

MAINE COMMERCIAL LENDING HANDBOOK

Christopher J. Devlin

and

Mark K. Googins

First Edition

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To Julia, Nick, Tim and Claire

- CJD

*To Christopher J. W. Coggeshall
and the late Robert B. Patterson, Jr.
— two invaluable mentors.*

-MKG

INTRODUCTION

This volume is designed to serve as a practical guide to conducting a commercial loan closing in the State of Maine. It is written for the reader that is more interested in competently completing a commercial loan closing than in acquiring a deep knowledge of the legal theory underlying these transactions. This is to say that it is more of a “how-to” book than a treatise. Nevertheless, we have included in the text, or in the footnotes, citation to the Maine cases and statutes that we believe are significant and relevant to our topic. Thus, the seasoned or the out-of-state commercial lender or practitioner will find here a reference list of pertinent Maine authority, including identification of any unique features of Maine commercial law.

We have confined ourselves to the topic of Maine commercial lending. We do not address consumer law and touch only on those federal laws that routinely impact Maine commercial loan transactions. For this reason, we do not discuss tax-exempt lending, which depends heavily on the federal tax code. We also avoid the topic of lender regulation, assuming throughout that our hypothetical lenders are fully authorized and licensed to make commercial loans in Maine. Where Maine commercial lending law depends on explanation of Maine real estate law, the Maine Uniform Commercial Code or other Maine law, we have attempted to limit our discussion to the area of intersection, and to refer the reader to other sources for a more thorough discussion of the law.

Footnotes are not necessary to an understanding of the text, but are provided as an additional resource, containing case or statutory authority or additional discussion of points raised in the main body of the work. We have attempted to divide gender references equally between male and female.

Some mortgages are 80 pages long; others are two pages. The authors have steered a middle course with the forms provided in this volume. Most come in at the average in length and level of detail. Sample party names and transactional information have been included in forms where this made them more useful. Thus, some forms (such

as the forms of commitment letter in §2-2(b) and closing agenda in §2-4(b)) are completed for the same model commercial loan. In other cases (such as the form of loan agreement in §6-1), the forms are left blank so that variables are evident. The authors provide no assurances regarding the enforceability or sufficiency of the forms either generally or for specific transactions.

Research in the book is current through July 31, 2010, though we have sometimes ventured beyond this date where newer developments merited special mention.

Where opinions are expressed about the state of the law or best practices, they are the opinions only of the authors, and not of their respective firms or employers. We do not purport to offer any legal advice here.

We wish to thank Johanna Babb, Margaret Callaghan, and Riikka Morrill of Verrill Dana LLP for their help in correcting and finalizing the text and to Christopher McLoon of Verrill Dana LLP for his contributions to the discussion of Maine's new limited liability company statute. Jim Palmer, David Galgay and Bill Saufley provided helpful comments. We also wish to thank Marie Martinez and Beth Cary at Verrill Dana for their assistance in preparing the manuscript.

The authors are happy to field questions, suggestions or corrections and can be reached via e-mail for this purpose at mgoogins@verrilldana.com (for Mark Googins) and cdevlin@unum.com (for Christopher Devlin).

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MAINE COMMERCIAL LENDING HANDBOOK

TABLE OF CONTENTS

§1	The Maine Legal System	1
§1-1	Maine Governmental Organization	
§1-2	Sources of Maine Law	
§1-3	Organization of Courts	
§1-4	Registries of Deeds	
§1-5	Department of the Maine Secretary of State	
	§1-5(a) Bureau of Corporations, Elections and Commissions	
	§1-5(b) Bureau of Motor Vehicles	
§1-6	Taxation	
	§1-6(a) Taxation of Commercial Loan Documents	
	§1-6(b) Taxation of Lenders	
§1-7	Doing Business/Licensing Requirements Applicable to Commercial Lenders	
	§1-7(a) Qualifications for Doing Business in Maine	
	§1-7(b) Licensing Requirements	
§2	Preliminaries	13
§2-1	Types of Loans and Structural Considerations	
	§2-1(a) Commercial and Consumer Loans	
	§2-1(b) The Secured Obligations	
	§2-1(c) Term Loans and Line of Credit Loans	
	§2-1(d) Cross Collateralization and Cross Default	
	§2-1(e) Non-Recourse and Limited Recourse Loans	
	§2-1(f) Co-Borrower versus Guarantor	
	§2-1(g) Parties Accorded Special Status	
	§2-1(g)(1) Elderly Persons	
	§2-1(g)(2) Minors	
	§2-1(g)(3) Utilities Regulated by the Maine Public Utilities Commission	
§2-2	The Commitment Letter/Term Sheet	
	§2-2(a) Background and Initial Considerations	
	§2-2(a)(1) Commitment v. Term Sheet	

	§2-2(a)(2) Execution by Borrower, Guarantor, Subordinate Lender	
	§2-2(a)(3) Survival of Commitment	
	§2-2(a)(4) Provision for Fees and Expenses	
	§2-2(a)(5) Commitment Fee	
	§2-2(a)(6) Prefiling Authorization	
	§2-2(a)(7) OFAC Search	
	§2-2(a)(8) Statutory Requirement for Writing	
	§2-2(b) Form of Commitment Letter	
§2-3	Choice of Law	
§2-4	The Closing Agenda	
	§2-4(a) Background and Initial Considerations	
	§2-4(b) Form of Closing Agenda	
§2-5	Pacing the Transaction	
	§2-5(a) Background and Initial Considerations	
	§2-5(b) Real Property Title Investigations	
	§2-5(c) UCC Personal Property Title Investigations	
	§2-5(d) Entity Organizational and Authorizing Documents	
	§2-5(e) Lease Review	
	§2-5(f) Other Third Party Items	
	§2-5(f)(1) Survey	
	§2-5(f)(2) Existing Lender Pay-Offs	
	§2-5(f)(3) Environmental Assessments	
	§2-5(f)(4) Landlord and Tenant Agreements	
	§2-5(f)(5) Subordination Agreements	
	§2-5(f)(6) Appraisal	
	§2-5(f)(7) Zoning Inquiry	
	§2-5(f)(8) Regulatory Approvals	
	§2-5(f)(9) Flood Plain Search	
	§2-5(f)(10) Life Insurance	
§2-6	The Roles of Borrower's and Lender's Counsel	
§3	The Obligation	73
§3-1	Promissory Notes	
	§3-1(a) Background and Initial Considerations	
	§3-1(b) Unique Features of Maine Promissory Notes	

TABLE OF CONTENTS

§3-1(b)(1)	Provisions Affecting the Statute of Limitations	
§3-1(b)(2)	Statutory Requirement for Writing	
§3-1(b)(3)	Usury; Pre and Post-Judgment Interest	
§3-1(b)(4)	Attorneys' and Paralegals' Fees	
§3-1(b)(5)	Integration Clauses	
§3-1(c)	Late Charges and Default Interest	
§3-1(d)	Prepayment and Prepayment Premiums	
§3-1(e)	Form of Promissory Note	
§3-2	Guaranties	
§3-2(a)	Background and Initial Considerations	
§3-2(a)(1)	Suretyship Defenses	
§3-2(a)(2)	Separate Nature of Guaranty Contract	
§3-2(a)(3)	Guaranties of Collection and Payment	
§3-2(a)(4)	Subrogation and Contribution	
§3-2(a)(5)	Guarantor Covenants	
§3-2(a)(6)	Continuing and Limited Guaranties	
§3-2(b)	Spousal Guaranties: Maine ECOA Case Law	
§3-2(c)	Upstream Guaranties	
§3-2(d)	Unique Features of Maine Guaranties	
§3-2(e)	Form of Guaranty	
§4	Real Property Collateral	125
§4-1	Mortgages	
§4-1(a)	Background and Initial Considerations	
§4-1(a)(1)	Title Theory	
§4-1(a)(2)	Forms of Mortgage and the Maine Short Form Deeds Act	
§4-1(a)(3)	Recording of Mortgages	
§4-1(a)(4)	Acknowledgement	
§4-1(b)	Unique Features of Maine Mortgages	
§4-1(b)(1)	Power of Sale	
§4-1(b)(2)	Open-End Mortgage Statute	

	§4-1(b)(3) Receipt of Funds During Foreclosure Process	
	§4-1(b)(4) Receivership	
	§4-1(c) Priority of Mortgages	
	§4-1(c)(1) Tax Liens	
	§4-1(c)(2) Mechanics' Liens	
	§4-1(c)(3) Other Statutory Liens	
	§4-1(c)(4) Purchase Money Mortgages	
	§4-1(d) Mortgage Holder's Responsibility to Effect Discharge	
	§4-1(e) Mortgagee's Ability to Bid at Public Foreclosure Sale	
	§4-1(f) Form of Mortgage	
§4-2	Collateral Assignments of Leases and Rents	
§4-3	Condominiums	
	§4-3(a) Background and Initial Considerations	
	§4-3(b) Form of Condominium Rider to Mortgage, Including Assignment of Special Declarant Rights	
§4-4	Title Insurance	
§4-5	Specific Types of Real Property	
	§4-5(a) Waterfront Property and Intertidal Land	
	§4-5(b) Timberland and Stumpage	
	§4-5(c) Fixtures	
	§4-5(d) Crops	
§5	Personal Property Collateral	191
	§5-1 Background and Initial Considerations	
	§5-2 The Uniform Commercial Code	
	§5-2(a) Non-Uniform Features of the Maine UCC	
	§5-3 Financing Statements	
	§5-3(a) Background and Initial Considerations	
	§5-3(b) Debtor Name	
	§5-3(b)(1) Debtor that is a Registered Organization	
	§5-3(b)(2) Individual Debtor	
	§5-3(b)(3) Trust Debtor	

TABLE OF CONTENTS

- §5-3(b)(4) Post-Closing Change in Debtor Name
- §5-3(c) Identification of the Collateral
- §5-3(d) Location of the Debtor
- §5-3(e) Authorization to File
- §5-3(f) Filing Office
- §5-3(g) Duration of Filings
- §5-3(h) Filing Office Operations
- §5-3(i) Bogus Filings and Terminations
- §5-4 Filing
 - §5-4(a) Electronic Filing
 - §5-4(b) Fixture Filings
 - §5-4(b)(1) Location of Fixture Filing
 - §5-4(b)(2) Type of Fixture Filing
- §5-5 Priorities
- §5-6 Fixtures
 - §5-6(a) Background and Initial Considerations
 - §5-6(b) Priority Problems Concerning Fixtures
- §5-7 Federal Statutes Affecting Filing and Priority
 - §5-7(a) Perishable Agricultural Commodities Act
 - §5-7(b) Packers and Stockyards Act
 - §5-7(c) Federal Assignment of Claims Act
 - §5-7(d) Food Security Act
- §5-8 The Security Agreement
 - §5-8(a) Background and Initial Considerations
 - §5-8(b) Form of Security Agreement
- §5-9 Specialized Collateral
 - §5-9(a) Registered Motor Vehicles, Trailers, Semi-Trailers and Camp Trailers
 - §5-9(b) Mobile Homes or Manufactured Housing
 - §5-9(c) Portable Classrooms and Construction Site Trailers
 - §5-9(d) Watercraft
 - §5-9(e) Aircraft
 - §5-9(f) Agricultural Collateral
 - §5-9(g) Life Insurance Policies
 - §5-9(h) Intellectual Property

- §5-9(i) Limited Liability Company Membership Interests and Partnership Interests
 - §5-9(i)(1) Background and Initial Considerations
 - §5-9(i)(2) LLC and Partnership Interests as General Intangibles
 - §5-9(i)(3) LLC and Partnership Interests as Investment Property
- §5-9(j) Pledges of Certificated Securities
 - §5-9(j)(1) Background and Initial Considerations
 - §5-9(j)(2) Attachment and Perfection of Security Interests
 - §5-9(j)(2)(A) Perfection by Filing
 - §5-9(j)(2)(B) Perfection by Control - Certificated Securities in Bearer Form
 - §5-9(j)(2)(C) Perfection by Control - Certificated Securities in Registered Form
 - §5-9(j)(3) Form of Stock Pledge Agreement
- §5-9(k) Control of Uncertificated Securities and Securities Entitlements
 - §5-9(k)(1) Background and Initial Considerations
 - §5-9(k)(2) Attachment and Perfection of Security Interests
 - §5-9(k)(2)(A) Perfection – Uncertificated Securities
 - §5-9(k)(2)(B) Perfection – Securities Entitlements and Securities Accounts
 - §5-9(k)(3) Financial Assets
 - §5-9(k)(4) Control Agreements
- §5-9(l) Deposit Accounts
 - §5-9(l)(1) Background and Initial Considerations
 - §5-9(l)(2) Definitions

TABLE OF CONTENTS

	§5-9(1)(3) Attachment and Perfection of Security Interests	
	§5-9(1)(4) Form of Control Agreement	
	§5-10 UCC Insurance	
§6	Other Loan Documents	289
	§6-1 The Loan Agreement	
	§6-1(a) Background and Initial Considerations	
	§6-1(b) Form of Loan Agreement	
	§6-2 The Environmental Indemnity Agreement	
	§6-2(a) Background and Initial Considerations	
	§6-2(b) Form of Environmental Indemnity Agreement	
	§6-3 Subordination Agreements	
	§6-3(a) Background and Initial Considerations	
	§6-3(b) Lien Subordination	
	§6-3(c) Debt Subordination	
§7	Choice of Entity	337
	§7-1 Background and Initial Considerations	
	§7-2 Corporations	
	§7-2(a) Formation	
	§7-2(b) Structure	
	§7-2(c) Authorization	
	§7-2(d) Duration of Entity Existence	
	§7-2(e) Types of Corporation, Limitations on Liability and Tax Treatment	
	§7-2(f) Organizational and Authority Documents	
	§7-3 Limited Liability Companies	
	§7-3(a) Formation	
	§7-3(b) Structure	
	§7-3(c) Authorization	
	§7-3(d) Duration of Entity Existence	
	§7-3(e) Types of LLC, Limitations on Liability and Tax Treatment	
	§7-3(f) Organizational and Authority Documents	
	§7-4 Partnerships	
	§7-4(a) Formation	
	§7-4(b) Structure	

	§7-4(c) Authorization	
	§7-4(d) Duration of Entity Existence	
	§7-4(e) Types of Partnership, Limitations on Liability and Tax Treatment	
	§7-4(f) Organizational and Authority Documents	
	§7-5 Trusts	
	§7-6 Sole Proprietorships	
	§7-7 Foreign Entities	
§8	Closing and Post-Closing	357
	§8-1 Background and Initial Considerations	
	§8-2 Scheduling the Closing	
	§8-3 Preparing for the Closing	
	§8-4 Conducting the Closing	
	§8-5 Closing in Escrow	
	§8-5(a) Form of Escrow Closing Instructions	
	§8-6 Payoff Letters	
	§8-6(a) Background and Initial Considerations	
	§8-6(a)(1) All Payoff Letters	
	§8-6(a)(2) Payoff Letters for Lender Doing the Take-Out	
	§8-6(a)(3) Payoff Letters for Lender Being Taken Out	
	§8-6(b) Form of Payoff Letter (for Lender being Taken Out)	
	§8-7 Insurance Coverage	
	§8-7(a) Background and Initial Considerations	
	§8-7(b) Evidence of Insurance	
	§8-7(c) How Lender Should Be Named	
	§8-8 The Closing Statement	
	§8-8(a) Background and Initial Considerations	
	§8-8(b) Form of Closing Statement (Loan Without Acquisition)	
	§8-8(c) Form of Closing Statement (Loan With Acquisition)	
	§8-9 Form 1099-S	
	§8-10 Transfer and Withholding Taxes	

TABLE OF CONTENTS

§8-10(a) Transfer Tax	
§8-10(a)(1) Transfers of Real Estate	
§8-10(a)(2) Transfers of Controlling Interest	
§8-10(b) Withholding Tax	
§8-11 Opinions	
§8-11(a) Maine Opinion Practice	
§8-11(b) Form of Opinion	
§8-12 Post-Closing	
Appendix 1	A-1
Registries of Deeds Contact Information	
Appendix 2	A-6
Registries of Deeds – Fee Schedule	
Appendix 3	A-7
Summary of Collateral Types – Perfection Methods under the UCC	
Table of Cases	C-1
Table of Statutes	S-1
Index	I-1

Chapter 1

THE MAINE LEGAL SYSTEM

§1-1 Maine Governmental Organization

Maine is divided into 16 counties. Its capital is Augusta, in Kennebec County. Its largest city is Portland, in Cumberland County.

The chief executive office is that of governor. The governor is elected for four-year terms, subject to a maximum of two consecutive elective terms. The legislative branch consists of a bicameral legislature comprising a 151-member house of representatives and a 35-member senate. Representatives and senators are elected for a term of two years, and members are limited to four consecutive terms (eight years). Further information about the House and Senate are available at the Maine State Legislature's website: <http://www.maine.gov/legis>.

Maine's Constitution authorizes the incorporation of villages and cities as municipal corporations, which may exercise all powers of local self-government that are not in conflict with general laws.¹

§1-2 Sources of Maine Law

Before attaining statehood on March 15, 1820, Maine was part of the Commonwealth of Massachusetts, and Massachusetts law prior to that time is valid precedent to the extent that it has not been departed from in subsequent Maine statutes or cases.²

The law of Maine is contained in its Constitution, its Revised Statutes, its Code of Regulations and its common law. The Maine Constitution contains ten articles that, among other things, declare the rights of the people (Article I), set forth voting qualifications (Article II) and describe the distribution of powers among the

¹ Me. Const. art VIII, pt. 2.

² Me. Const. art X, § 3. *See, e.g., Kennebec Fed. Sav. & Loan Ass'n v. Kueter*, 1997 ME 123, ¶ 3, 695 A.2d 1201, 1202 (Maine constitution provides right to a jury trial in all civil cases, except where pre-1820 Massachusetts common or statutory law provided otherwise).

legislative (Article IV), executive (Article V) and judicial (Article VI) departments of government. Initiative and referendum provisions were added to the Constitution in 1908.

Maine statutory law is found in the Maine Revised Statutes, which include fifty titles (numbered 1 through 39-A). Titles of special interest to commercial lenders are:

Title 9	Banks and Financial Institutions
Title 9-B	Financial Institutions
Title 10	Commerce and Trade
Title 11	Uniform Commercial Code
Title 13	Corporations
Title 13-B	Maine Non-Profit Corporation Act
Title 13-C	Maine Business Corporation Act
Title 24	Insurance
Title 24-A	Maine Insurance Code
Title 29-A	Motor Vehicles
Title 31	Partnerships and Associations ³
Title 33	Property
Title 36	Taxation

The Maine Revised Statutes are found online at <http://www.maine.gov/legis/statutes/>.

The Maine Rules of Civil Procedure govern civil actions and include special rules for certain actions such as those involving real estate (M.R. CV. P. 80A) and forcible entry and detainer actions (M.R. CV. P. 80D). Title 14 of the Maine Revised Statutes supplements the Maine Rules of Civil Procedure. Appeals are governed by the Maine Rules of Appellate Procedure. The Maine Rules of Civil Procedure, the Maine Rules of Appellate Procedure and the Maine Rules of Evidence are available online at http://www.courts.state.me.us/court_info/rules/rules.html.

A number of Maine agencies have rulemaking and regulatory authority. Agencies and bureaus of particular interest to commercial lenders are the Department of Professional and Financial Regulation (which includes the Bureau of Financial Institutions, the

³ This title includes limited liability companies as well.

Office of Securities, the Bureau of Consumer Credit Protection and the Bureau of Insurance), the Department of Environmental Protection, the Department of Labor, the Office of the Attorney General (which is responsible for many consumer-protective regulations) and the Bureau of Revenue Services. Maine regulations are found in the Code of Maine Rules. Details concerning the organization and duties of various Maine departments and agencies are found at Title 5 of the Maine Revised Statutes under the heading of “Administrative Procedures and Services.”

At the municipal level, commercial lenders will be particularly interested in town and city ordinances and rules regarding zoning, building permits and other aspects of land use regulation.

