commitment agreements to be in writing, the statute provides certainty to the terms of the credit transaction. The borrower therefore knows that the lender is likewise bound by the terms of the loan commitment.

Further, the statute clearly benefits the legal system as a whole. By requiring the commitment letter to be in writing, the statute reduces the number of law suits because the borrower can no longer sue on an oral agreement. The system also relieves the lender from defending law suits that are difficult to prove or disprove.

Florida courts have yet to clearly interpret the statute's language. Although the Florida courts have not yet dealt specifically with this statute in regard to a loan commitment letter, there are two Florida cases that address this statute in the context of other agreements to lend, and could easily be analogized to a commitment letter.

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<sup>37</sup> *Id.*

<sup>38</sup> § 687.0304(1)(a), Fla. Stat. (1992). The primary effect of the statute is the prevention of borrowers' suits against lenders on credit agreements unless the agreements are in writing. A commitment letter would fall within this category of credit agreements.

In *Brenowitz v. Central National Bank*,<sup>39</sup> a lender brought an action against a borrower seeking to recover on a promissory note owed to the bank. The borrower responded with affirmative defenses that included allegations that discussions were held between the borrower and the lender that if the borrower brought his interest payments up to date and provided more security for the loan, the lender would stay its demand for acceleration. The thrust of the borrower's affirmative defenses was to estop the lender from taking advantage of the original terms of the written loan agreement in the face of a later waiver or modification of the terms. However, the court found that the note represented an "agreement to lend" and this fell under the statute. Because the agreement is classified under this statute, the borrower could not base its defense on the oral statements made to it by the lender. However, the court did hold that the borrower could defend an action by the creditor by alleging waiver, estoppel or bad faith arising out of an alleged oral credit agreement.<sup>40</sup>

In *Griffiths v. Barnett Bank of Naples*,<sup>41</sup> the Second District once again held that the absence of any written credit agreement bars an action against the lender. The borrower's claims of negligence, breach of contract, indemnification, breach of fiduciary duty and fraud were all founded on the assertion that the banking officer made statements or agreements concerning the extension of credit. These alleged actions were specifically excluded as specified in Fla. Stat. § 687.0304(3).<sup>42</sup>

## VI. LOAN COMMITMENT LETTERS FROM THE BORROWER'S PERSPECTIVE

From the borrower's perspective, the negotiation of a commitment letter is a challenge of considerable dimension. In few other business transactions does one party have so little apparent negotiating leverage to temper documents so exclusively protective of the other party's interest. This bias towards lenders is usually justified by the argument that it is, after all, the lender's money that is being advanced to the borrower. Thus, there should be no limits on the lender's ability to safeguard its investment and ultimately to obtain repayment. However, such arguments overlook the fact that a real estate loan is frequently

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<sup>39</sup> 597 So.2d 340 (Fla. 2d DCA 1992).

<sup>40</sup> *Id.* at 343; *see also* John L. Maynard v. Central National Bank, 19 Fla. L. Weekly D1677 (Aug. 5, 1994).

<sup>41</sup> 603 So.2d 690 (Fla. 2d DCA 1992).

<sup>42</sup> However, the court once again reiterated that estoppel, fraud and other affirmative defenses may be asserted by way of an answer in accordance with Florida Rule of Civil Procedure 1.110(d).

part of a larger transaction, in which the borrower has made a substantial economic investment and incurred significant liability. Further, it is the borrower's property that is being burdened by the constraints of the mortgage lien.

A commercial real estate loan is a mutually beneficial transaction in which many lenders are every bit as anxious to close the deal as is the borrower. The lender is, after all, in the business to make loans and to earn the resulting fees and interest. It is common in a borrower's market, that interest rates, the availability of funds and competition from other lenders stimulate a lender to fairly negotiate with a borrower to ensure that a deal does not break up.