§1-3 Organization of Courts

Maine has two principal tiers of trial court, the District Court and the Superior Court, and an ultimate appellate court, the Supreme Judicial Court or “Law Court.” There are also county probate courts. Except for probate judges, who are elected, Maine judges are appointed by the governor and confirmed by the legislature.⁴

The District Court is the lowest level trial court. Although it has original criminal and civil jurisdiction, it typically handles family law, traffic, juvenile, small claims and lesser criminal and civil matters. It is divided into 28 judicial divisions, each sitting at a location specified by statute.⁵ Importantly, jury trials are not available in the District Court. Cases initiated in the District Court in which a party requests a jury trial must be removed to the Superior Court for trial.⁶

The Superior Court sits in each county as a court of original jurisdiction over civil, criminal and equitable matters including appeals from state and local administrative agencies.⁷ The Superior Court also has authority to hear appeals from some decisions of the District Court.⁸ Jury trials are available in the Superior Court.⁹ Some

⁴ Me. Const. art. V, pt. 1, § 8 and art. VI, § 6.

⁵ 4 M.R.S.A. §153 (Supp. 2009).

⁶ M. R. Civ. P. 76C.

⁷ 4 M.R.S.A. § 105 (Supp. 2009).

⁸ 4 M.R.S.A. § 105(3)(B) (Supp. 2009).

⁹ M. R. Civ. P. 38.

method of alternative dispute resolution is mandatory for most civil cases in the Superior Court.¹⁰ Because there are fewer Superior Court justices than there are counties, a sitting justice is not present at all times in less populous counties.

In 2007, the Maine Supreme Judicial Court created the Business and Consumer Court, also known as the BCD. The BCD was designed to promote greater predictability and efficiency in resolution of business and consumer cases. One aim of the BCD is to reduce delays in case disposition through intensive case management and special (often truncated) discovery procedures. The cases eligible to be heard by the BCD are jury and nonjury civil actions and family matters that do not involve children, in which

- the principal claim or claims involve matters of significance to the transactions, operation or governance of a business entity and/or the rights of a consumer arising out of transactions or other dealings with a business entity, and
- the case requires specialized and differentiated judicial management.¹¹

Cases may be directed to the BCD by recommendation of any superior court justice or district court judge or on application for transfer made by a party to the action. More information concerning the BCD is found at http://www.courts.maine.gov/maine_courts/specialized/business/faq.shtml.

The Maine Supreme Judicial Court (which in its appellate role is referred to as the “Law Court”) is Maine’s highest court and has exclusive jurisdiction over appeals from all Superior Courts and Probate Courts and most appeals from District Courts.¹²

Further information about the Maine State court system is available at the state judiciary’s website:
<http://www.courts.maine.gov>.

¹⁰ M. R. Civ. P. 16B.

¹¹ Establishment of the Business and Consumer Docket, Admin. Order M.S.J.C. (effective Nov. 17, 2008).

¹² 4 M.R.S.A. § 57 (Supp. 2009).

Maine has a single U.S. District Court and a single U.S. Bankruptcy Court; however, each is administratively divided into two divisions with sitting judges (and, in the case of the District Court, also including magistrate judges) in both Bangor and Portland. Additional information on the federal courts can be found at <http://www.med.uscourts.gov/> (United States District Court) and <http://www.meb.uscourts.gov/> (United States Bankruptcy Court).

§1-4 Registries of Deeds

33 M.R.S.A. § 201¹³ (sometimes referred to as the “recording statute”) provides:

No conveyance of an estate in fee simple, fee tail or for life, or lease for more than 2 years or for an indefinite term is effectual against any person except the grantor, his heirs and devisees, and persons having actual notice thereof unless the deed or lease is acknowledged and recorded in the registry of deeds within the county where the land lies, and if the land is in 2 or more counties then the deed or lease shall be recorded in the registry of deeds of each of such counties, and in counties where there are 2 or more registry districts then the deed or lease shall be recorded in the district legal for such record.

Thus, the registries of deeds are the offices in which real estate records are filed. These include deeds, easements, mortgages, leases (or memoranda of leases) and fixture filings.¹⁴ Maine has a “race-notice” rule for priority of mortgages, meaning that the first to record enjoys priority unless she has actual or constructive notice of a prior grant.¹⁵

Maine is divided into 18 registry districts with an elected Register of Deeds responsible for each office. In most cases, there is one registry per county, located in the “shire town” for that county.¹⁶ However, Oxford County has both an eastern and western District and

¹³ 33 M.R.S.A. § 201 (1999).

¹⁴ Execution liens relating to real property are also filed at the applicable registry of deeds. 14 M.R.S.A. § 4651-A (1) (Supp. 2009).

¹⁵ Paul G. Creteau, MAINE REAL ESTATE LAW 265 (Castle Publishing 1969).

¹⁶ 33 M.R.S.A. § 701 (1999).

Aroostook County a northern and southern district, and care must be taken to determine the proper recording office for a given property in either of these counties, since a failure to record a document in the correct registry or registry district means that the recording party will not have the benefit of the recording statute. The parameters of the Oxford County western district and Aroostook County northern district are set out in 33 M.R.S.A. §§ 702 and 703, respectively.¹⁷ The location and address of each registry is listed in Appendix 1. The fee schedule for recording costs is found at 33 M.R.S.A. §§ 751 and 752 and is summarized in Appendix 2, but registry practice varies on incidental charges and also on some formal requirements, such as the margin and type size of an instrument and the number of names on certain instruments, so it is wise to consult the fee schedule and requirements for plans and instruments imposed by the pertinent registry before recording there.¹⁸

Recorded documents and plans are copied and placed in bound volumes and also scanned into the registry's computer system. All Maine registries keep at least two distinct sets of volumes: One for plans (which are identified by Plan Book ____, Page ____) and another for all other instruments (which are identified simply by Book ____, Page ____). 33 M.R.S.A. § 652 sets out the requirements for plan material and dimension. Instruments are indexed by grantor and grantee name in alphabetical order.¹⁹ The quirks of past Maine registry record keeping are legion, and include occasional maintenance of separate books for some categories of instruments and unorthodox indexing methods. These have nearly disappeared for current periods, but the authors recommend using an experienced Maine abstractor for title work.

The registry will stamp the instrument with the book and page number or plan book and page number, and keep a copy in its records. After recording an instrument, the registry will return the original either to the person that submitted it or, alternatively, to the person designated on the document. This designation is often made on the top of the front page or the reverse side of the last page. This means you need either to put a legend at the top of the first page, or turn the

¹⁷ 33 M.R.S.A. §§ 202 and 703 (1999).

¹⁸ 33 M.R.S.A. §§ 751 and 752 (Supp. 2009).

¹⁹ 33 M.R.S.A. § 652 (Supp. 2009).

document over and print on the reverse of the last page something to the effect of “Return after recording to [name and address]”. Registries vary from weeks to months in the amount of time it takes them to return originals of recorded documents, although if you bring the instrument to the registry in person, you may wait and leave with a copy of the document that is stamped with both the document number and the book and page number.

§1-5 Department of the Maine Secretary of State

The Department of the Secretary of State comprises three distinct bureaus: (1) the Maine State Archives, (2) the Bureau of Corporations, Elections and Commissions, and (3) the Bureau of Motor Vehicles. The latter two are of importance in commercial loan transactions.

§1-5(a) Bureau of Corporations, Elections and Commissions

The Bureau of Corporations, Elections and Commissions includes the Division of Corporations, UCC and Commissions. Where an entity such as a corporation or limited liability company is created by filing with a Maine public office, the Bureau of Corporations, through the Division, is that office. As discussed in §7 below, this means that Maine corporations, limited liability companies, limited partnerships and limited liability partnerships all are created by filings with the Bureau of Corporations and are subject to requirements for periodic reporting and fee payment to the Bureau in order to remain in good standing.

Copies of filed organizational documents and evidence of entity good standing are available from the Bureau of Corporations. The Bureau’s website, found at <http://icrs.informe.org/nei-sos-icrs/ICRS> gives subscribers access to copies of organizational documents and good standing certificates for a fee and also includes a helpful free entity name search feature. The information available through the free name search feature is not a substitute for a careful examination of the entity’s organizational documents themselves, but it is an easy and useful tool for confirming proper entity name, particularly in cases where the entity has numerous, similarly-named affiliates. Thus, where a loan is written up as being made to Acme Products, Inc., a look at this database can save lots of confusion and wasted paper by

establishing early on that the entity is in fact Acme Products, Inc. and not Acme Enterprises, Inc. or Acme, LLC, etc., and the authors recommend that it be consulted as a matter of course at the beginning of a transaction.

The Bureau, through the UCC Division, handles all of the Uniform Commercial Code filings in Maine, other than the local filings that are made at the registries of deeds. In other words, this is the sole “central filing” office in Maine for UCC statements. It is also where non-UCC liens against personal property are filed (including state and federal tax liens for personal property taxes and income taxes and miscellaneous liens for obligations such as child support).²⁰

Filings may be made in person or electronically by credit card payment or subscription. The office employs standardized Revised Article 9 search logic and follows the practice of disregarding “ending noise words” as adopted by the International Association of Corporation Administrators. The electronic filing and searching system is efficient and reliable and is preferable to carrying out these tasks by mail. The UCC division website by which filings and searches can be conducted is found at <http://www.maine.gov/sos/cec/ucconline/>. The site also posts the division’s model rules, which answer some questions about filing and search practice. A fee schedule is found on the website and in the statute at 11 M.R.S.A. §9-1525.²¹

§1-5(b) Bureau of Motor Vehicles

Maine is a certificate of title jurisdiction, meaning that ownership of most motor vehicles and liens on them are evidenced by certificates that are registered with the Maine Bureau of Motor Vehicles.²² Unlike the other bureaus discussed, the Bureau of Motor

²⁰ See 11 M.R.S.A. § 9-1501 (Supp. 2009). Food Security Act filings aren’t regarded as “liens” for purposes of this discussion. They are described in §5-7(d), below. The Maine Secretary of State’s office is also the filing location for execution liens relating to personal property. 14 M.R.S.A. § 4651-A (2) (Supp. 2009).

²¹ 11 M.R.S.A. § 9-1525 (Supp. 2009).

Vehicles does not transact the pertinent parts of its business on-line and does not allow title to be transferred or liens registered by electronic means. The Bureau does make basic forms available on its website (<http://www.maine.gov/sos/bmv/forms/index.html>), although it does not include among these the application for certificate title form (known as the MVT-2) that is probably the most important form to commercial lenders. The Bureau also includes an online schedule of title fees: (<http://www.maine.gov/sos/bmv/registration/titlefees.htm>).

§1-6 Taxation

§1-6(a) Taxation of Commercial Loan Documents

Maine does not assess any fee or stamp, mortgage or other tax to document and collateralize commercial loan transactions. Thus, the practice in some states, such as New York, of amending and restating loan documents to avoid paying tax on the refinanced portion of any debt is fortunately unheard of in Maine.

§1-6(b) Taxation of Lenders

Every financial institution that had Maine assets or Maine net income during the taxable year must make a filing under the Maine Franchise Tax Law and pay Maine franchise tax.²³ Financial institution means a bank, bank holding company, thrift institution, savings association, insured institution, savings bank holding company, qualified savings bank, insured depository institution, appropriate federal banking agency or qualified family partnership (as defined in the Bank Holding Company Act of 1956 or any other financial institution, other than a credit union, authorized to do business in Maine, as defined in 9-B M.R.S.A. § 131(17-A)).²⁴ Financial institution includes any corporation of which more than 50% of the voting stock is owned, directly or indirectly, by a financial institution or by a credit union as defined in 9-B M.R.S.A. § 131 (2009).

²² 29-A M.R.S.A. § 652 (Supp. 2009) lists the categories of vehicles that are exempt from the certificate of title requirement. The topic of perfecting liens on vehicles is discussed further in §5-6(a).

²³ 36 M.R.S.A. §§ 5206, 5206D-5206G (2010).

²⁴ 2 U.S.C.A. § 1841 (2001 & Supp. 2010); 9-B M.R.S.A. § 131(17-A) (2009).

Real and personal property taxes are assessed at the municipal level on real property situated in Maine and on tangible personal property located in Maine.²⁵

§1-7 Doing Business/Licensing Requirements Applicable to Commercial Lenders

§1-7(a) Qualifications for Doing Business in Maine

Business corporations and other business entities (other than general partnerships) that are not formed under Maine law, and that are transacting business in the State of Maine (referred to as “foreign” corporations, limited liability companies, etc.) must qualify to do so under Maine law. Foreign entities transacting business in Maine that have failed to qualify may be subject to civil penalties assessed by judicial action initiated by the Maine Attorney General. In addition, unqualified foreign entities may lose access to Maine’s state courts. A foreign entity that is transacting business in Maine without qualification may have its legal proceedings stayed by the court until the entity has filed for qualification and paid any related fees.²⁶

The Maine statutes on foreign corporations do not affirmatively define “transacting business,” but include a non-exhaustive list of activities that by themselves do not constitute transacting business in Maine (e.g., maintaining, defending or settling proceedings, maintaining bank accounts, creating or enforcing indebtedness, acquiring or enforcing liens or security interests and conducting an isolated transaction).²⁷ A similar approach is taken with respect to limited liability companies, limited partnerships and limited liability partnerships. A foreign business entity may apply for authority to do business in Maine by use of standard forms published by the Maine

²⁵ The priority of a real estate tax lien over the prior mortgage of a lender is discussed in Chapter 4.

²⁶ 13-C M.R.S.A. § 1502 (2005). Similar strictures apply to limited liability companies (31 M.R.S.A. §§ 1621-1629 (Supp. 2010)) and limited partnerships (31 M.R.S.A. §§ 1411-1418 (Supp. 2010)), with the additional right on the part of the Maine Attorney General to bring action restraining such entities from continuing in the unauthorized transaction of business, (31 M.R.S.A. § 1629(4) (Supp. 2010) (limited liability companies); 31 M.R.S.A. § 1418 (Supp. 2010) (limited partnerships).

²⁷ 13-C M.R.S.A. § 1501(2) (2005).

Secretary of State. The application must be accompanied by a recent certificate of existence or its analogue from the jurisdiction of organization of the applicant and a filing fee. Upon acceptance of the application, the foreign business entity (unless there are limitations on its powers noted in the application) has all the powers that may be exercised by a Maine-domiciled entity of like character. In order to maintain authorization, the entity must remain in good standing in its jurisdiction of organization and must submit an annual report and pay an annual fee to the Bureau of Corporations.

Foreign corporations, foreign limited liability companies, foreign limited partnerships and foreign limited liability partnerships are required to maintain a registered agent in the State of Maine.²⁸

The provisions of the Maine Business Corporation Act regarding foreign corporations apply to special classes of business such as banks and trustees, although foreign insurers are governed solely by the insurance laws.²⁹

§1-7(b) Licensing Requirements

As a general rule, out-of-state commercial lenders and equipment lessors transacting business in Maine are not subject to any special licensing requirements. Licenses from the Bureau of Financial Institutions are required, however, for lenders that are engaged in the “business of banking,” defined as carrying out the following activities in Maine: “soliciting, receiving, or accepting of money or its equivalent on deposit and the loaning of money as a regular business...”³⁰ In addition, if a lender uses a restricted term such as “bank,” “trust,” or “savings” in part of its name, Bureau approval may be required.³¹

²⁸ 13-C M.R.S.A. § 1507-A (Supp. 2009) (corporations); 31 M.R.S.A. § 714(2-B) (Supp. 2009) (limited liability companies); 31 M.R.S.A. § 1314-A (Supp. 2009) (limited partnerships); 31 M.R.S.A. § 854(2-B) (Supp. 2009) (limited liability partnerships). The subject of registered agents is addressed in 5 M.R.S.A. § 101 (Supp. 2009). Among other requirements, a registered agent must have a place of business in Maine to which service of process and other documents may be delivered. 5 M.R.S.A. § 106(1)(C) (Supp. 2009).

²⁹ 24-A M.R.S.A. §420 (2000).

³⁰ 9-B M.R.S.A. § 131(5) (2009).

³¹ 9-B M.R.S.A. §241(9) (Supp. 2009).

Out-of-state commercial lenders are permitted to engage in the business of electronic banking, subject to the general and administrative parts of Title 9-B, even if such lenders are not authorized to do business in Maine within the meaning of 9-B M.R.S.A. §131.³²

³² 9-B M.R.S.A. §241(12) (Supp. 2009).

Chapter 3

THE OBLIGATION

§3-1 Promissory Notes

Practice Pointers:

- **Notes that establish a variable rate by reference to an index rate, such as the lender's prime rate, should include a specific backup index in case the initial one ceases to be published.**
- **Notes should include reference to 10 M.R.S.A. §1146, which requires that certain promises and modifications be in writing in order to be enforceable.**
- **Lenders may want to include an integration clause in their forms of note, stating that the note and related loan documents represent the entire agreement of the parties.**

§3-1(a) Background and Initial Considerations

The promissory note is an instrument by which the note maker promises to pay a debt in money to the note holder.¹ This promise could as easily be included in a loan or security agreement, but use of a separate note is the common practice in most types of commercial financing. The one liable on the promissory note is sometimes called the “maker,” “payor” or “obligor,” and the parallel references to the one to whom payment is due are “holder,” “payee” and “obligee,” respectively.

Some transactions will include multiple promissory notes, made with different terms and for different purposes. Thus, a loan to an operating company may include a long-term real estate loan, a shorter term equipment loan and a demand line of credit.² Each note evidences a distinct obligation, so original notes should not be executed in duplicate.

¹ See *Coolbroth v. Purinton*, 29 Me. 469 (1849).

² See §2-1(c) for the distinction between the basic types of loan.

Promissory notes can be very short, with cross references to other documents (such as the loan agreement) for the bulk of their terms, or they can be long-form documents that contain within their four corners all of their terms. The contents (and, accordingly, the length) of a note will also depend on whether the drafter wishes the instrument to constitute a “negotiable instrument” within the meaning of Article 3-A of the Uniform Commercial Code (the “UCC”).³ The main point of negotiability is to make the note freely transferable, and since most lenders and borrowers do not view this as desirable, Article 3-A is not usually a factor in Maine commercial loan transactions.⁴

³ 11 M.R.S.A. §§ 3-1101-1605 (1995 & Supp. 2009). Article 3-A applies to “negotiable instruments,” the criteria for which are set forth in 11 M.R.S.A. § 3-1104 (1995). Article 3-A is, pursuant to 11 M.R.S.A. § 1-1103(2) (Supp. 2009), supplemented by principles of common law and equity “unless displaced by [its] particular provisions,” and the national cases have developed an analysis to determine when displacement has occurred. *See* Sarah Howard Jenkins, *Preemption and Supplementation Under Revised §1-103: The Role of Common Law and Equity in the New UCC*, 54 SMU L. Rev. 495 (2001). *See, also, Schiavi Mobile Homes, Inc. v. Gironda*, 463 A.2d 722 (Me. 1983) (although not explicitly required by the UCC, common law duty to mitigate damages survives enactment of the UCC, since duty is also implicit in the UCC’s broad requirements of good faith, commercial reasonableness and fair dealing); *Fleet Nat’l Bank v. Liberty*, 2004 ME 36, 845 A.2d 1183 (discussing whether enactment of Article 3-A, which contains a statute of limitations period applicable to negotiable instruments, repeals by implication the pre-UCC statute of limitations applicable to certain promissory notes).

⁴ The failure of a lender to meet the UCC’s technical requirements for being a “holder in due course” does not render the note any less enforceable as long as the lender can show that it is in possession of the note and that it is payable to the lender. *Ali, Inc. v. Fishman*, 855 F. Supp. 440, 443 (D. Me. 1994). Likewise, the failure of the note to satisfy the conditions to negotiability does not by itself compromise the enforceability of the note (*Balkan v. Johnston*, 561 A.2d 177, 178 (Me. 1989)) or of a guaranty of the note. *See also, Jenness v. Barron*, 95 Me. 531, 50 A. 712 (1901) (“If the holder of a nonnegotiable note transfers it with a guaranty of payment he is just as liable to the transferee upon the contract of guaranty as if the note was negotiable.”) Of course, the holder in due course takes a note free of defenses to which one not enjoying that status might take subject. 11 M.R.S.A. § 3-1305 (1995).

Promissory notes that bear interest at a variable rate, based upon a reference rate (such as a particular bank's prime rate), should include a back-up to the specified reference rate. If the specified reference rate were discontinued at some point in the future it is possible that the absence of a reference rate could render the interest component undefined.⁵ Although it seems unlikely that a court would ever find the requirement to pay interest unenforceable as a result of such a turn of events, it might decide to apply the judgment rate of interest, pursuant to 11 M.R.S.A. § 3-1112(2) (1995) (applies to negotiable instruments when "the amount of interest payable cannot be ascertained from the description") or 9-B M.R.S.A. § 432 (2009) (applies to loans made by financial institutions), which would presumably leave one of the two parties to the transaction unhappy.⁶

Promissory notes may be payable on a stated date (the "maturity date") or on the demand of the holder.⁷ The former are typically

⁵ An example of a provision providing a back up rate is as follows: "If, for any reason, the Lender does not publish a Prime Rate, the term shall mean the fluctuating interest rate per annum equal to the rate of interest published in The Wall Street Journal as the U.S. Prime Rate or the base rate on corporate loans posted by at least 70% of the ten (10) largest U.S. banks, as it may vary. In the event The Wall Street Journal ceases to publish the Prime Rate, Lender shall select in its reasonable discretion a comparable substitute interest rate index and shall provide notice thereof to Borrower."

⁶ In *Bank of Maine, N.A. v. Weisberger*, 477 A.2d 741 (Me. 1984), the court concluded that the interest provision of a promissory note expressing the applicable rate as "prime + 1%" was not so uncertain as to be unenforceable. "Absent some specific indication to the contrary, a bank's use of 'prime,' without more, in a lending instrument would normally be understood to mean the bank's prime rate." *Id.* at 744. The fact that the rate was subject to adjustment by the lender itself likewise did not mean that no agreement had been reached on an applicable rate. A lender's prime rate is set by reference to general money market conditions, and the Law Court would infer an obligation resting on the lender to make its redeterminations of the prime rate in good faith and in the ordinary course of business.

⁷ *Matthews v. Matthews*, 128 Me. 495, 148 A. 796 (1930) (a demand note is payable immediately on the demand of the holder).

referred to as “term” notes; the latter as “demand” notes.⁸ Demand notes are frequently used with asset-based lines of credit or revolving credit facilities and sometimes in construction loans, but are otherwise uncommon. The inclusion in a demand note of term note-type features such as enumerated defaults or an installment payment schedule may result in the note being re-characterized as a term obligation, leaving the lender potentially liable for improperly calling the note.⁹ A disadvantage of a pure demand note is that the statute of limitations begins to run from the date of the note’s issuance, since the note is theoretically due the instant it is signed and delivered.¹⁰ If the note includes a stated maturity date (“payable on demand; if no demand is made then on June 15, 2011”), however, some cases from outside of Maine have held that the limitations period runs from the earlier of that stated date or the date of demand.¹¹

Although it seems self-evident, it is critical to confirm that the numbers in the promissory note are all correct (each reference to the principal amount, in words and numbers, and each reference to the interest rate and/or the increment used to calculate the interest rate),

⁸ Where a transaction involves both demand and term notes from a given borrower, counsel needs to be mindful that the practical effect of cross-defaulting these obligations is to render the term note a de facto demand instrument. This is so because a failure to pay the demand instrument when called will result in a default under the term instrument, allowing the lender to accelerate it prior to the maturity date.

⁹ See *Reid v. Key Bank of Southern Maine, Inc.*, 821 F.2d 9, 14 (1st Cir. 1987) (demand note with default provisions); *Barron v. Boynton*, 137 Me. 69, 15 A.2d 191 (1940) (installment payment schedule); but see *In re Red Cedar Const. Co. Inc.*, 63 B.R. 228, 238 (Bankr. W. D. Mich. 1986) (demand note may be called with or without reason).

¹⁰ See *Barron v. Boynton*, 137 Me. 69, 15 A.2d 191 (1940); *Young v. Weston*, 39 Me. 492 (1855). For negotiable demand notes, the UCC establishes a limitations period of six years after the demand. In order to cover situations in which the parties did not really intend the obligation to be enforced (such as might be the case in family loans), the UCC bars a lawsuit on a negotiable demand note if no demand has been made and no principal or interest has been paid on it for a continuous period of ten years. 11 M.R.S.A. § 3-1118(2) (1995).

¹¹ *Loomis v. Republic Nat’l Bank of Dallas*, 653 S.W.2d 75, 78 (Tex. App. 5th Dist. 1983); *First Nat’l Bank v. Bell*, 140 Okl. 24, 282 P. 147, 148-9 (1929).

including, if applicable, any stated installment payments. The numbers should be confirmed with the lender's business staff.

§3-1(b) Unique Features of Maine Promissory Notes

§3-1(b)(1) Provisions Affecting the Statute of Limitations

The statute of limitations is the period during which legal action may be brought upon claims or in enforcement of rights or remedies. Expiration of the statute of limitations does not result in extinguishment of the underlying right but only bars the remedy of being able to enforce the right by judicial process, i.e., by suing. The distinction may not matter in many cases, since the inability to sue on the note could render it useless, but it is meaningful in a discussion of promissory notes that are secured by mortgages, since Maine courts have held even after the statute of limitations has passed on a note, the debt survives and, accordingly, any mortgage securing the debt survives as well and may be foreclosed if the limitations period for mortgage foreclosure has not likewise passed.¹²

The statute of limitations for the common run of contracts is 6 years.¹³ However, a longer period of 20 years applies to (i) contracts or liabilities under seal and (ii) promissory notes signed in the presence of an attesting witness.¹⁴ The UCC, in 11 M.R.S.A. § 3-1118(1), provides a shorter 6-year statute of limitations, but the Maine Law Court has held that the 20-year limitations period has not been implicitly repealed by this shorter period.¹⁵ The longer 20-year period applies to notes, both negotiable and non-negotiable, that were signed in the presence of an attesting witness, while the shorter UCC

¹² *Johnson v. McNeil*, 2002 ME 99, 800 A.2d 702.

¹³ 14 M.R.S.A. § 752 (2003). Under Article 2 of the UCC, sales contracts are subject to a shorter 4 year limitations period. 11 M.R.S.A. § 2-725 (1995). Also, a different statute of limitations may apply to loans governed by federal law, such as those guaranteed by the Small Business Administration. See *United States v. Hanson*, 649 F. Supp. 100, 104-105 (D. Me. 1985).

¹⁴ 14 M.R.S.A. § 751 (2003).

¹⁵ 11 M.R.S.A. § 3-1118(1) (1995); *Fleet Nat'l Bank v. Liberty*, 2004 ME 36, 845 A.2d 1183. Justice Levy issued a lengthy and cogent dissent.

limitations period applies to negotiable instruments “not issued pursuant to the formalities described in [14 M.R.S.A.] § 751.”¹⁶

The requirements of a seal and attesting witness are disjunctive, so it appears that either feature will earn the 20-year period.¹⁷ Of the two, compliance with the seal requirement is easiest, since a formula is provided by statute. 1 M.R.S.A. §72 (26-B) (Supp. 2009) states in pertinent part that:

A recital that such instrument is sealed by or bears the seal of the person signing the same or is given under the hand and seal of the person signing the same, or that such instrument is intended to take effect as a sealed instrument, shall be sufficient to give such instrument the legal effect of a sealed instrument without the addition of any seal of wax, paper or other substance or any semblance of a seal by scroll, impression or otherwise.¹⁸

¹⁶ The rule in *Fleet*, 2004 ME 36, 845 A.2d 1183, was misstated in *Tornesello v. Tisdale*, 2008 ME 84, 948 A.2d 1244, which suggested that a non-negotiable note could not qualify for the 20-year statute of limitations under Maine law. Under *Fleet*, the applicability of the 20-year limitations period turned not on the negotiability of the instrument, but on whether the formalities of 14 M.R.S.A. § 751 were followed. *Fleet Nat'l Bank*, 2004 ME 36, ¶ 10, 845 A.2d at 1186. The *Tornesello* opinion does not address the extent to which the promissory note at issue adhered to these formalities, does not discuss *Fleet* in its review of Maine law regarding the applicable statute of limitations and ultimately leaves the trial court to determine whether Maine's or Massachusetts's limitations period applies, so the effect of *Tornesello* on *Fleet Nat'l Bank* is uncertain.

¹⁷ In *Fleet Nat'l Bank*, the court applied the 20 year limitations period on the strength merely of attestation, without discussion of the status of the notes at issue as sealed instruments. *Fleet Nat'l Bank*, 2004 ME 36, 845 A.2d 1183.

¹⁸ For a document to be under seal, the seal must be that of the signer of the instrument. *Lloyd v. Robbins*, 2010 ME 59 ¶13, 997 A.2d 733, 739. In *Lloyd*, a deed was delivered that contained no recital as to its status as a sealed document, but only included the word “seal” as part of the notarial block. A notarial seal, the Court held, “does not render a document under seal for purposes of 14 M.R.S. §751 because the seal of office belonging

Following these cues, the attached form of promissory note includes a statement of intention that the note take effect as a sealed instrument.

The term “attesting witness” is not defined by statute, although the Maine cases indicate that such a witness is nothing more than one signing a note as a witness, who is not a party to the instrument and who is otherwise competent to testify as to the circumstances of the attestation.¹⁹ The requirement is dealt with in the form note by identifying the witness as an “Attesting Witness” above the pertinent signature block.

§3-1(b)(2) Statutory Requirement for Writing

The statute of frauds requires that certain agreements be in writing in order to be enforceable. Maine provides statute of frauds-type protection with respect to agreements to modify debt instruments and promises to make loans.²⁰ The statute applies only to indebtedness of more than \$250,000.²¹ Subsection 1 reads:

to a notary public is not the personal seal of the individual signing the document.” *Lloyd v. Robbins*, 2010 ME at ¶14, 997 A.2d at 739.

¹⁹ See *Shepard v. Parker*, 97 Me. 86, 53 A. 879 (1902) (wife of payee could qualify as attesting witness for purposes of the statute of limitations since at the time of the attestation she was competent to testify in court in regard to the subject matter thereof); See, also, *Shepard v. Davis*, 114 Me. 58, 95 A. 335 (1915) (payee of note cannot serve as attesting witness). Whether one is signing in the capacity of an attesting witness is a matter that can be proved by parol evidence. See *Farnsworth v. Rowe*, 33 Me. 263 (1851). If execution of a note was witnessed by a person, but that person failed to sign the note until a later time, then the 20 year limitations period will apply as long as the otherwise applicable limitations period had not run at the time of the later signature. *Boody v. Lunt*, 19 Me. 72 (1841) (subsequent attestation by witness who was present operates to extend statute); *Brackett v. Mountfort*, 11 Me. 115 (1834) (subsequent attestation by putative witness who was not present at signing of note operates as alteration that defeats note).

²⁰ 10 M.R.S.A. § 1146 (2009).

²¹ See *Steamship Navigation Co. v. Camden Nat'l Bank*, 2006 ME 11, ¶ 2, 889 A.2d 1014, 1017 (where evidence indicated that proposed loan amount was \$239,000, 10 M.R.S.A. § 1146 did not apply). See, also, *Wells Fargo Home Mortg. v. Spaulding*, 2007 ME 116, 930 A.2d 1025

1. Writing and signature required. A borrower may not maintain an action upon any agreement to lend money, extend credit, forbear from collection of a debt or make any other accommodation for the repayment of a debt for more than \$250,000 unless the promise, contract or agreement on which the action is brought, or some memorandum or note of the promise, contract or agreement, is: A. In writing; and B. Signed by the party to be charged with the promise, contract or agreement, or by some person lawfully authorized to sign for the party to be charged.

The protections of the statute are available only if the person to be charged with the promise, contract or agreement (in our case, the lender) notifies the borrower that the promise, contract or agreement must be in writing for an action to be maintained. Thus, where notice of the statute was given in connection with a 1999 renovation loan for a commercial property, the lender's failure to give the notice again with respect to an equipment loan relating to the same property rendered the statute inapplicable, even though discussions for the equipment loan commenced within 6 months of the time the earlier loan was reduced to writing.²² It is unclear how closely before loan closing a notice of the statute must be given in order to be effective, although the court cites with approval the lower court's instruction that notice be "sufficiently contemporaneous" with the promise to lend money. The authors' recommendation is to include the notice in all term sheets or commitment letters relative to a loan proposal and closing, as well as in the loan documents.

§3-1(b)(3) Usury; Pre and Post-Judgment Interest

In Maine commercial transactions, there is no usury law applicable with the exception of 9-B M.R.S.A. § 432 (2009), which provides that the maximum legal rate of interest on a loan made by a financial institution, in the absence of an agreement in writing

(parol evidence of loan modification agreement permitted where loan at issue was less than \$250,000). Most commercial loan documents in Maine purport to render the statute applicable to all loans regardless of whether they are over \$250,000, although neither the statute nor the cases support this approach.

²² *Steamship Navigation Co.*, 2006 ME 11, 889 A.2d 1014.

establishing a different rate, shall be 6% per year.²³ Maine decisions have not addressed whether an interest rate in a commercial loan could be invalidated on grounds of unconscionability, although the statutory provision that has provided the underpinning for such a decision in other jurisdictions is included in the Maine UCC.²⁴

Further, the interest rate set forth in a promissory note will be given effect as the operative pre-and post-judgment interest rate, unless, in the case of post-judgment interest, the note rate is lower than the Treasury-based rate set forth in the statute.²⁵

²³ *Id.* at ¶ 10, 889 A.2d at 1018, Maine statutory law does not impose limits on interest on non-consumer loans. 9-A M.R.S.A. § 1-201(1) (2009).

²⁴ 11 M.R.S.A. § 2-302 (1995), which is in the part of the UCC that deals with transactions in goods, authorizes a reviewing court to refuse to enforce an unconscionable contract in whole or in part. *See A.L. Brown Const. Co., Inc. v. McGuire*, 495 A.2d 794, 797 n.1 (Me. 1985) (“While ‘unconscionable’ contracts are specifically made unenforceable in 11 M.R.S.A. § 2-302...the Law Court has long applied the doctrine of unconscionability as part of the equity power.”) The unconscionability standard of 11 M.R.S.A. § 2-302 has been applied by analogy to bargains outside the UCC and has been applied to interest rates in commercial loans. *See Carboni v. Arrospide*, 2 Cal. App. 4th 76 (1991). To call the doctrine of unconscionability into play, many cases require both an excessive interest rate and some “procedural unfairness,” such as sharp lender practices, or an unsophisticated or desperate borrower who has no reasonable alternatives to the high rate loan. *See In re Chateaugay Corp.*, 162 B.R. 949, 959-60 (Bankr. S.D.N.Y. 1994) (noting that unconscionability doctrine “requires the party invoking [it] to show both an absence of meaningful choice in the contract formation process and contract terms unreasonably favoring the other party, i.e., procedural and substantive unconscionability”); Stephen W. Bender, *Rate Regulation at the Crossroads of Usury and Unconscionability: The Case For Regulating Abusive Commercial and Consumer Interest Rates Under the Unconscionability Standard*, 31 Hous. L. Rev. 721, 752-53 (1994) (noting that “[c]ourts have not clearly articulated the requisite proof of these factors or specified a recipe for their successful combination”).

²⁵ 14 M.R.S.A. §§ 1602B, 1602-C (Supp. 2009).

Compound interest (i.e., interest upon interest) can be recovered as long as the parties expressly agree to it.²⁶

§3-1(b)(4) Attorneys' and Paralegals' Fees

Provisions allowing collection of attorneys' fees incurred in enforcing a promissory note are enforceable in Maine, provided the fees requested are reasonable.²⁷ A similar reasonableness requirement is imposed in the context of mortgage foreclosure.²⁸

Some cases decided in the Federal District Court for the District of Maine in the early 1990s held paralegal fees to be a portion of law firm overhead and thus not recoverable as collection costs where they were not listed as such in the loan documents.²⁹ These caused some lenders to specifically include paralegals' fees in the costs of enforcement provisions of their commercial loan documents. Similar holdings have not been found in the Maine state court decisions, and, indeed, the Maine Law Court has permitted paralegals' fees to be awarded in foreclosure actions although it has expressed no clear standard on their inclusion among enforcement costs.³⁰

²⁶ *Premier Capital, Inc v. Doucette*, 2002 ME 83, ¶ 17, 797 A.2d 32, 37; *Bradley v. Merrill*, 91 Me. 340, 346, 40 A. 132, 133 (1898) (compound interest allowed when the parties have agreed to it in advance, in writing). *See Stickney v. Jordan*, 58 Me. 106, 107 (1870) (“In [the State of Maine] interest upon interest is not allowed”).

²⁷ *Chueng v. Wu*, 2007 ME 22, ¶ 24, 919 A.2d 619, 625.

²⁸ 14 M.R.S.A. § 6101 (2003). In a mortgage foreclosure case, the Law Court found that as long as a note entitles the lender to costs of enforcement, attorneys' fees will be included, even if not expressly mentioned. *Pepperell Trust Co. v. Mehlman*, 155 Me. 318, 321-322, 154 A.2d 161, 163 (1959). *See, also, Top Line Distributors, Inc. v. Spickler*, 525 A.2d 1039, 1041 (Me. 1987) (guarantor's agreement in guaranty agreement to indemnify creditor from costs of collection amounted to agreement to pay reasonable attorneys fees incurred in collection).

²⁹ *See Auburn Police Union v. Tierney*, 762 F. Supp. 3 (D. Me. 1991); *Fleet Bank of Maine v. Steeves*, 793 F. Supp. 18 (D. Me. 1992).

³⁰ *First NH Banks Granite State v. Scarborough*, 615 A.2d 248, 251 (Me. 1992) (“We adopt no talismanic formula with regard to the inclusion of paralegal fees”).

§3-1(b)(5) Integration Clauses

Loan documents typically contain an “integration clause” stating that the document at issue (or the group of documents memorializing the transaction) expresses the full and final agreement of the parties on the subject matter and supersedes any prior understandings concerning the subject matter of the agreement. It is not customary to include these provisions in promissory notes, although some lenders now do so in light of *Rogers v. Jackson*, 2002 ME 140, 804 A.2d 379. This case involved a promissory note under which the maker agreed to pay the principal amount plus interest, half in one year and the rest in two years. The maker claimed that there existed an oral agreement that no payment would be required unless or until he had available cash for that purpose. The Law Court permitted introduction of parol evidence of the oral agreement on the grounds that, even if the note were fully integrated, the oral condition was not inconsistent with the express payment terms of the note since “the condition, as a term of the larger agreement of which the promissory note is but one part, prevents [maker’s] payment obligation under the note from coming into effect until such time as he can afford to pay.”³¹

In a persuasive dissent, Chief Justice Saufley wrote that parol evidence should have been barred, since the note was a fully integrated, unambiguous contract and observed that the court’s holding risked “opening every contract, except those whose drafters are savvy enough to include an ironclad integration clause, to a factual dispute over the agreement to pay, even when that agreement is specifically and unambiguously included in the written contract.”³²

Taking a cue from the Chief Justice, some lenders’ counsel now include an integration clause in their promissory notes, as does the form at §3-1(e). Others are content to rely on the presence of an integration clause in other the other loan documents, on the provisions of 10 M.R.S.A. §1146 (discussed in §3-1(b)(2)) for loans over

³¹ *Rogers v. Jackson*, 2002 ME 140, ¶ 11, 804 A.2d 379, 380. The decision appears implicitly to overrule earlier case law, such as *Sears v. Wright*, 24 Me. 278 (1844), which held inadmissible evidence of oral conditions to payment of a note that contained express payment terms.

³² *Rogers v. Jackson*, 2002 ME 140, ¶¶ 22-23, 804 A. 2d at 384-385.

\$250,000, or on their conviction that the *Rogers v. Jackson* decision is wrongly-decided.