The borrower should be aware of the significant liability that may ensue from execution of the loan commitment. Such liability, as seen in the Florida cases, may range from the loss of significant monetary deposits or fees to exposure for payment of the lender's damages in the event the loan does not close, even if through no fault of the borrower. Finally, it is increasingly common to find in loan commitments the detailed requirements that must be met in order for the borrower to actually receive the loan. In sum, the borrower must take great care in negotiating all terms of the commitment letter. Some of the crucial provisions found in a commitment letter that should be cautiously considered and negotiated by the borrower are as follows:

- (a) The commitment fee, when earned and when refunded.
  - (i) Lender does not approve title, survey, leases, financial data.
  - (ii) Lender defaults.
  - (iii) Lender's failure to procure participants, if applicable.
  - (iv) No fault of Borrower, i.e., casualty/change in financial condition prior to closing.
  - (v) Cannot agree on loan documents.
- (b) Payment of Principal.
  - (i) Maturity Date Extensions. No default at time of extension vs. no default during term of loan.
  - (ii) Fees for Extensions. Reduction of available credit to reduce fees.
  - (iii) Release Prices. Application of payments/payment of interest applicable to payment/retention of portion of sales price to pay taxes. Release prices need not be accompanied by prepayment fee.
  - (iv) The ability to make prepayments, without cost; yield maintenance formulas; LIBOR considerations. No prepayment penalty towards end of loan term. Right to substitute collateral.

- (c) Payment of Interest/Rate.
  - (i) Index - Lenders vs. Wall Street Journal. Alternate if Lender fails to publish.
  - (ii) LIBOR vs. Prime.
  - (iii) Rate after default.
  - (iv) Usury.
- (d) Conditions to Loan Closing.
  - (i) Extension for force majeure.
  - (ii) "Materiality" standards.
  - (iii) "Substantial performance."
  - (iv) Confirm contingencies satisfied (e.g., appraisal, construction contract, environmental audit; etc.).
  - (v) Alternatives if contingencies are not met (e.g., pledge of cash collateral if property appraisal low).
  - (vi) Payment of costs of appraisal, environmental, legal.
- (e) Provisions of Mortgage/Loan Agreement.
  - (i) Grace periods, notice and opportunity to cure and late charges.
  - (ii) Recourse vs. Non-Recourse - carve-out for waste, misapplication of funds, environmental, fraud, etc.
  - (iii) The collateral. Due on Sale or Encumbrance.
  - (iv) Escrows of taxes and insurance after default/time for pay ment/interest on escrows.
  - (v) The use of insurance proceeds to restore the property.
  - (vi) The use of condemnation proceeds to restore the property.
  - (vii) Right to contest Liens, Taxes.
  - (viii) Hazardous substance indemnities terminate upon foreclosure for future discharges.
  - (ix) Covenants regarding financial conditions. Particularly those permitting a default if the lender "deems itself insecure".
  - (x) Covenants requiring the maintenance of bank accounts' (anti-tying provisions).
  - (xi) Leases. Lender's right to approve. Handling of modifications and termination of leases. Management approval. Subordina-tion/Non-disturbance. Reporting requirements.
  - (xii) Insurance requirements, builder's risk, hazard, compre-hensive liability, workmen's compensation, business interruption, flood, earthquake, is it available, what will it cost, and what are the deductibles.

- (xiii) Financial reporting (and certification) requirements. Availability and cost.
- (xiv) Cross defaults. Extension to obligations of guarantors or Borrower's partners, and to other loans of Borrower.
- (xv) Change of control of Borrower.
- (xvi) Indemnities. Carve out Lender's gross negligence and willful misconduct.
- (f) Guaranties:
  - (i) Full or limited, payment or performance.
    - a. Top vs. Bottom
    - b. First vs. Last
  - (ii) Guaranties of Completion - Balance of Loan Fund to be advanced to the Guarantors.
- (g) Opinion letters: Are required opinions reasonable; cost of giving same.
- (h) Assignment of Commitment or Loan by Lender. Only after funding obligation has terminated; only to financial institution capable of funding; not to a foreign institution that would trigger withholding pass-throughs.
- (i) Loan Documents to supersede Commitment to extent of inconsistencies.

## **VII. CONCLUSION**

In light of the foregoing discussion, the most crucial period of any loan transaction is the commitment negotiating period. By settling as many issues as possible in advance, a commitment letter will be a clear representation of the intent of both the borrower and the lender in connection with the subject loan transaction. The resolution of all of the legal and business issues at the commitment letter stage of the loan transaction will prevent any threat of misunderstanding, litigation, cost or delay in closing a loan transaction.