§3-1(c) Late Charges and Default Interest

The terms of most notes will include charges that are intended, according to one's perspective, either to discourage late payment and default or to compensate the lender for the administrative costs and lost profit that result from borrower delinquency.³³ Both of these types of charges are provided for in the attached form note. Their enforceability depends in Maine on whether they are adjudged to be reasonable liquidated damages or a penalty.³⁴ In order to qualify as the former, (1) damages caused by the breach must be difficult to estimate, and (2) the amount fixed by the agreement must be a reasonable estimate of fair compensation to the party harmed by the breach. Although the enforceability of these provisions is a legal question, whether the foregoing test is met is a factual determination.

§3-1(d) Prepayment and Prepayment Premiums

Commercial promissory notes that allow prepayment commonly provide for a prepayment premium.³⁵ This is designed to compensate the lender for the loss of the interest that it would have been paid over the life of the loan had the borrower not cut that life short by paying the debt early.³⁶ This protection of the lender's investment can be seen as trade-off for the borrower obtaining the right to prepay at all, since most jurisdictions hold to the rule that the note maker in an

³³ In fact, banks are obligated to establish loan loss reserves for problem loans and the default interest charge could be characterized as partial reparation for that financial burden. *See, e.g.*, Financial Accounting Standards Board, Statements 114 and 118, Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures, for a statement of loan loss reserve accounting policy.

³⁴ *Raisin Memorial Trust v. Casey*, 2008 ME 63, 945 A.2d 1211.

³⁵ The cases on prepayment premiums, both in and outside of the bankruptcy courts, are collected by John C. Murray in *Enforceability of Prepayment-Premium Provisions in Mortgage Loan Documents*, found at http://local.firstam.com/ekcms/uploadedFiles/firstam_com/References/Reference_Articles/John_C_Murray_Reference/Mortgages_and_Financing/Prepayment_article.pdf.

³⁶ *Warrington 611 Associates v. Aetna Life Ins. Co.*, 705 F. Supp. 229 (D. N.J. 1989).

unregulated transaction does not have the right to compel a creditor to accept prepayment unless the note allows it.³⁷

Prepayment premiums are more regularly applied to fixed rate obligations than to variable rate ones, since the fixed rate contract will be difficult to duplicate if interest rates have fallen significantly since inception of the loan. If the prevailing rate for a given type of loan was 9% when the loan was closed, but is now 6%, where is a lender going to find a borrower willing to take a loan at the higher rate? Conversely, the variable rate obligation on which, for instance, interest is accruing at a spread over The Wall Street Journal prime, will remain more or less in line with market rates. Nevertheless, prepayment premiums are sometimes found in variable rate obligations as well.

Prepayment premiums are generally calculated according to one of two formulae: A declining percentage premium or a yield maintenance premium. Sometimes these are combined to make the premium either the greater or lesser of the amount derived by the two formulae.

A declining percentage premium is calculated as a percentage of the loan prepaid in a given year during the loan term. Thus, a note with a 5 year term might assess a premium of 5% of any prepayment made during the first year, followed by a premium of 4% of any prepayment made during the second year, followed by 3% of any prepayment made during the third year, and so on down to loan maturity.

Yield maintenance premiums are calculated by reference to changes in prevailing interest rates rather than arbitrary percentages and are sometimes referred to as “make whole” premiums. They

³⁷ The majority rule is that a lender has the right to receive payment in exact accordance with the terms of the loan documents and if these are silent on a right to prepay, no such right exists. This is sometimes referred to as the “perfect tender in time” rule. The decisions indicate that Maine belongs to this majority. *Briggs v. Briggs*, 1998 ME 120, ¶ 8, 711 A.2d 1286, 1289 (“Where a note provides for a fixed succession of installment payments, each installment becomes due and payable at the time specified for its payment and not before.”). See *Murray, supra*, note 35, for a list of perfect tender in time cases and a discussion of the status of the doctrine.

typically require payment of an amount that the lender could, hypothetically, reinvest (commonly in U.S. Treasury bonds or notes) at the time of prepayment, together with the repaid principal, to recover its lost interest income.³⁸ If interest rates have fallen since the loan was made, the premium will grow since more Treasury bonds or notes would have to be purchased to match the return on the original higher-rate loan. Conversely, if rates have risen since the loan was made the premium would be lower since fewer such instruments would have to be acquired to duplicate the return. If rates have risen sufficiently there may be no premium at all since the repaid principal could, all by itself and without need for any additional payment, be reinvested in Treasury securities to duplicate or even exceed the contracted-for return.

Maine cases have not addressed the enforceability of either type of prepayment premium, although some federal courts in Maine have allowed collection of premiums where the parties did not raise the issue of enforceability.³⁹

Loan documents should specify whether partial prepayment will be allowed or whether only full prepayment is permitted. Where the loan may be prepaid in part, the documents should state whether the amount of monthly or other periodic payments on the note will be lowered to reflect the reduced amount of the outstanding loan or, instead, if the periodic payments will remain the same but the maturity shortened to reflect the lower amount to be repaid. Finally, the note should specify that a premium can be collected even upon

³⁸ The use of a given reinvestment index, such as U.S. Treasury rates, simply provides the basis for calculating the prepayment premium; the lender is not required actually to use the funds for this reinvestment. *See, River East Plaza, L.L.C. v. The Variable Life Annuity Co.*, 498 F.3d 718 (7th Cir. 2007). The calculation should include a present value factor to reflect the fact that the lender is receiving the premium earlier than it would have received the ordinary course interest payments.

³⁹ *In re Barrett*, 370 B.R. 1 (Bankr. D. Me. 2007) (percentage premium included in secured claim of first mortgagee in analysis of whether junior judgment lien impaired debtor's homestead exemption).

prepayment due to the lender's acceleration of the maturity date upon the borrower's default.⁴⁰

§3-1(e) Form of Promissory Note

The following is a form of term note on which interest accrues at a fixed rate. The form includes optional language regarding a loan agreement if the note is used in conjunction with one. The note is customized to serve as the term note described in the sample commitment letter at §2-2(b).

PROMISSORY NOTE (TERM NOTE)

\$1,600,000.00

Cashland, Maine
June 1, 2010

FOR VALUE RECEIVED,⁴¹ the undersigned, ACME PRODUCTS, INC., a Maine corporation with a place of business at Warner, Maine ("Borrower") promises to pay to LENDER BANK, N.A., a Maine financial institution with a place of business at Cashland, Maine (together with its successors and assigns, "Lender"), the principal sum of One Million Six Hundred Thousand Dollars (\$1,600,000.00), together with interest on the principal balance from time to time outstanding hereunder, computed from the date hereof at a fixed rate equal to eight percent (8.0%) per annum. Borrower shall

⁴⁰ See, e.g., *In re LHD Realty Corp.*, 726 F.2d 327, 330 (7th Cir. 1984) (refusing to permit the lender to collect a prepayment premium after the borrower's default because prepayment advances maturity so payment therefor is not prepayment.) The Borrower will sometimes negotiate for an exception to payment of a premium where the prepayment results from an event beyond its control that gives the lender the option to call the note, such as a fire or other casualty after which the lender elects to accelerate and collect insurance proceeds rather than to allow the borrower to rebuild.

⁴¹ The recital "for value received" in a negotiable instrument is prima facie evidence of consideration, which may be rebutted by parol evidence. *Greely v. Greely*, 119 Me. 264, 110 A. 637 (1920); *Pyrofax Gas Corp. v. Consumers Gas Co.*, 151 Me. 172, 116 A.2d 661 (1955). This is seldom an issue in commercial loans.

make equal monthly payments of principal and interest in the amount of Thirty-two Thousand Four Hundred Forty-two and 23/100 Dollars (\$32,442.23) each, commencing on July 1, 2010 and continuing on the first day of each and every consecutive month thereafter through and including May 1, 2013. On June 1, 2013, all principal, accrued but unpaid interest and all other amounts due under this Note shall be due and payable in full.

The foregoing monthly payments may be applied as follows, at the option of Lender: (1) first, to any prepayment premium payable hereunder, (2) second, to all late charges and other costs and charges payable hereunder or in connection herewith, other than principal or interest, (3) third, to the interest on the unpaid balance of the debt evidenced hereby, with interest on all overdue interest at the same rate, and (4) the remainder to the unpaid principal of the debt, until the same is paid in full. The Borrower acknowledges that the above payments are based upon a five (5) year amortization schedule, with a balloon payment of all outstanding principal and accrued interest due and payable three (3) years from the date of this Note.

Borrower shall pay to Lender a late charge in an amount equal to five percent (5.0%) of any amount due hereunder that is not paid within five (5) days of the date when due, with a minimum charge of \$500 per occurrence. In addition, upon the occurrence of an Event of Default (defined below), interest on all unpaid balances hereunder shall accrue from the date of such Event of Default at a fixed rate equal to thirteen percent (13%) per annum (the “Default Rate”) until the earlier of the time that (i) Lender elects in its sole discretion to accept cure of such Event of Default in writing, or (ii) such balances are paid in full. All computations of interest due hereunder shall be based on the actual number of days elapsed over a 360-day year. Interest at the Default Rate and late charges as described in this paragraph shall be due upon demand.⁴²

In the event that any or all of the following shall occur (each, an “Event of Default”): (i) Borrower fails to pay any amount when due

⁴² The note should specify when late charges and default interest are payable, or they may be held to be first due at maturity. *Perry v. Wolaver*, 433 F. Supp. 2d 126, 128 (D. Me. 2006), *aff’d*, 506 F.3d 48 (1st Cir. 2007).

hereunder [, and such failure continues for _____ (____) days]; (ii) there occurs an “Event of Default” as such term is defined in the Loan Agreement of near or even date herewith entered into between Lender and Borrower (the “Loan Agreement”); or (iii) there occurs a default in the terms or conditions of any other instruments or documents executed in connection herewith or that may from time to time be given as additional security herefor (the “Loan Documents”) and such default continues after the period, if any, set forth in the pertinent Loan Document for the purpose of curing such default,⁴³ then, in each and every such case, Lender shall have the option to declare due and payable at once the entire principal balance hereof together with accrued interest, and Lender shall have such additional rights and remedies as are set forth in the Loan Agreement and the other Loan Documents and as are available at law.⁴⁴

This Note is subject to the condition that at no time shall Borrower be obligated or required to pay interest at a rate that could subject Lender to either civil or criminal liability, forfeiture or loss of principal, interest, or other sums as a result of being in excess of the maximum interest rate that Borrower is permitted by law to contract or agree to pay or that Lender is permitted to receive. If, by the terms of this Note, Borrower is at any time required or obligated to pay interest at a rate in excess of such maximum rate, the rate of interest under this Note shall be deemed to be immediately reduced to such maximum rate for so long as such maximum rate shall be in effect and shall thereafter be payable at the rate herein provided.

If any payment of principal or interest hereunder shall be deemed by final order of a court of competent jurisdiction to have been a voidable preference or fraudulent conveyance, the obligation of Borrower and all other parties liable herefor shall, jointly and

⁴³ If the Loan Agreement defines “Event of Default” to include a default beyond applicable grace or cure periods in any of the Loan Documents, then the Event of Default trigger in clause (iii) is unnecessary and can be deleted.

⁴⁴ In the absence of an acceleration clause, installment payments under a note are due at the respective times specified and not before (*Briggs v. Briggs*, 711 A.2d 1286, 1289 (1998)) and the holder may bring action only for accrued installments, not for the entire debt (*Hills v. Gardiner Savings Institution*, 309 A.2d 877, 882-83 (Me. 1973)).

severally, to the extent thereof, survive as an obligation due hereunder and shall not be discharged by said payment, notwithstanding the return by Lender to Borrower or any other party of the original of this Note.

Borrower shall have the right to prepay all, but not merely a portion of the principal balance of this Note, on any payment date, upon thirty (30) days' prior written notice to Lender and upon payment of the Prepayment Premium (as defined below). The "Prepayment Premium" is that amount which, if invested with the outstanding principal balance in U.S. Treasury bills, bonds or notes (each, a "Treasury Security") maturing at or nearest the maturity date of this Note, would return to Lender the discounted present value [utilizing a discount factor equal to the Reinvestment Rate (as defined below)] of the stream of payments under this Note. The "Reinvestment Rate" is the yield on the current coupon U.S. Treasury Security having a maturity date closest to (before, on or after) the maturity date of this Note, as reported in the online edition of The Wall Street Journal (<http://www.wsj.com>) or similar source selected by Lender on the fifth (5th) business day preceding the date of payoff (or if the Prepayment Premium is being calculated in connection with an Event of Default, on the fifth (5th) business day preceding the date of acceleration). Borrower acknowledges and agrees that Lender is making the loan evidenced by this Note in consideration of the receipt by Lender of all interest and other benefits intended to be conferred by this Note and if payments of principal are made to Lender prior to the regularly scheduled due date of such payments, for whatever reason (whether voluntarily or involuntarily) including, but not limited to, as a result of or in connection with (a) Lender's acceleration of the loan evidenced by this Note on account of an Event of Default, (b) the exercise of Lender's rights under "due-on-sale," "due-on-encumbrance" or similar provisions in the Loan Documents, (c) any bankruptcy proceeding involving the Borrower or any security given for Borrower's obligations to Lender, (d) payment to Lender by any holder of a subordinate or superior interest in any such security; or (e) any foreclosure sale under power, execution sale, judicial order or trustee's sale of any such security, whether judicial or non-judicial, Lender will not receive all such interest and other benefits and may incur additional costs. For these reasons, and to induce Lender to make the Loan, Borrower expressly waives any

right to prepay this Note except pursuant to this paragraph and agrees that all voluntary and involuntary prepayments will be accompanied by the Prepayment Premium.⁴⁵ The Prepayment Premium shall be required whether payment is made by Borrower, anyone on behalf of Borrower, or by the purchaser at any judicial or non-judicial foreclosure sale or execution sale, and may be included in any bid by Lender at such sale.

Lender shall have a security interest in, and rights of set-off with respect to, the checking and other deposit accounts and a security interest in certain other property of Borrower, as follows: any sums credited by or due from Lender to Borrower and any property of Borrower in which Lender has any security interest or which may be in the possession of Lender may, at any time, be treated or held as collateral for the payment or performance of Borrower's obligations hereunder. Regardless of the adequacy of collateral, Lender may apply such sums or property or realizations upon any such security interest against said obligations at any time after occurrence of an Event of Default.⁴⁶

Borrower and all other parties liable herefor, whether principal, guarantor, endorser or otherwise, hereby severally (i) waive demand, presentment, protest and notice of every kind, and (ii) waive all recourse to suretyship and guarantorship defenses generally, including, but not limited to, any extensions of time for payment or performance which may be granted to Borrower or to any other liable party, any modifications or amendments to this Note or any documents securing payment and performance hereof, any act or omission to act by or on behalf of Lender, any invalidity or unenforceability of any security, guaranty or endorsement given herefor, any release of security, whether any such release is intentional, unintentional or by operation of law, and all other indulgences of any type which may be granted by Lender to Borrower or to any other party liable herefor, and (iii) waive any right to indemnity, contribution, exoneration or reimbursement of any kind by any other party directly or indirectly liable herefor, whether maker,

⁴⁵ An exception to applicability of the Prepayment Premium is often made for prepayments resulting from a pay down of the loan with insurance proceeds after a casualty or with a condemnation award after a taking.

⁴⁶ The references to deposit accounts will apply only to bank-type lenders.

endorser, guarantor or otherwise, on account of any payment made hereunder, and (iv) waive any right of subrogation to the rights, remedies or security of Lender on account of any payment made hereunder, and (v) agree to pay on demand all costs of collection and/or enforcement of the indebtedness and other obligations evidenced hereby, including reasonable attorneys' and paralegals' fees and costs.

All installments and sums due hereunder shall be paid to Lender Bank, N.A., as payee hereof at One Bank Street, Cashland, Maine, or to such other parties or addresses as Lender may from time to time designate in writing to Borrower or to other parties liable herefor. This Note evidences a loan for business and commercial purposes, and not for personal, family or household purposes and is secured by a mortgage and security interest in and upon all assets of Borrower.

Borrower and any undersigned guarantors confirm and acknowledge their understanding that, pursuant to 10 M.R.S.A. § 1146, to the extent applicable, in order to maintain an action against Lender with respect to a promise, contract or agreement to lend money, extend credit, forbear from collection of a debt or make any other accommodation for the repayment of a debt, such promise, contract or agreement (or some memorandum or note thereof) must be both (a) in writing and (b) signed by the Lender.

This Note, together with the Loan Agreement and the other Loan Documents, are intended by the parties as the final, complete and exclusive statement of the transactions evidenced by the Loan Documents.⁴⁷ All prior or contemporaneous promises, agreements and understandings, whether oral or written, are deemed to be superseded by the Loan Documents, and no party is relying on any promise, agreement or understanding not set forth in the Loan Documents. This Note may not be amended or modified except by a written instrument describing such amendment or modification executed by Lender and Borrower.

No delay or omission on the part of Lender in exercising any right

⁴⁷ Use of this clause is prompted by *Rogers v. Jackson*, 2002 ME 140, 804 A.2d 379 (oral agreement may be barred if not consistent with writing). When using such a clause, be careful to include all of the relevant loan and security documents, either specifically or generically.

hereunder shall operate as a waiver of such right or of any other right under this Note. No waiver of any right of Lender or any modification of the terms and conditions of this Note shall be effective unless set forth in writing and signed by Lender. Further, no forbearance or waiver by Lender on one occasion shall be construed as a waiver of any right of Lender on any future occasion.

IN RECOGNITION OF THE HIGHER COSTS AND DELAY WHICH MAY RESULT FROM A JURY TRIAL, BORROWER AND LENDER WAIVE ANY RIGHT TO TRIAL BY JURY OF ANY CLAIM, DEMAND, ACTION OR CAUSE OF ACTION (A) ARISING HEREUNDER, OR (B) IN ANY WAY CONNECTED WITH OR RELATED OR INCIDENTAL TO THE DEALINGS OF BORROWER AND LENDER OR EITHER OF THEM WITH RESPECT HERETO, IN EACH CASE WHETHER NOW EXISTING OR HEREAFTER ARISING, AND WHETHER SOUNDING IN CONTRACT OR TORT OR OTHERWISE; AND EACH OF BORROWER AND LENDER FURTHER WAIVES ANY RIGHT TO CONSOLIDATE ANY SUCH ACTION IN WHICH A JURY TRIAL HAS BEEN WAIVED WITH ANY OTHER ACTION IN WHICH A JURY TRIAL CANNOT BE OR HAS NOT BEEN WAIVED; AND EACH OF BORROWER AND LENDER HEREBY AGREES AND CONSENTS THAT ANY SUCH CLAIM, DEMAND, ACTION OR CAUSE OF ACTION SHALL BE DECIDED BY COURT TRIAL WITHOUT A JURY, AND THAT EITHER BORROWER OR LENDER MAY FILE AN ORIGINAL COUNTERPART OR A COPY OF THIS PARAGRAPH WITH ANY COURT AS WRITTEN EVIDENCE OF THE CONSENT OF BORROWER AND LENDER TO THE WAIVER OF THEIR RIGHT TO TRIAL BY JURY. THE PROVISIONS OF THIS PARAGRAPH HAVE BEEN FULLY DISCUSSED BY BORROWER AND LENDER, AND THESE PROVISIONS SHALL NOT BE SUBJECT TO ANY EXCEPTIONS. NEITHER PARTY HAS AGREED WITH OR REPRESENTED TO THE OTHER THAT THE PROVISIONS OF THIS PARAGRAPH WILL NOT BE FULLY ENFORCED IN ALL INSTANCES. LENDER SHALL BE BOUND BY THIS PARAGRAPH UPON ITS ACCEPTANCE OF THIS NOTE.

No invalidity or unenforceability of any portion of this Note shall

affect the validity or enforceability of the remaining portions hereof. This Note is intended to take effect as a sealed instrument, and all rights and obligations hereunder, including matters of construction, validity and performance, shall be governed by those laws of the State of Maine that are applicable to agreements that are negotiated, executed, delivered and performed solely in the State of Maine.

ATTESTING WITNESS:

ACME PRODUCTS, INC.⁴⁸

Name:

By: _____

Robert T. Principal
Its President

The undersigned acknowledges that this Note is one of the obligations guaranteed by the undersigned pursuant to the terms of a Guaranty dated June 1, 2010.⁴⁹

⁴⁸ This form of signature block is recommended when the borrower is an entity, not an individual, and the parties intend to create liability in the maker-entity without also imposing it on the officer-signatory. Other forms may result in such unwanted personal liability on the signatory's part. *See Sturdivant v. Hull*, 59 Me. 172 (1871) (signature block styled "John T. Hull, Treas. St. Paul's Parish" resulted in Hull's personal liability on the note). The personal liability of a representative signing a negotiable note is addressed in 11 M.R.S.A. § 3-1402 (1995). The statute generally follows agency law in determining whether the principal is bound. 11 M.R.S.A. § 3-1402(1) (1995). As for the agent, he is not liable if the signature block unambiguously so indicates and, where such ambiguity exists, his liability depends on whether the party seeking recovery is a holder in due course. 11 M.R.S.A. § 3-1402(2) (1995). The prescription of specific forms of signature found in former Article 3 has been abandoned, rendering obsolete those cases that were decided with reference to the forms. *See Maine Gas & Appliances, Inc. v. Siegel*, 438 A.2d 888 (Me. 1981) (finding individual signatory liable on note under predecessor to 11 M.R.S.A. § 3-1402, 11 M.R.S.A. § 3-403, repealed by P.L. 1993, ch. 293, § A-1).

⁴⁹ This is not a guaranty and this form presupposes that the guarantor has signed a separate guaranty agreement. This cross reference to the guaranty is short and not intended to summarize the terms of the guaranty. Although it is not required that guarantors sign on the note that they are guaranteeing, it is helpful if there is any concern that they might later

WITNESS:

Name:

Robert T. Principal,
individually

§3-2 Guaranties⁵⁰

Practice Pointers:

- **Use a full guaranty form and do not rely on a single sentence or two to establish a guaranty.**
- **Analyze the relationship of the guarantor to the loan and consider fraudulent conveyance issues.**
- **Involve all guarantors in the commitment letter and in any modifications.**

§3-2(a) Background and Initial Considerations

A guaranty is a contract by which a party agrees to become liable for the debts of another.⁵¹ The person or entity giving the guaranty is

claim that they did not understand what they were guaranteeing. If the parties do use this approach, it is recommended that they be consistent and use it with amendments as well as with the original documents.

⁵⁰ The authors use “guaranty” as the noun, “guaranties” as the plural, and “guarantee” as the verb.

⁵¹ The guaranty must identify with specificity not only the guarantor and borrower but also the creditor for whose benefit the guaranty is made. In *Unique Logistics International (ATL), Inc. v. The Foreside Group, LLC*, 561 F. Supp. 2d 120 (D. Me. 2008), several affiliated companies provided transportation and customs brokerage services for the Foreside Group. Foreside Group’s owner gave his personal guaranty of the company’s payment of the charges for these services. The guaranty only named one of the affiliates as beneficiary of the guaranty, however, and the other affiliates were required to engage in further fact-finding to prove the existence of an arrangement by which the principal agreed to guaranty Foreside’s debt to them.

called the “guarantor” or sometimes a “surety,”⁵² and the body of law that governs the relationship among the guarantor, the lender, the borrower and any other guarantors is usually referred to as “suretyship law.”⁵³

Lenders will commonly require personal guaranties from the owners of a closely-held business, including individual owners and corporate parents of subsidiaries, and some government loan programs, such as the Small Business Administration’s 7a loan program,

⁵² There is a technical difference between a surety and a guarantor, with the former sharing primary liability with the borrower on the same instrument, and the latter having secondary liability pursuant to a separate contract (*see* Black’s Law Dictionary), but the terms are often used interchangeably and the UCC abolishes the distinction between a surety and a guarantor. 11 M.R.S.A. § 1-1201(39) (Supp. 2010).

⁵³ General common law principles of suretyship and guaranties apply in Maine, and are supplemented by the suretyship and accommodation party sections of the Maine Uniform Commercial Code (11 M.R.S.A. §§ 1-1201(39) (Supp. 2010), 3-1419 (1995), 3-1605 (1995)). However, Article 3 of the UCC (which is now Article 3-A in Maine) doesn’t generally apply to guaranties since they rarely meet the requirements for a negotiable instrument. *See Vesta State Bank v. Independent State Bank of Minnesota*, 506 N.W.2d 307, 312 (Minn. 1993), *aff’d and rev’d on other grounds*, 518 N.W.2d 850 (Minn.1994) (Article 3 does not apply to guaranty because guaranty is not an unconditional promise to pay, is not a promise to pay a fixed amount of money and is not payable on demand or at a definite time.) The RESTATEMENT OF SURETYSHIP AND GUARANTY has sometimes been relied on by the Law Court as a valid statement of the common law in this area. *See John Nagle Co. v. Gokey*, 2002 ME 101, ¶ 3, 799 A. 2d 1225, 1227 ; *MP Associates v. Liberty*, 2001 ME 22, ¶ 25, 771 A.2d 1040, 1047. Finally, though this volume doesn’t generally address the topic of enforcement of loan documents, it should be mentioned that the UCC does impose obligations on a secured party to provide certain notices to “secondary obligors,” such as guarantors. *See* 11 M.R.S.A. § 9-1611(3)(a) and (b) (Supp. 2009) (parties entitled to notice include debtor and secondary obligors), and 11 M.R.S.A. § 9-1102(28) (Supp. 2009) (definition of “debtor” which may include, for example, a guarantor that has given collateral to secure the primary obligor’s debt).

require that the owners of more than a fixed percentage of the equity in a business provide a personal guaranty.⁵⁴

§3-2(a)(1) Suretyship Defenses

Although guarantors of commercial loans are usually people or entities that have an interest in the borrower's business, they are nonetheless not the ones getting the direct financial benefit of the loan.⁵⁵ Historically, this has led courts to look on the guarantor with sympathy and they have readily recognized "suretyship defenses" to the guarantor's liability.⁵⁶ These "suretyship defenses" are manifold, but mostly arise where the creditor (sometimes in cooperation with the borrower) takes some action that could potentially increase the guarantor's risk of liability.⁵⁷ A guarantor may argue that his obligation is reduced or eliminated if, for example, a lender impairs the collateral, extends the time for performance of the loan, modifies the loan, or releases the borrower without the guarantor's consent. Modern courts have generally not supported such arguments absent a showing of damage to the guarantor.⁵⁸ The suretyship defenses can be

⁵⁴ See 13 C.F.R. § 120.160 (2010).

⁵⁵ The guarantor will often obtain an indirect financial benefit, however, such as where the loan is made to an entity that is wholly-owned by the guarantor.

⁵⁶ The Law Court once characterized individual guarantors as being "actuated by beneficent motives" to lend their credit to a transaction. *Foster, State Treasurer v. Kerr & Houston, Inc.*, 133 Me. 389, 179 A. 297, 300 (1935).

⁵⁷ A list of *The 24 Defenses of the Guarantor* is found in 1 Clark & Clark, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE ¶ 4.03[3][b] (rev. ed., A.S. Pratt & Sons 2010).

⁵⁸ The traditional view was that the guarantor was relieved of liability without need to prove harm from the creditor action if there was a change to the obligation being guaranteed without the guarantor's consent, but the modern authority is more inclined to confine the discharge to the extent the guarantor suffers loss. See RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY §§ 40 and 41 (1996) (guarantor is discharged by extension of time or loan modification only to extent it suffers loss). Even the older Maine cases have tended to require harm to the guarantor in order to effect his discharge. *Gillighan v. Boardman*, 29 Me. 79, 82 (1848) ("a guarantor is not discharged by proof of negligence and laches, when it appears, that he has not thereby suffered any loss or injury.")

waived and a commercial lender's guaranty ought to include waiver language such as is found in the form of guaranty at the end of this section.⁵⁹ Abbreviated, one-line guaranties are unlikely to include

⁵⁹ The RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY § 48 authorizes waiver of most suretyship defenses and suggests a short hand means of doing this. See RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY § 48(1) and illustration 3 (1996) (waiver of defenses accomplished by statement that guarantor "waives all suretyship defenses"). The Maine cases have not considered the Restatement approach, but have given effect to some waivers of guarantor defenses. In *Bumila v. Keiser Homes of Maine, Inc.*, 1997 ME 139, 696 A.2d 1091, a loan was made to a company by a trust but was evidenced by a note payable to one of the individuals serving as trustees of the trust. The company's obligations under the note to the individual were guaranteed by third parties. After the closing, the mistake in identity of the note payee was corrected by the company signing a substitute note in favor of the trust. *Id.* at 1093. The guarantors' consent was never sought for the correction and they argued that the substitution of the note resulted in discharge of their guaranty obligations. The Law Court disagreed, focusing on language in the guaranties by which the guarantors waived notice of loans made, loan extensions and loan modifications and agreed to "the provisions of the notes and/or other papers evidencing the obligations [thereby] guaranteed." *Id.* at 1094. The guaranty agreement did not expressly cover note substitutions, but revealed that the guarantors intended to grant the borrower and lender great latitude in conducting their transaction and that extending the guaranties to the trust note was consistent with that intent. The court went on to observe that the guarantors were not harmed by the substitution and could not cry foul on that basis. Thus, the case indicates the Law Court's readiness to take a broad view of party intent and to give effect to waivers in arm's length commercial guaranties, and confirms its historic resistance to relieving a guarantor who has not been harmed by a change in contract terms. See, also, *Ford Motor Credit Co. v. Moore*, 663 A.2d 30 (Me. 1995) (giving effect to waiver of defenses by guarantor arising from cessation of prime obligor's liability). However, older cases where no waiver of defenses is included in the relevant instrument took a stricter view. *Lime Rock Bank v. Mallett*, 34 Me. 547, 549 (1852) (where creditor extends time for payment of principal loan without consent of surety, surety is discharged without proof of prejudice or damage, even where surety agreed to earlier extensions). Despite the modern trend toward relieving only the guarantor who is actually harmed, the better practice is still to involve the guarantor in any changes to the guaranteed obligation.

adequate waivers, and it is primarily for this reason that a commercial lender should require a full, separate guarantee from the guarantor.

§3-2(a)(2) Separate Nature of Guaranty Contract

The guaranty contract is separate from the one by which the primary debt is established (usually the promissory note)⁶⁰ and can be enforced by a separate cause of action.⁶¹ An implication of this rule is that a lender will be entitled to attachment and other relief against a guarantor without discounting for the value of the collateral provided by the borrower, since the borrower collateral secures only the borrower's separate obligation.⁶² Likewise, where several co-guarantors are jointly and severally liable, attachment may be granted in the full amount of the likely recovery from each of them.⁶³

§3-2(a)(3) Guaranties of Collection and Payment

Although in rare instances the guarantor provides a “guaranty of collection,” under which a lender first has to pursue the borrower and exhaust its collateral before enforcing the guaranty, the standard in commercial loans is the “guaranty of payment.”⁶⁴ The guaranty of

⁶⁰ *Fleet Bank v. Harriman*, 1998 ME 275, ¶ 5, 721 A.2d 658, 660 and cases cited therein.

⁶¹ *Top Line Distributors v. Spickler*, 525 A.2d 1039 (Me. 1987). *Spickler* held that that suit could be brought against the guarantor without joining the primary obligor in the action. *Id.* at 1040.

⁶² *Casco Northern Bank, N.A. v. Moore*, 583 A.2d 697, 698 (Me. 1990). Similarly, in assessing the value of a lender's security interest in its borrower's assets for purposes of determining the amount of permissible pre-judgment attachment, a loan guaranty made in favor of the lender by the borrower's principal should not be valued as part of the security, since it is not an asset of the borrower. *Citizens Bank New Hampshire v. Acadia Group, Inc.*, 2001 ME 41, ¶ 8, 766 A.2d 1021, 1023.

⁶³ *Chase Commercial Corp. v. Hamilton & Son*, 473 A.2d 1281, 1284 (Me. 1984).

⁶⁴ Where a guaranty doesn't address whether it is one of collection or payment, the common law rule is that it is the latter. RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY §§ 50 and 51 (1996). Some formulae have been devised for determining when the creditor holding a guaranty of collection has satisfied its obligation to exhaust remedies against the borrower and collateral. 11 M.R.S.A. § 3-1419(4) (1995) (applicable to suretyship arrangements governed by the UCC);

payment allows the lender to pursue the guarantor immediately upon default. A commercial lender will want this immediate right to proceed against the guarantor upon default in the primary obligation and so the guaranty should be explicit about its character as a payment guaranty, which will usually be done by saying outright that “this is a guaranty of payment and not of collection.”⁶⁵

§3-2(a)(4) Subrogation and Contribution

In addition to the relationships of lender and borrower and of lender and guarantor that arise from the use of a guaranty, there are others: First, the borrower will have an obligation to reimburse the guarantor if the latter is required to pay the borrower’s debt and, similarly, if there are multiple guarantors, they will have rights of contribution among one another if any of them pays more than his fair share.⁶⁶ Furthermore, the guarantor that pays the borrower’s debt will be “subrogated” to the lender’s rights against the borrower, meaning that it will inherit the lender’s rights against the borrower to the extent of its payment, although such rights may not vest until the debt is paid in full.⁶⁷ The lender will want to limit the guarantor’s exercise of

RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY § 15(b) (1996). In the case of a guaranty not governed by the UCC, the First Circuit Court of Appeals, applying Maine law, has held that the reduction to cash of collateral from the primary obligor constituted exhaustion of remedies against the primary obligor, entitling the lender to proceed against the surety. *Depositors Trust Co. v. Slobusky*, 692 F.2d 205, 209 (1st Cir. 1982).

⁶⁵ The form of guaranty in §3-2(e) addresses the issue in section 4: “This Guaranty is an absolute, unconditional and continuing guaranty of the full and punctual payment and performance of the Guaranteed Obligations, and not of their collectibility only...”

⁶⁶ *MP Associates*, 2001 ME 22, ¶ 14, 771 A.2d at 1045 (guarantors are entitled to reimbursement from a primary obligor for performance of the secondary obligation); *Goodall v. Wentworth*, 20 Me. 322, 324 (1841) (co-sureties have contribution rights against one another and reimbursement rights against the borrower). In the authors’ view, *Goodall* takes the prize for the most baffling recitation of facts in the history of Maine commercial case law.

⁶⁷ *Stewart v. Ticonic Nat. Bank*, 104 Me. 578, 72 A. 741 (1908) (guarantor who paid primary debt to lender was subrogated to lender’s rights against the primary debtor).

these rights of reimbursement, subrogation and contribution so that they do not interfere with the lender's collection efforts by turning debtor parties into competing creditors. For example, a lender will typically prohibit a guarantor from pursuing reimbursement obligations against a borrower before the lender's loan has been fully repaid. Although some forms of guaranty require the guarantor to waive subrogation rights altogether, the attached form instead just postpones the exercise of these rights until the debt to the lender has been fully paid.⁶⁸

⁶⁸ Waivers of subrogation rights by guarantors have been given effect in Maine. *Duhamel v. Turner*, 334 B.R. 483, 486 (Bankr D. Me. 2005). *Leighton v. Fleet Bank of Maine*, 634 A.2d 453 (Me. 1993), also involved enforcement of a subrogation clause included in a guaranty. There, Fleet Bank made an equipment loan to Dinex Two, which was secured by equipment of Dinex and guaranteed by Leighton. Leighton also obtained a security interest in Dinex's equipment, junior to that of Fleet, although it is unclear whether this secured some separate obligation from Dinex to Leighton (in which case standby and debt subordination concepts would be relevant) or whether it secured Leighton's right of reimbursement against Dinex (in which cases subrogation would be at issue). In any event, the court held that the clause, which postponed both exercise of any right of subrogation and of "any remedy," prevented Leighton from enforcing his junior security interest prior to payment of Fleet's loan. *Id.* at 456.

In *Kandlis v. Huotari*, 678 A. 2d 41 (Me. 1996), the Law Court assessed the defenses raised by several guarantors against their co-guarantor's contribution claims. The court found ambiguous language in the guaranty agreement by which the guarantors waived contribution rights (suggesting an absolute relinquishment of those rights) but which also suggested that the waiver was only a deferral of the rights until the lender's debt was fully satisfied. *Id.* at 43-44. Also, the Law Court disagreed with cases in other jurisdictions finding that guarantors implicitly waive contribution rights when their guaranty agreements allow the lender to settle with one guarantor without affecting the liability of the others. *Id.* at 45. In this case, the Law Court found that this provision was for the benefit of the lender, not the non-settling guarantors. *Id.* at 44. Guarantors who desire to change their contribution liability to one another should do so by an agreement among themselves.

§3-2(a)(5) Guarantor Covenants

Some guaranty agreements provide just for the guarantee of indebtedness, while others include extensive agreements on the part of the guarantor, such as agreements to observe financial covenants (such as net worth requirements) or to provide the lender with financial information. Where this is the case, the lender will want to be able to declare a default under the primary obligation if the guarantor breaches these agreements.⁶⁹

§3-2(a)(6) Continuing and Limited Guaranties

Guaranties can either be confined to a particular debt or can cover all future obligations of the principal obligor (borrower) to the obligee (lender). The latter type of guaranty is a “continuing guaranty.”⁷⁰ A continuing guaranty is terminable at any time by notice to the lender, although such notice relieves the guarantor of liability only for principal debt incurred after the effective date of the notice of termination.⁷¹ In addition, the lender’s agreement with the primary obligor may include a provision by which such a termination by the guarantor is a default under the primary obligation. Extensions of credit by the lender to the borrower in excess of the note amount or line of credit limit may allow the guarantor to argue that the excess is not covered by the guaranty even if the guaranty purports to be

⁶⁹ A lender will also want the death, financial failure or bankruptcy of any obligor, including another guarantor, to trigger a default under the loan documents, although these types of defaults are typically addressed in the primary loan documents and, so, are not typically restated in the guaranty documents. The federal court sitting in Maine gave effect to a cross-default provision that triggered a default under one loan if any of the guarantors of that loan defaulted under any of their other loan obligations to the lender. *New Maine Nat’l Bank v. Liberty*, 778 F. Supp. 86 (D. Me. 1991). This resulted in the former loan being called in default even though payments were current on it. However, a default based on the bankruptcy of the party against which the claim is being made may be ineffective if it violates the prohibition on ipso facto clauses that is found in the Bankruptcy Code, 11 U.S.C.A. § 365(e)(1) (2004).

⁷⁰ *John Nagle Co. v. Gokey*, 2002 ME 101, ¶ 3, 799 A. 2d at 1227.

⁷¹ *Clark v. Anderson*, 123 Me. 165, 122 A. 337, 338 (1923).

unlimited and continuing.⁷² To avoid any such argument, the lender should obtain the guarantor's consent to any such new loans if the lender expects them to be subject to the guaranty. It is also good practice to require the written acknowledgement of the guarantor to any amendments or other modifications to the loan documents, even though there is not a new debt. Lenders should also be careful about any course of conduct in requiring such acknowledgments; if they have asked for them on one occasion, they should do so on each subsequent one.

Guaranties can also differ in the extent of liability that they impose on the guarantor. Guaranty agreements typically cover all of the borrower's obligations to the lender, which might include not only principal debt, interest, fees, prepayment premiums and costs of collection, but also indemnification liabilities, such as those arising from environmental contamination of real estate collateral for the loan. It is possible to more narrowly circumscribe the guarantor's liability, however. This is usually accomplished by limiting liability to a fixed amount, to a percentage of the outstanding debt, or to the value of any security given for the guaranty.⁷³

Limitation to a fixed amount. The limitation to a specific amount seems simple enough, but does entail consideration of a few issues: First, costs of enforcing the guaranty should be in addition to the fixed amount, since otherwise the guarantor has nothing to lose by fighting the lender's collection efforts tooth and nail.⁷⁴ Secondly,

⁷² 38 Am. Jur. 2d Guaranty § 83 (West 2010). The effect of modifications of the principal obligation on the guarantor's liability is discussed in the RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY § 41 which is based on section 3-605 of the Uniform Commercial Code (11 M.R.S.A. § 3-1605 (1995)).

⁷³ A guaranty made in consideration of a \$50,000 line of credit from creditor to debtor that extended to "any outstanding balances and obligations of the [debtor] to [creditor]" was not capped at \$50,000. *Unique Logistics Int'l. (ATL), Inc.*, 561 F. Supp. 2d at 122. ("It would have been a simple matter to insert a dollar cap on the guarantee and on [guarantor's] personal exposure, but the parties did not do that.")

⁷⁴ See *FDIC v. Proia*, 663 A.2d 1252, 1255 (Me.1995) (even where guarantor was found to have made fraudulent transfer of his assets, attorneys fees could not be awarded for enforcement of guaranty, since

interest should continue to accrue on the principal amount that constitutes the limit once the guaranty is called. The lender will want to include an incentive to pay quickly on the guaranty and the accrual of interest at the default rate will provide this. Finally, if the guarantor is taking on any other liabilities that aren't intended to be limited in amount (as might be the case if the guarantor is joining in an unlimited environmental indemnity) this must be specified. A sample provision follows.

The aggregate liability of Guarantor hereunder shall be limited to the sum of (i) _____ Dollars (\$ _____) plus (ii) the costs and expenses identified in paragraph **[specify paragraph establishing liability for costs of collection]** of this Guaranty plus (iii) interest on uncollected amounts due from Guarantor hereunder at the **[Default Rate]** set forth in the **[Note]** [**provided, however, that nothing contained in this Guaranty shall limit the liabilities and obligations of Guarantor under the environmental Indemnity Agreement of near or even date herewith given by Guarantor, among others, to Lender, Guarantor agreeing that such liabilities and obligations are and shall remain unlimited**].

Limitation to a fixed percentage. When limiting a guaranty to a percentage of the debt, the parties need to establish the point at which the scope of the debt is determined. If the note balance at the time of default is \$100, and the lender realizes \$25 upon foreclosure, does the percentage limitation apply to the \$100 or to the \$75? The sample language assumes the former. As with a guaranty limited to amount, the parties need to consider liability for collection costs, interest, fees and premiums, and the need to make exceptions to the limitation for obligations that are not intended to be capped. Sometimes, the percentage limitations established in one guaranty are intended to dovetail with those in another such that the guaranties collectively cover the full debt. Provision is made in the sample language for the existence of such corresponding guaranties.

the guaranty was limited in amount to \$200,000 without additional provision for costs of collection).

The aggregate liability of Guarantor hereunder shall be limited to the sum of (i) _____ percent (___%) of the “Default Balance” (defined below) of the [Note], plus (ii) _____ percent (___%) of all interest on the Default Balance accruing at the [Default Rate] set forth in the [Note], plus (iii) _____ percent (___%) of all fees, late charges, prepayment premiums and other charges and costs payable under the [Note] and not otherwise itemized in this paragraph, plus (iv) the entire amount of any advances made by Lender to protect the security for **[this Guaranty] [the Guaranteed Obligations]**; plus (v) the costs and expenses identified in paragraph [specify paragraph establishing liability for costs of collection] of this Guaranty [, plus (vi) **the full payment and performance of all other components of the Guaranteed Obligations, including _____ (e.g., completion of construction)**] [; provided, however, that nothing contained in this Guaranty shall limit the liabilities and obligations of Guarantor under the environmental Indemnity Agreement of near or even date herewith given by Guarantor, among others, to Lender, Guarantor agreeing that such liabilities and obligations are and shall remain unlimited]. The foregoing percentage limitation on Guarantor’s liability is intended to coincide with the corresponding _____ percent (___%) liability of _____ for the remaining principal balance, interest, fees and charges due under the [Note], such that the combined liability for such principal balance, interest, fees and charges is a total of one hundred percent (100%). As used in this Guaranty, the term “Default Balance” means the total balance of principal outstanding under the [Note] as of the time of the acceleration of the [Note] by Lender, without reduction by any payment thereafter made by any party or from the proceeds of any security for the Guaranteed Obligations, and without reduction by any amounts refunded, turned over or paid by Lender as Turnover Payments (defined below).⁷⁵

⁷⁵ Turnover Payments are amounts that have been paid to the lender in reduction of the debt, but which have to be refunded to the borrower, or

Limitation to value of security. If a guarantor’s liability under a guaranty is limited to the value of collateral for the guaranty obligation, then the guaranty is characterized as a “non-recourse” obligation. That is to say, that the lender does not have recourse against the guarantor for a money judgment but can only enforce the guaranty debt to the extent of the value of security for the guaranty. For instance, if a lender believes that it has insufficient collateral for its loan to A, A’s father-in-law, B, might agree to provide a mortgage on additional real estate that would bring up the collateral value to an acceptable level. If the lender only needs the extra security and isn’t concerned about reaching other assets of B, a non-recourse guaranty would accomplish the lender’s objective. Borrower A would give a note, secured by A’s assets, and guarantor B would provide a non-recourse guaranty, secured by a mortgage. In the case of a default, the lender could sue A and realize on the security for A’s note, but could only proceed against B for the purpose of foreclosing the guaranty mortgage, and could not pursue B for a deficiency regardless of the extent of the sale proceeds from the mortgaged real estate. Here is some sample language:

Notwithstanding anything contained herein or in the other documents evidencing, securing or otherwise relating to the Loan (the “Loan Documents”) to the contrary, and except for the costs and expenses of enforcement and collection identified in paragraph [**specify paragraph establishing liability for costs of collection**] of this Guaranty, for which Guarantor shall have full personal liability,⁷⁶ Guarantor shall have no personal liability for payment or performance of the Guaranteed Obligations and Lender agrees not to seek a deficiency or personal money judgment against Guarantor for the failure to satisfy the same, but in such event Lender will look solely to the following security for satisfaction: All of Guarantor’s right title and interest in and to _____, all as mortgaged, pledged and assigned to Lender pursuant to

turned over to a bankruptcy trustee, usually on account of their status as preferential payments under 11 U.S.C.A. § 547 (2004 & Supp. 2010).

⁷⁶ If the guaranty is intended to be fully, non-recourse, this proviso creating personal liability for collections costs would not be included.

_____ of near or even date herewith from the Guarantor to Lender [**and any other property or rights of Guarantor that may now or later be mortgaged, pledged or assigned to Lender as security for payment and performance of the Guaranteed Obligations**]. Nothing herein contained shall be construed to prevent Lender from exercising and enforcing any other remedy not creating personal liability in Guarantor, whether such remedy be allowed at law or equity or allowed by any of the Loan Documents.

Where a guaranty is secured by collateral, lender's counsel should be sure that a default under the mortgage, security agreement or other document encumbering that collateral triggers a default under the principal obligation.

True non-recourse guaranties are rare. More common is the "limited recourse guaranty," under which, in addition to the value of any collateral, the guarantor is liable for various bad acts and some risks of loss that the lender is unwilling to bear. Non-recourse loans are discussed above at §2-1(e).

§3-2(b) Spousal Guaranties: Maine ECOA Case Law

The federal Equal Credit Opportunity Act, 15 U.S.C. §1691-1691f ("ECOA") prohibits discrimination in credit on the basis of race, color, religion, national origin, sex or marital status in connection with any credit transaction including commercial loans.⁷⁷ 15 U.S.C. § 1691a. Regulation B, which was issued by the Federal Reserve Board to implement ECOA, generally prohibits a creditor from requiring "the signature of the applicant's spouse or other person, other than a joint applicant, on any credit instrument if the applicant qualifies under the creditor's standards of creditworthiness for the amount and terms of the credit requested."⁷⁸ According to the

⁷⁷ 15 U.S.C. § 1691a (2009).

⁷⁸ 12 C.F.R. § 202.7(d)(1) (2010). A "creditor" is broadly defined to mean "a person who, in the ordinary course of business, regularly participates in a credit decision, including setting the terms of the credit. The term creditor includes a creditor's assignee, transferee, or subrogee who so participates." 12 C.F.R. § 202.2(l) (2010).

regulations, an “applicant” includes a guarantor.⁷⁹ Thus, if an individual is credit-worthy, the creditor cannot automatically require the individual’s spouse to incur liability on the loan documents. The creditor must instead inform the applicant that additional credit enhancement will be necessary and allow the applicant to offer some other signatory, without suggesting that it should be the applicant’s spouse.⁸⁰

Regulation B does allow a creditor to require a spousal guaranty in two situations. One is where an applicant relies on jointly owned property to support the creditworthiness of the loan. In such a case the creditor may require a spousal guaranty when the guaranty is necessary or “reasonably believed by the creditor to be necessary under the law of the state in which the property is located to enable the creditor to reach the property being relied upon in the event of the death or default of the applicant.”⁸¹ Maine law has not expressly required a guaranty or similar instrument in order to reach the spouse’s interest, so the reasonable belief justification for requiring such an instrument may not be available in Maine.⁸² The other

⁷⁹ Some courts have expressed skepticism about whether the statute can be stretched far enough to allow this interpretation. Writing for the court in *Moran Foods, Inc. v. Mid-Atlantic Market Development Co.*, 476 F.3d 436, 441 (7th Cir. 2007), Judge Posner acknowledged that “courts defer to administrative interpretations of statutes when a statute is ambiguous,” but found “nothing ambiguous about ‘applicant’ and no way to confuse an applicant with a guarantor.” *Contra Silverman v. Eastrich Multiple Investor Fund*, 51 F.3d 28, 31 (3rd Cir. 1995) (guarantors are covered by 1985 amendments to Regulation B).

⁸⁰ *Riggs Nat’l. Bank of Washington v. Lynch*, 36 F.3d 370, 374 (4th Cir. 1994).

⁸¹ 12 C.F.R. § 202.7(d)(2) (2010).

⁸² In *Key Bank, N.A. v. Mott*, 1998 ME 151, 712 A.2d 1064, the court held enforceable, as to both mortgagors, a mortgage granted by husband and wife as security for notes that had been made only by the husband and had not been guaranteed by the wife. The court’s discussion focused on the question of whether the wife had authorized certain future advances that the creditor claimed were secured by the mortgage, however, and not on whether a valid lien could be created on the wife’s interest in the absence of any secured obligation on her part, but some Maine cases have suggested that a grant of collateral for the debt of another is effective to create a relation of surety even in the absence of documentation so stating.

situation where a spousal guaranty is acceptable is where that spouse is a joint applicant for the credit at issue. Regulation B, clarified by the amendments in 2003, prohibits a creditor from presuming that the submission of joint financial information constitutes an application for joint credit, however.⁸³ Thus, as FDIC staff have explained,

where the financial statement lists jointly held property of a husband and wife and is signed by both spouses (attesting to the accuracy of the data), there would be ECOA and Regulation B problems if a creditor treats the financial statement as an indication that the husband and wife are

Id. at ¶¶ 11-12, 712 A.2d at 1067. See *Matthews v. Matthews*, 128 Me. 495, 148 A. 796, 797-8 (1930) (one who furnishes collateral for the loan of another stands in the relation of surety to the one accommodated and may compel him to exonerate him or his property from liability by payment of the debt). Cf. also *Rosenthal v. Means*, 388 A.2d 113, 115 (Me. 1978) (A's grant of a mortgage to secure B's bank loan allowed A, through its affiliate, to be subrogated to rights of bank upon payment of B's loan). Thus, though it falls short of clear guidance on the issue, there is support in Maine for the view that, just by granting collateral, and without joining in the note or guaranty, the owner of a joint interest in property can encumber it as security for the other joint owner's debt. That is consistent with the rule in other jurisdictions. See *In the Matter of the Foreclosure of the Deed of Trust of Enderle*, 431 S.E.2d 549, 550 (N.C. 1993) ("A "mortgage to secure the debt of a third person, the mortgagor being subject to no obligation, is clearly valid." Grant S. Nelson & Dale A. Whitman, *Real Estate Finance Law* § 2.1 (2d ed. 1985) (citation omitted); 9 George W. Thompson, *Commentaries on The Modern Law of Real Property* § 4776 (John S. Grimes ed. 1958) (mortgage valid without personal liability on part of mortgagor); 59 C.J.S. *Mortgages* § 90 (1949) (benefit to third party can constitute consideration for mortgage and "[h]ence, the debt may be the debt of another and the consideration... may consist [of] a loan to a third person" (footnotes omitted)); 55 Am. Jur. 2d *Mortgages* § 146 (1971) ("[m]ortgages may be executed to secure the obligations of third persons" and "[a]n undertaking...to be personally responsible for the payment of the debt of the third person is not essential to the validity" (footnotes omitted))." The Maine cases have not addressed the question squarely, however, and any such grant of collateral that did not include the usual waivers of suretyship defenses would seem to leave a lender exposed to some risk that use of an adequate guaranty form would avoid.

⁸³ 12 C.F.R. § 202.7(d)(1) (2010).

making a joint application. By doing so, a creditor may find itself requiring both property owners (husband and wife) to sign the promissory note when, in fact, only the property owner who is involved with the business intends to be obligated on the extension of credit.⁸⁴

Creditors who violate ECOA may be held liable to aggrieved guarantors for actual damages suffered, punitive damages of \$10,000 (or in a class action, the lesser of \$500,000 or one percent of the net worth of the creditor), reasonable attorney's fees, and any other relief the court may deem appropriate. Enforcement actions may be brought by applicants within two years after the occurrence of an equal credit violation, though the Maine Law Court has permitted ECOA to be raised as a defense to enforcement of a guaranty even after the two year statute of limitations for affirmative actions had expired.⁸⁵

An example of the problems caused by an effective ECOA defense is provided by *Calaska Partners Ltd. v. Corson*, 672 A.2d 1099 (Me. 1996). In that case, a bank had required the wife to cosign loans and a mortgage on the family residence even though the loans were for the sole benefit of her husband. When the bank's successor in interest attempted to foreclose the mortgage on both spouses' interests in the real estate, the wife raised ECOA as a defense. The wife's mortgage of the residence was held invalid, but worse than this, the creditor was not permitted to foreclose on the entire property and pay over half the proceeds to the wife. Instead, it had to foreclose only on the husband's one-half interest in the property. Since fractional interests in residences are not easily saleable, the creditor presumably did not receive a sale price equivalent to half the value of the real estate.

⁸⁴ FDIC, Financial Institution Letter, Guidance On Regulation B Spousal Signature Requirements, <http://www.fdic.gov/news/news/financial/2004/fil0604a.html#ft21>.

⁸⁵ See, e.g., *F.D.I.C. v. Notis*, 602 A.2d 1164, 1166 (Me. 1992) (excluding recoupment from the bar of statute of limitations); *Machais Savings Bank v. Ramsdell*, 689 A.2d 595 (Me. 1997). See, also, *Chittenden Trust Co. v. Cabot*, 2004 WL 2287763 (D. Me. Oct. 12, 2004) (ECOA may be raised as counterclaim to action on guaranty even after two-year statute of limitations has passed).

The interpretation of ECOA is constantly evolving and the courts reach different results in construing the statute and regulations, so fixed and clear guidance is difficult to find in this area. The risk of violation is reduced if the lender has unbiased creditworthiness guidelines by which it assesses applicants, and is careful to keep its form documents free of mandatory requirements for spousal information or other suggestions that the spouse should automatically incur liability for the loan. The FDIC also offers some periodic written guidance to creditors and provides a helpful flow chart, found at <http://www.fdic.gov/news/news/financial/2004/fil0604a.html>, to assist in navigating the signature requirements of Regulation B.

§3-2(c) Upstream Guaranties

Guaranties are often required in commercial loan transactions from parent corporations and/or the principals. They may also be required of other parties who have some relationship to the principals, in order to enhance the creditworthiness of the borrower. It is important that any guarantor receive “reasonably equivalent value” in exchange for its guaranty in order to avoid fraudulent conveyance problems.⁸⁶ This is an important factor to keep in mind when structuring a loan and guaranty arrangement.⁸⁷ Since a loan to a wholly-owned subsidiary is almost always considered to be of significant value to the parent (a “downstream” guaranty), these guaranties are seldom questioned. A loan to the parent corporation, however, may not be of any value to the subsidiary, and so the guaranty of the subsidiary (an “upstream” guaranty) may not withstand a fraudulent conveyance challenge. A guaranty by one subsidiary of a loan made to another subsidiary of the same parent (a “sidestream” guaranty) raises issues similar to the upstream guaranty.

⁸⁶ Monika Sanford, *Lenders Beware: Can Intercorporate Guaranty Withstand a Fraudulent Transfer Attack?*, 28 AM. BANKR. INST. J. 40 (2009); David S. Walls, *Promises to Keep: Intercorporate Guarantees and Fraudulent Transfers in Bankruptcy*, 19 UCC L.J. 219 (1987).

⁸⁷ Similar considerations come into play where the note maker is the subsidiary of the benefited parent. See *In re Kennebago Corporation*, 50 B.R. 153, 157 (Bankr. D. Me. 1985) (where debt was owed by ninety percent shareholder, note in amount of that debt, which was given by shareholder’s subsidiary, and mortgage securing the note were both void for lack of consideration).

§3-2(d) Unique Features of Maine Guaranties

Maine follows the common law of guaranties in most important respects and both features noted under this heading have already been discussed above.

Maine's undue influence statute, 33 M.R.S.A. § 1021-1025 (1999 & Supp. 2009), contains a presumption that any guaranty that is given by an elderly, dependent person to or for the benefit of a person with whom the elderly person (60 years or older) has a confidential or fiduciary relationship is the result of undue influence, unless the elderly person is separately represented in the transaction by independent counsel. This requirement is discussed in detail above at §2-1(g)(1).

As noted in §2-2(a)(8) and §3-1(b)(2), Maine statute provides statute of frauds-type protection with respect to modification of debt instruments and promises to make loans.⁸⁸ In the attached form, the guarantor acknowledges the application of Maine law on this point.

§3-2(e) Form of Guaranty

Like the form of promissory note at §3-1(e), this form includes optional language regarding a loan agreement if the guaranty is used in conjunction with one. The form is customized to serve as the guaranty described in the sample commitment letter at §2-2(b).

GUARANTY

THIS GUARANTY ("Guaranty") dated as of June 1, 2010 is made by ROBERT T. PRINCIPAL, an individual residing in Warner, Maine ("Guarantor") in favor of LENDER BANK, N.A., a Maine financial institution with a place of business at Cashland, Maine ("Lender").

RECITALS

WHEREAS, Lender is contemporaneously herewith making a loan or loans (collectively, the "Loan") to Acme Products, Inc., a Maine corporation ("Borrower") [**pursuant to a Loan Agreement of even date entered into by and between Lender and Borrower (the "Loan Agreement")**], as evidenced by two promissory notes of even

⁸⁸ 10 M.R.S.A. § 1146 (2009).

date herewith, one in the original principal amount of One Million Six Hundred Thousand Dollars (\$1,600,000.00) and the other in the original principal amount of up to One Million Dollars (\$1,000,000.00) (together with any and all amendments, supplements, and modifications thereto, substitutions and replacements therefor and renewals, restatements, consolidations and extensions thereof, each individually a “Note” and collectively the “Notes”); and

WHEREAS, the Loan will be to the direct interest, advantage and benefit of Guarantor; and

WHEREAS, in order to induce Lender to make the Loan, Guarantor has agreed to enter into this Guaranty;

NOW, THEREFORE, in consideration of the Loan and for other good and valuable consideration, the receipt and sufficiency of which are hereby conclusively acknowledged by Guarantor,⁸⁹ Guarantor does hereby agree as follows:

1. Guaranty. Guarantor hereby guaranties the full and punctual payment and performance of all debts, liabilities, agreements and other obligations of Borrower to Lender, whether direct or indirect, absolute or contingent, due or to become due, secured or unsecured, now existing or hereafter arising or acquired, including, without limitation, the obligations of Borrower to pay to Lender principal, interest (including interest that, but for the filing of a petition in bankruptcy, would have accrued on the Notes),⁹⁰ fees and other amounts as

⁸⁹ A recital of the consideration for the guaranty is not necessary to make it enforceable (*Gillighan v. Boardman*, 29 Me. 79, 81 (1848)), but such recitals are common and provide prima facie evidence of the adequacy of consideration, which may then be rebutted by parol evidence. *Pyrofax Gas Corp. v. Consumers Gas Co.*, 151 Me. 172, 175, 116 A.2d 661, 662 (1955) (“These are not idle or meaningless words and must be interpreted to mean that [guarantor] received what he then considered was a sufficient consideration.”). Nevertheless, the issue of the benefit to the guarantor can be critical, as discussed above.

⁹⁰ This reference to bankruptcy is prompted by Section 502(b)(2) of the Bankruptcy Code, which allows a creditor to add post-petition interest to its claim amount only if the creditor is oversecured (11 U.S.C.A. § 502(b)(2) (2004 & Supp. 2010)). The language is intended to prevent the guarantor from arguing that, since no post-petition interest is due from the borrower, the guarantor is relieved of the obligation to pay such

provided under the terms of the Notes **[and the obligations of Borrower to Lender under the terms of a _____ of even date herewith, signed and given by Borrower to Lender]** (the foregoing debts, liabilities, agreements and other obligations of Borrower being hereinafter referred to singly as a “Guarantied Obligation” and collectively as the “Guarantied Obligations”).

2. Costs and Expenses. Guarantor hereby agrees to pay all costs and expenses incurred by Lender in enforcing this Guaranty and in collecting or in attempting to collect any Guarantied Obligations from any party liable therefor, including without limitation all reasonable attorneys’ **[and paralegals’]** fees⁹¹ and expenses incurred in connection therewith **[, and, until paid to Lender, such sums shall bear interest at the default rate set forth in the Note with the highest interest rate unless collection from Guarantor of interest at such rate would be contrary to applicable law, in which event such sums shall bear interest at the highest rate that may be collected from Guarantor under applicable law].**⁹²

3. Unlimited Guaranty. The liability of Guarantor hereunder shall be unlimited.⁹³

interest under its guaranty. See *United States v. Bruno*, 747 F.2d 53, 54 (1st Cir. 1984), where this argument was made unsuccessfully. The lender is likely protected from such arguments by general language providing that the guarantor’s liability for the debt continues notwithstanding its being uncollectible from the debtor, but some lenders prefer the more specific reference to post-petition interest.

⁹¹ Reasonable attorneys’ fees for enforcement of the guaranty may be collected when the guaranty so provides. *Peterman v. Clegg*, 641 A.2d 867, 869 (Me. 1994). Even general guaranty of “all obligations” of the borrower may be sufficient to capture attorneys’ fees and costs of collection if the underlying loan documents cover these expenses. *Ali, Inc. v. Fishman*, 855 F. Supp. 440, 444 (D. Me. 1994).

⁹² As noted in §3-1(b)(3), Maine currently does not limit interest on commercial loans, so the reference here to the “highest rate that may be collected from Guarantor under applicable law” is unnecessary under current Maine law.

⁹³ This paragraph is intended to stress that the guaranty is not subject to any principal ceiling, though guarantors will sometimes oppose its inclusion on the grounds that it appears to allow expansion of the Guarantied Obligations defined in Section 1 of the document. Since the section is not

4. Unconditional Guaranty; Waivers. This Guaranty is an absolute, unconditional and continuing guaranty of the full and punctual payment and performance of the Guaranteed Obligations, and not of their collectability only, and is in no way conditioned upon any requirement that Lender pursue or exhaust its remedies against Borrower, or its successors [**heirs**], or against any other party liable for the Guaranteed Obligations, whether maker, guarantor, or otherwise, or against any property or assets mortgaged or pledged as security therefor, but upon nonpayment or nonperformance of the Guaranteed Obligations, Lender may immediately demand and enforce payment and performance from Guarantor pursuant to this Guaranty. Guarantor waives presentment, demand, protest, notice of acceptance,⁹⁴ notice of Guaranteed Obligations incurred and all other notices of any kind, all defenses which may be available by virtue of any valuation, stay, moratorium law or other similar law now or hereafter in effect, any right to require the marshaling of assets of Borrower, and all suretyship defenses generally. Without limiting the generality of the foregoing, Guarantor agrees to the provisions of all instruments and other agreements evidencing, securing or otherwise executed in connection with any Guaranteed Obligation and agrees that the obligations of Guarantor hereunder shall not be released or discharged, in whole or in part, or otherwise affected by (i) the failure of Lender to assert any claim or demand or to enforce any right or remedy against Borrower; (ii) any extensions or renewals of any Guaranteed Obligation; (iii) any rescission, waiver, amendment or modification of any of the terms or provisions of any agreement evidencing, securing or otherwise executed in connection with any Guaranteed Obligation; (iv) the substitution or release of any party

critical given the guaranty's lack of any express limit on guarantor liability for the Guaranteed Obligations, some lenders' counsel may decide to leave it out in order to avoid unnecessary controversy.

⁹⁴ The common law rule is that a guaranty is merely a proposal, making necessary acceptance by the other party to complete the contract. *Howe v. Nickels*, 22 Me. 175, 176 (1842). Exceptions to the rule are enumerated in *American Agricultural Chemical Co. v. Ellsworth*, 109 Me. 195, 83 A. 546, 547 (1912) (notice of acceptance not required where (1) valuable consideration moves directly or indirectly to the guarantor, (2) guaranty is made at creditor's request, and (3) when the agreement to accept or the contract guaranteed is contemporaneous with the guaranty).

primarily or secondarily liable for any Guaranteed Obligation; (v) the adequacy of any rights Lender may have against any collateral or other means of obtaining repayment of the Guaranteed Obligations; (vi) the impairment of any collateral securing the Guaranteed Obligations, including without limitation, the failure to perfect or preserve any rights Lender might have in such collateral or the substitution, exchange, surrender, release, loss or destruction of any such collateral; or (vii) any other act or omission which might in any manner or to any extent vary the risk of Guarantor or otherwise operate as a release or discharge of Guarantor, all of which may be done without notice to Guarantor.

5. Unenforceability of Obligations Against Borrower. If for any reason Borrower has no legal existence or is under no legal obligation to discharge any of the Guaranteed Obligations, or if any of the Guaranteed Obligations have become irrecoverable from Borrower by operation of law or for any other reason, or if Borrower or any other party shall have any right or power to assert any claim or defense as to the invalidity or unenforceability of the Guaranteed Obligations, no such asserted or actual unenforceability or invalidity of the Guaranteed Obligations as against Borrower or any other party shall affect or impair the Guarantor's obligations under this Guaranty, and Guarantor's liability for payment and performance of the Guaranteed Obligations shall subsist to the same extent as if Guarantor at all times had been the principal obligor on the Guaranteed Obligations. In the event that acceleration of the time for payment of the Guaranteed Obligations is stayed upon the insolvency, bankruptcy or reorganization of Borrower, or for any other reason, acceleration of the Guaranteed Obligations shall not be likewise stayed, but the same shall be immediately due and payable by Guarantor.

6. Termination of Guaranty. This Guaranty shall in all respects be a continuing, unlimited, absolute and unconditional guaranty, and shall remain in full force and effect (notwithstanding, without limitation, the death or incompetency of Guarantor or that at any time or from time to time the balance of the outstanding Guaranteed Obligations shall have been reduced to zero),⁹⁵ until the Guaranteed

⁹⁵ The loan might be reduced to zero temporarily in the case of a line of credit that is borrowed, repaid and re-borrowed. The lender would not want occasional repayment to result in extinguishment of the guaranty.

Obligations shall have been paid and performed in full. If, for any reason, any payment to Lender of any of the Guaranteed Obligations is required to be refunded by Lender to Borrower, or paid or turned over by Lender to any other person, including without limitation by reason of the operation of the United States Bankruptcy Code (all such refunds, turnovers or payments being collectively referred to herein as “Turnover Payments”), Guarantor agrees to pay to Lender, on demand, an amount equal to all such Turnover Payments, and the obligations of Guarantor hereunder shall not be treated as having been discharged by the original payment to Lender giving rise to the Turnover Payment, and this Guaranty shall be treated as having remained in full force and effect for any such Turnover Payment so made by Lender, as well as for any amounts not previously paid to Lender on account of the Guaranteed Obligations.

7. Application of Payments. Any amount received by Lender from any source on account of the Guaranteed Obligations may be applied by Lender to the payment of such of the Guaranteed Obligations, and in such order of application, as Lender may from time to time elect.

8. Subrogation; Subordination.⁹⁶ Until the Guaranteed Obligations shall have been paid, performed and discharged in full, Guarantor shall have no right of subrogation, reimbursement, exoneration, contribution or any other rights that would result in Guarantor being deemed a creditor of Borrower under the United States Bankruptcy Code or any other law, and, until such time, Guarantor accordingly waives (i) all such rights, (ii) the right to assert any such rights, (iii) any right to enforce any remedy which Lender may now or hereafter have against Borrower, and (iv) any benefit of, and any right to participate in, any security now or hereafter held by Lender, whether any of the foregoing rights arise in equity, at law or by contract.

⁹⁶ The topic of subrogation is discussed at §3-2(a)(4) and subordination is more fully discussed in §6-3. In the above provision, a choice is provided between “deep” and “inchoate” subordination, as those concepts are described in §6-3. The inchoate subordination provision gives the alternative of being triggered by a “Default” or an “Event of Default.” The distinction is aimed at loan documents that define a “Default” as simply the prohibited act or omission and “Event of Default” as the act or omission plus passage of any cure periods.

[Full Subordination: Any and all present and future debts and obligations of Borrower to Guarantor are hereby postponed in favor of and subordinated to the full payment and performance of the Guaranteed Obligations. Any instruments now or hereafter evidencing any indebtedness of Borrower to Guarantor shall be marked with a legend that the same are subject to this Guaranty [and, if Lender so requests, shall be delivered to Lender]. Upon the liquidation or bankruptcy of Borrower, or upon the distribution of any of Borrower's assets, Guarantor shall assign to Lender all of Guarantor's claims on account of such indebtedness so that Lender shall receive all dividends and payments on such indebtedness until payment in full of the Guaranteed Obligations. This paragraph shall constitute such an assignment if Guarantor fails to execute and deliver such an assignment. Guarantor also agrees that Lender's books and records showing the account between Lender and Borrower shall be admissible in any action or proceeding relating to this Guaranty, shall be binding upon Guarantor for the purpose of establishing the amount and terms of the Guaranteed Obligations, and shall constitute prima facie proof thereof.]

[Partial Subordination: Any and all present and future debts and obligations of Borrower to Guarantor are hereby postponed in favor of and subordinated to the full payment and performance of the Guaranteed Obligations; provided that so long as no "Default", ["Event of Default"], as such term is defined in the Loan Agreement, has occurred [and is continuing], Borrower may make, and Guarantor may demand and accept, any scheduled payments of principal of and interest on such subordinated indebtedness in the amounts, at the rates and on the dates specified in such instruments, securities or other writings as shall evidence such subordinated indebtedness. Any such instruments, securities or other writings shall be marked with a legend that the same are subject to this Guaranty [and, if Lender so requests, shall be delivered to Lender]. Guarantor agrees that after the occurrence of any "Default", ["Event of Default"], Guarantor will not demand, sue for or otherwise attempt to collect any such indebtedness of Borrower to Guarantor until the Guaranteed Obligations shall have been paid in full. If, notwithstanding the foregoing sentence, Guarantor shall collect,

enforce or receive any amounts in respect of such indebtedness, such amounts shall be collected, enforced and received by Guarantor as trustee for Lender and be paid over to Lender on account of the Guaranteed Obligations without affecting in any manner the liability of Guarantor under the other provisions of this Guaranty. In addition to Guarantor's agreements not to demand, sue for or otherwise attempt to collect any subordinated indebtedness after occurrence of any "Default", ["Event of Default",] upon the liquidation or bankruptcy of Borrower, or upon the distribution of any of Borrower's assets, Guarantor shall assign to Lender all of Guarantor's claims on account of such subordinated indebtedness so that Lender shall receive all dividends and payments on such indebtedness until payment in full of the Guaranteed Obligations. This paragraph shall constitute such an assignment if Guarantor fails to execute and deliver such an assignment. Guarantor also agrees that Lender's books and records showing the account between Lender and Borrower shall be admissible in any action or proceeding relating to this Guaranty, shall be binding upon Guarantor for the purpose of establishing the amount and terms of the Guaranteed Obligations and shall constitute prima facie proof thereof.]

9. Financial Information; Further Assurances. Guarantor agrees that it will, from time to time at the request of Lender, provide to Lender its most recent [**balance sheets and related statements of income and changes in financial condition**] and such other information relating to the business and affairs of Guarantor as Lender may reasonably request. Guarantor also agrees to do all such things and execute all such documents, including financing statements, as Lender may consider necessary or desirable to give full effect to this Guaranty and to perfect and preserve the rights and powers of Lender hereunder.

10. Assignment of Guaranteed Obligations. Lender may, from time to time, assign or transfer any or all of the Guaranteed Obligations or any interest therein, and, notwithstanding any such assignment or transfer or any subsequent assignment or transfer thereof, such Guaranteed Obligations shall be and remain Guaranteed Obligations for the purposes of this Guaranty, and each and every immediate and successive assignee or transferee of any of the Guaranteed

Obligations or of any interest therein shall, to the extent of the interest of such assignee or transferee in the Guaranteed Obligations, be entitled to the benefits of this Guaranty to the same extent as if such assignee or transferee were Lender; provided, however, that, unless Lender shall otherwise consent in writing (which consent shall not impair this Guaranty in any way whatsoever), Lender shall have an unimpaired right, prior and superior to that of any such assignee or transferee, to enforce this Guaranty, for the benefit of Lender, as to those of the Guaranteed Obligations which Lender has not assigned or transferred.

11. Waiver. No delay on the part of Lender in the exercise of any right or remedy shall operate as a waiver thereof, and no single or partial exercise by Lender of any right or remedy shall preclude other or further exercise thereof or the exercise of any other right or remedy; nor shall any amendment, modification or waiver of any of the provisions of this Guaranty be binding upon Lender except as expressly set forth in a writing duly signed and delivered by an officer of Lender. No action of Lender permitted hereunder shall in any way affect or impair the rights of Lender or the obligations of Guarantor under this Guaranty.

12. Security and Rights of Set-off.⁹⁷ Guarantor hereby grants to Lender, as security for the full and prompt payment and performance of Guarantor's obligations hereunder, a continuing lien on and security interest in any and all securities or other property belonging to Guarantor now or hereafter held by Lender and in all deposits (general, specific, time or demand, provisional or final, regardless of currency, maturity or the branch of Lender where the deposits are held) now or hereafter held by Lender and other sums credited by or due from Lender to Guarantor or subject to withdrawal by Guarantor, and, regardless of the adequacy of any collateral or other means of obtaining repayment of such obligations, during the continuance of any "Default", [**Event of Default**], as such term is defined in the [**Loan Agreement**], Lender may, at any time and without notice to

⁹⁷ This provision will normally apply only to bank-type lenders that hold funds of the guarantor on deposit. Also, this type of provision will need to be modified or deleted when the guaranty is intended to be non-recourse, since in that case the lender will have agreed to seek recovery only from specific collateral offered by the guarantor.

Guarantor, set-off and apply the whole or any portion or portions of any or all such deposits and other sums against amounts payable under this Guaranty, whether or not any other person or persons could also withdraw money therefrom. **[This Guaranty is also secured by a _____ encumbering _____.]**⁹⁸

13. Miscellaneous. This Guaranty constitutes the entire agreement of Guarantor with respect to the matters set forth herein. The rights and remedies herein provided are cumulative and not exclusive of any remedies provided by law or any other agreement, and this Guaranty shall be in addition to any other guaranty of the Guaranteed Obligations. The provisions of this Guaranty shall be binding upon Guarantor and its heirs, successors, successors in title, legal representatives, and assigns, and shall inure to the benefit of Lender, its successors, successors in title, legal representatives and assigns.⁹⁹ The recitals set forth at the outset of this Guaranty are a part of this Guaranty agreement, as fully as if set forth in their entirety in the body hereof. Wherever possible, each provision of this Guaranty shall be interpreted in such manner as to be effective and valid under applicable law, but if any provision hereof should be invalid or unenforceable under such law, such invalidity or unenforceability shall not affect in any way the continued validity and enforceability of any other provision hereof.

14. Construction. As used in this Guaranty, the singular number shall include the plural, the plural the singular, and the use of one gender shall be deemed applicable to all genders. Captions are for ease of reference only and shall not affect the meaning of the relevant provisions of this Guaranty. Guarantor acknowledges and agrees that this Guaranty and the obligations of Guarantor hereunder, including matters of construction, validity and performance, shall be governed by those laws of the State of Maine that are applicable to agreements that are negotiated, executed, delivered and performed solely in the State of Maine.

⁹⁸ The bracketed language would likely not be used, as there is no indication in the sample commitment letter at §2-2(b) that the guaranty obligations are to be secured by any property of the Guarantor.

⁹⁹ A statement that the terms will benefit assigns of the original lender has been given effect to permit assignment of the guaranty. *Ali, Inc. v. Fishman*, 855 F. Supp. 440, 443 (D. Me. 1994).

15. Notices. All notices, demands or requests provided for or permitted to be given pursuant to this Guaranty (hereinafter in this paragraph referred to as “Notice”) must be in writing and shall be deemed to have been properly given or served by personal delivery or by sending the same by overnight courier or by depositing the same in the United States Mail, postage pre-paid and registered or certified, return receipt requested, at the addresses set forth below. Each Notice shall be effective upon being delivered personally or upon being sent by overnight courier or upon being deposited in the United States Mail as aforesaid. The time period in which a response to any such Notice must be given or any action taken with respect thereto, however, shall commence to run from the date of receipt if personally delivered or sent by overnight courier or, if so deposited in the United States Mail, the earlier of three (3) business days following such deposit or the date of receipt as disclosed on the return receipt. Rejection or other refusal to accept or the inability to deliver because of changed address of which no Notice was given shall be deemed to be receipt of the Notice sent. By giving at least five (5) days prior Notice thereof, Guarantor or Lender shall have the right from time to time and at any time during the term of this Guaranty to change their respective addresses and each shall have the right to specify as its address any other address within the United States of America. For the purposes of this Guaranty:

The Address of Lender is:

Lender Bank, N.A.
One Bank Street
Cashland, Maine 04000
Attention: D. E. Warbucks, Senior Vice President

The Address of Guarantor is:

Robert T. Principal
123 Surety Lane
Warner, Maine 04999

16. No Oral Modification. Under Maine law, no promise, contract, or agreement to lend money, extend credit, forbear from collection of a debt or make any other accommodation for the repayment of a debt for more than \$250,000 may be enforced against

Lender unless the promise, contract or agreement is in writing and signed by Lender.

17. Forum; Submission to Jurisdiction. Guarantor hereby irrevocably agrees that any legal action or proceeding arising out of or relating to this Guaranty may be brought in any state or federal court in the State of Maine, at the election of Lender, its successors and assigns. By the execution and delivery hereof, Guarantor hereby irrevocably submits to the nonexclusive jurisdiction of any such court in any such action or proceeding, and hereby waives the benefit of jurisdiction derived from present or future domicile.¹⁰⁰ Final judgment against Guarantor in any such action, suit or proceeding shall be conclusive and may be enforced in any other jurisdiction by suit on the judgment, a certified or exemplified copy of which shall be conclusive evidence of the fact.

18. Jury Trial. IN RECOGNITION OF THE HIGHER COSTS AND DELAY WHICH MAY RESULT FROM A JURY TRIAL, THE PARTIES HERETO WAIVE ANY RIGHT TO TRIAL BY JURY OF ANY CLAIM, DEMAND, ACTION OR CAUSE OF ACTION (A) ARISING HEREUNDER, OR (B) IN ANY WAY CONNECTED WITH OR RELATED OR INCIDENTAL TO THE DEALINGS OF THE PARTIES HERETO OR ANY OF THEM WITH RESPECT HERETO, IN EACH CASE WHETHER NOW EXISTING OR HEREAFTER ARISING, AND WHETHER SOUNDING IN CONTRACT OR TORT OR OTHERWISE; AND EACH PARTY FURTHER WAIVES ANY RIGHT TO CONSOLIDATE ANY SUCH ACTION IN WHICH A JURY TRIAL HAS BEEN WAIVED WITH ANY OTHER ACTION IN WHICH A JURY TRIAL CANNOT BE OR HAS NOT BEEN WAIVED; AND EACH PARTY HEREBY AGREES AND CONSENTS THAT ANY SUCH CLAIM, DEMAND, ACTION OR CAUSE OF ACTION SHALL BE DECIDED BY COURT TRIAL WITHOUT A JURY, AND THAT ANY PARTY HERETO MAY FILE AN ORIGINAL COUNTERPART OR A COPY OF THIS PARAGRAPH WITH ANY COURT AS WRITTEN EVIDENCE OF THE CONSENT OF

¹⁰⁰ Guarantors are routinely located out of state and it is advisable to include a provision such as this to reduce the opportunity for the guarantor to argue that it is not subject to jurisdiction of the Maine courts.

THE PARTIES HERETO TO THE WAIVER OF THEIR RIGHT TO TRIAL BY JURY. THE PROVISIONS OF THIS PARAGRAPH HAVE BEEN FULLY DISCUSSED BY GUARANTOR AND LENDER, AND THESE PROVISIONS SHALL NOT BE SUBJECT TO ANY EXCEPTIONS. NEITHER PARTY HAS AGREED WITH OR REPRESENTED TO THE OTHER THAT THE PROVISIONS OF THIS PARAGRAPH WILL NOT BE FULLY ENFORCED IN ALL INSTANCES. LENDER SHALL BE BOUND BY THIS PARAGRAPH UPON ITS ACCEPTANCE OF THIS GUARANTY.

IN WITNESS WHEREOF, Guarantor has executed this Guaranty as a sealed instrument as of the date first set forth above.

WITNESS:

Name:

Robert T. Principal,
individually

Chapter 8

CLOSING AND POST-CLOSING

Practice Pointers:

- **Don't schedule complicated closings or those with open issues for Fridays, since you may not complete in time to allow funding to occur.**
- **Use the closing checklist as your planning tool and as the means of tracking outstanding items and circulate it frequently to keep parties apprised of status.**
- **During closing, order items for completion with a mind to meeting external deadlines such those for wiring funds or recording documents.**

§8-1 Background and Initial Considerations

The loan closing consists of a meeting involving the lender, the borrower, any third parties having an interest in the transaction and their respective lawyers. It is generally held at the office of the lender or its counsel. The practice of conducting a closing in person, once the norm for loan transactions in Maine, is becoming much less common.

The loan closing requires planning, forethought and careful organization and attention.¹ Generally speaking, a closing will be easy in proportion to how much prep work and planning was done by the parties and their counsel.

§8-2 Scheduling the Closing

Ideally, a closing would get scheduled only when all of the work was done. Once lender's counsel had finalized documents and con-

¹ One commentator has observed that the suggestion to "just relax" is not "very good advice for closings." Joshua Stein, *Closings: Step By Step*, 45 No. 7 Prac. Law 77, 75 (1999).

firmed the borrower's submission of all its closing deliverables in satisfactory form, the parties would take out their calendars and fix a day on which to sign documents and fund the loan. Things don't often work that way, however. Usually, the lender will be able to offer a given interest rate only for a prescribed period and timing is often dictated by other factors such as vacation schedules of the parties or, where the closing involves acquisition financing, the closing date set in the underlying purchase agreement. This means that there will usually be a more or less arbitrary deadline against which the parties need to work. As discussed at §2-5 above, the closing date should be a realistic one that is set a few days before the ultimate deadline, so as to allow some leeway in case of delays. Also, unless the parties are willing to risk the funding slipping into the following week, it is a bad idea to schedule any but the most simple closings for a Friday, since this may not allow enough time to resolve all issues before the deadline for disbursing loan proceeds.

§8-3 Preparing for the Closing

It is helpful to use the closing agenda as the main planning vehicle. The agenda can be annotated to show proposed delivery dates of items and to identify the party responsible for each item, and it can be re-circulated (generally with increasing frequency as closing approaches) to identify missing or incomplete items. Lender's counsel will usually have the task of keeping the parties aware of where things stand. It is sometimes helpful to flag particularly important missing items, rather than count on the parties to spot them in the agenda. Thus, an e-mail message accompanying the agenda might say that "Without attempting to list all of the incomplete items on the attached checklist, I note the following items and issues that still need to be provided or resolved: **[list big items/issues]**." The message can then be updated and re-circulated to show the status of items listed, just as the agenda can.

The agenda can also be used as the basis for organizing a closing file. The closing file is a re-usable file whose individual folders bear either document names or simply numbers. Numbers are probably simpler, since they don't have to be changed for each closing. Thus, folder number 1 will contain the commitment letter listed as item number 1 on the agenda and so on. This makes it easy to find docu-

ments that correspond to agenda items when the closing is taking place.² Once the closing is finished and documents copied and delivered, the file can be employed for the next closing.

Before the closing, counsel should run through the closing file to make sure the necessary documents are in place. If there are open questions or discussion points on any, the document can be flagged or a note made in the right place in the agenda. Counsel should also consider what issues might arise at the table and how to respond to them. The closing file will ideally include copies of items that other parties are delivering so that lender's counsel can quickly compare the copies to the originals that are brought to the table.

Lender's counsel will also want to be paid. If fees have come in at or below the amount estimated for the transaction, it may not be necessary to provide a preview of them to the lender or to the borrower that is paying them. If the estimate has been exceeded, lender's counsel is hopefully not discovering that for the first time on the eve of closing. However soon the discovery is made, an unexpectedly large fee should be reviewed first with the loan officer and, if approved at that checkpoint, broadcast to the borrower via an advance draft of the closing statement. In most discrete loan transactions, lender's counsel should look to closing as her last chance to get paid and will not be expected to submit any bill after the closing. This means that counsel will have to estimate the amount of time that closing and any post-closing work will take and include the grand total in the bill submitted at closing.

§8-4 Conducting the Closing

Closing is usually held at the office of the lender or its counsel. If the closing involves several components, such as multi-lender deals or acquisition-financings, it may be more efficient to stagger atten-

² Leave some room on the agenda for new items, showing them as "Reserved." This allows new documents to be added to the agenda without having to re-file those that come after it on the list. Thus, if agenda item #27 is the Note, #28 is "Reserved" and #29 is the Mortgage, when it turns out that a guaranty will be needed, item #28 on the agenda can be changed to "Guaranty," and the Mortgage (and everything that comes after it on the agenda) can stay in its original numbered file.

dance. Thus, the business people involved only in the acquisition might show up earlier and get their closing done and those involved only in the loan transaction can appear later to conduct their business. Lender's counsel should be available throughout to field questions and generally keep things moving. Complex or multi-party deals may also merit booking several conference rooms where different parts of the transaction can proceed simultaneously or where participants can confer in privacy.

The agenda can also serve as the program for the closing. Make copies for the participants and devise a system for marking the agenda to identify items that are complete, incomplete, missing, or waived. At the end of the closing, your notes on the agenda should allow you to summarize those items and decide whose job it is to produce them.

Some transactions move to closing so quickly or are so rife with issues that finalizing documents at the table is unavoidable. More often, the documents and closing requirements have been circulated well in advance of the funding date and present no novel concepts that can't be fully discussed before closing. Where this is the case, counsel should do their best to resolve issues beforehand. In the authors' view, it is discourteous to all involved and costly for the borrower for a lawyer to hold the documents for weeks without comment and to start discussing them at closing. Usually, this is prompted by counsel's failure to prepare or by a desire to grandstand in front of his clients, acting the part of vigorous advocate while the rest of the participants look at their watches and wonder whether a closing set to last an hour will now make them miss their dinner. Counsel should do their homework and avoid prolonging closings with belated diligence or theatrics.

As the closing progresses, lender's counsel should be thinking along two tracks: First, she should be methodically working her way through the closing checklist, making sure that each item is accounted for. If counsel is seeing items for the first time, she should resist the pressure to rush and should take enough time to make sure they satisfy her requirements. Second, counsel should be thinking about how to finish as quickly as possible and in time to meet any applicable deadlines for recording or wiring of funds. This may require additional staffing and some flexibility in the order in which sections of the agenda are completed. For instance, counsel may want

to have a paralegal or assistant help to collect signatures and acknowledgments to speed up the process of execution. If funding depends on documents being recorded, counsel may want to start with those so that they can be copied and delivered to the registry while other papers are being processed. The ideal is to avoid dead time at a closing where everyone is sitting around waiting for completion of some part of the process that could have already been done with better planning.

Only one promissory note should be signed, since each original represents a separate obligation to pay. It is a good idea to get duplicate originals of recorded documents in case the counterpart sent to the registry never makes its way back to the lender. As for the rest, practices vary. Some lender's counsel like to see only one original even of multi-party documents so as to eliminate any question of which is the definitive final version; more often, each party to a document gets a fully-executed original version of it.

Most closings will involve some degree of post-closing follow-up.³ The degree to which a lender will allow a closing to occur without all of the closing requirements being satisfied will depend on a number of factors. As a general matter, out-of-state lenders tend to be more reluctant to allow matters to be addressed post-closing than in-state lenders and insurance company lenders tend to be more reluctant than bank lenders. Ideally, any matters that are to be addressed post-closing will be addressed in a side agreement that specifies what it is that is to be done, by what date it must be accomplished and what the consequences of a failure to comply will be.

In any event, lender's counsel will usually be responsible for standard post-closing items such as the recording of mortgages, filing of UCC-1's, obtaining the title insurance policy from the title insurance company and preparing closing binders or discs. In

³ Some good tips on reeling in post-closing items and a reminder of the importance of persistence in those efforts are found in Joshua Stein, *After the Closing: A Legal Tragedy That Didn't Need To Be*, 15-DEC Prob. & Prop. 54 (2001). The article is also found at the author's website at http://www.real-estate-law.com/infoFrame.php?pdf=After_the_Closing_-_1313.pdf.

addition, some lenders now perform a UCC-11 search immediately after they have made their UCC filings in order to assure that the filings will be revealed by a search under the borrower's name.⁴

§8-5 Closing in Escrow

Escrow closings avoid much of the logistical juggling of those conducted in person. By the time the closing comes around, documents are negotiated and signed, and the parties are just waiting for the escrow agent to complete ministerial tasks like filing in dates and updating title. The escrow agent is usually the title company that is issuing coverage for the real estate involved in the transaction, though sometimes a party's attorney will serve as the escrow agent.⁵ The escrow agent will either be sent all of the operative closing documents, or just those that require recording, with the balance being held by lender's counsel pending closing. Where the title company is serving as escrow agent, it will usually administer the closing funds.

§8-5(a) Form of Escrow Closing Instructions

The following form is designed for a real estate loan in which the escrow agent is the title company.

⁴ This search can actually be done in advance of closing. As discussed in §2-2(a)(6), the UCC permits filing before a security interest is made or a security interest attaches. 11 M.R.S.A. § 9-1502(4) (Supp. 2009). This means that the lender can make its UCC-1 filing, followed by its UCC-11 search so that its priority position is fixed and confirmed before closing. A secured party needs express authorization (or subsequent ratification) to pre-file a financing statement if the debtor has not yet authenticated a security agreement.

⁵ In Maine, "an attorney to one of the parties can act as escrow agent in a transaction between his principal and another party, as long as his escrow role 'involves no violation of duty to the principal and the person acts as an individual and not as an agent.'" *Hilltop Community Sports Center, Inc. v. Hoffman*, 2000 ME 130, ¶ 22 n. 3, 755 A.2d 1058, 1063 n.3 (quoting *Progressive Iron Works Realty Corp. v. Eastern Milling Co.*, 155 Me. 16, 19, 150 A.2d 760, 762 (1959)).

_____, 201__

Title Insurance Company

[address]

Attention: _____

Re: \$ _____ Loan ("Loan") from _____ ("Lender") to _____ ("Borrower") secured by Property Located in _____.

Dear _____:

This firm represents Lender in connection with the above referenced Loan, and we intend this letter to provide the instructions in accordance with which you will serve as escrow agent (the "Escrow Agent") for purposes of holding the documents described below and disbursing the Loan.

The Loan is to be secured by a first-priority Mortgage and Security Agreement encumbering the fee interest of Borrower in the property ("Real Property") that is the subject of Title Insurance Company ("Title Company") Commitment for Title Insurance (and/or a "pro forma" policy of title insurance), Commitment No. _____ (the "Title Commitment"). As used in these instructions, the term "Title Policy" means a final loan policy of title insurance with respect to the Loan, reflecting the comments and requirements of this office regarding the issuance of endorsements and special coverages and the satisfaction of all requirements, and deletion of noted exceptions, including any requirements noted in any "mark up" of the Title Commitment.

A. Escrowed Funds. Pursuant to the terms of this letter, you will receive from Lender the net proceeds of the Loan (the "Funds") in the amount set forth on (or to be calculated as set forth on) the final, approved Loan Closing Statement prepared **[by this office] [by the Title Company and previously approved by this office]** (the "Closing Statement"), representing the net proceeds of the Loan amount and a refund of specified commitment or standby fees (after deduction of expenses as set forth on the Closing Statement). Lender

will cause the Funds to be delivered to you by wire transfer for you to hold as Escrow Agent and for you to disburse only in accordance with these escrow instructions.

B. Escrow Documents. In connection with the making of the Loan by Lender to Borrower, you will receive the following original documents:

1. Mortgage and Security Agreement (the “Mortgage”) as executed by the Borrower; this will be sent to you by the Borrower in the form we provided to the Borrower;⁶
2. Assignment of Rents and Leases (“Lease Assignment”) as executed by the Borrower; this will be sent to you by the Borrower in the form we provided to the Borrower;
3. UCC-1 Financing Statement (to be filed in the Secretary of State records of the State of _____) (“Financing Statement”); this will be sent to you by this office; and
4. The Closing Statement, as executed by the Borrower; this will be sent to you by the Borrower in the form we provided to the Borrower;

(the foregoing documents are sometimes referred to collectively herein as the “Escrow Documents”). As to the other documents evidencing and securing the Loan (herein referred to, together with the Escrow Documents, as the “Loan Documents”), this is to confirm to the Title Company, and to the Borrower, that this firm shall hold such other documents executed by the Borrower and other parties in trust pending the closing of this transaction.

C. Ancillary Documents. In order that you may satisfy the requirements of the Title Commitment, you will also be receiving from Borrower or from other parties on behalf of Borrower the following items:

1. Evidence of the Borrower’s authority to enter into the Loan Documents (we understand that this evidence is to be delivered to you directly by Borrower’s counsel); and

⁶ Here, the documents are not enclosed, but are being sent into escrow separately by the lender and borrower.

2. Any other lien affidavits, gap indemnities, or other documents that you require pursuant to the Title Commitment in order to issue the Title Policy;

(collectively the documents listed above are sometimes referred to herein as the “Ancillary Documents”). To the extent that any Ancillary Documents are delivered to you from Borrower or Borrower’s counsel, originals or copies thereof, as applicable, must be delivered to the undersigned to complete the Lender’s records.

D. Completion of Closing Statement; Closing Date. To the extent that the Closing Statement is incomplete in any respect, [we shall deliver the replacement pages to you] [you shall deliver the replacement pages to us] for replacement with the Closing Statement as signed and shall attach the signature pages to the final version of the Closing Statement. The Closing Statement must be executed by you. In addition, to the extent that the Escrow Documents do not have a closing date indicated thereon, or to the extent that the date changes, we will forward to you replacement pages to be added to the documents prior to recording and/or direct you to insert the applicable date on the applicable pages of the Escrow Documents.

E. Borrower’s Contribution. If the net proceeds of the Loan are not sufficient to pay all items set forth on the Closing Statement, Borrower shall deposit with you, in good funds, all amounts necessary to permit you to make all disbursements set forth on the Closing Statement and any other amounts necessary to fund any amounts under any other settlement statement entered into by you and the Borrower (collectively, the “Borrower’s Contribution”). You shall confirm to the undersigned your receipt of the Borrower’s Contribution.

F. Borrower’s Authorization to Advance Funds (Interest Accrues). By its signature below, the Borrower acknowledges and agrees that interest shall be payable at the rate specified in the Note from the date of the Lender’s wiring to Escrow Agent hereunder, without regard to the day the Loan actually closes pursuant to these escrow instructions. Accordingly, the Borrower takes the risk of failure of any of the conditions to release of the Funds under these instructions.

G. Title Company Final Approval. Upon your receipt and approval (as acceptable for recording and filing, as applicable) of the original, executed Escrow Documents and of the Borrower's Contribution, you shall telephone this office at _____ - _____ - _____ or email me at _____ to confirm your receipt and approval. Please note that your approval shall constitute your confirmation of the following:

1. That the Title Company shall issue to Lender the Title Policy, with an effective date as of the date of recording of the Mortgage (as the Title Company must insure any "gap"), showing Lender as the named insured and title to the Real Property vested in Borrower, all pursuant to the Title Commitment and the definition of the Title Policy noted above. The legal description in the Title Policy shall be identical in all respects to the legal description set forth in the Title Commitment, the Mortgage and the Lease Assignment.

2. That you hold in your possession sums sufficient to pay in full all loan payoffs, closing costs, recording fees, title insurance premiums (and any other fees of the Title Company) and all other charges and expenses payable by you or any other party in connection with the Loan, all of which are to be paid for by the Borrower. Lender is to incur no expense in connection with this transaction. With respect to title insurance, this is to confirm that you have provided us with the total amount due and payable for all title insurance premiums, title examination and abstract fees, and all expenses in connection with the foregoing, as set forth on the Closing Statement, and that payment of such amounts set forth on the Closing Statement constitutes payment in full of such expenses.

3. That any and all other elements of this transaction (including, but not limited to, any acquisition of the Real Property by Borrower) have closed, or have closed in escrow subject only to funding hereunder.

4. You are prepared to deliver the original and two copies of the Title Policy to the undersigned at the above address within two (2) weeks of recording.

H. Title Policy Issuance, Funding and Recording. Upon receipt of the Loan Documents and approval thereof, and Lender's confirmation of the satisfaction of any other pre-closing requirements applicable hereto, we will advise your office with final instructions for recording and release of the Escrow Documents. Upon receipt of final telephonic or email instructions to record the Escrow Documents, the Title Policy shall be issued, and you shall record or file (as applicable) the Mortgage, the Lease Assignment and the Financing Statement in the applicable records. Upon recordation and receipt by you of one (1) conformed copy of each of the Mortgage and Lease Assignment, each showing all recording information thereon (if recording of such documents is a precondition to the issuance of the Title Policy), you shall then disburse the Funds promptly in accordance with these instructions and the final Closing Statement and in no other manner.

Notwithstanding the foregoing, if any of the conditions set forth above are not satisfied by 4:00 P.M. on _____, 201_, these instructions shall be deemed canceled, and lender and Borrower will thereafter no longer authorize the disbursement of the Funds or the filing, recording and delivery of any of the Escrow Documents. You will then be required to contact this office for instructions regarding the return of the Funds and the Escrow Documents, or for further direction as to this Loan. We reserve the right to amend or modify these instructions and to withdraw all documents and funds submitted herewith or pursuant hereto at any time prior to closing.

I. Post Closing Tasks. Upon closing, you shall remain obligated to perform the following obligations:

1. Immediately upon recording, contact the undersigned and confirm recordation and provide all recording information.
2. Deliver to us an original signed counterpart of the final Closing Statement, together with any other Escrow Documents deposited with your office.
3. Deliver to us the Mortgage and the Lease Assignment, showing all recording information thereon.

4. Deliver to us a certified copy of the Financing Statement showing that it is an exact copy of the Financing Statement sent for filing in the Secretary of State's office.⁷

5. Deliver to us the original Title Policy in accordance with these instructions.

6. Obtain, and record, all release instruments to be delivered after closing pursuant to any payoff letters or other obligations relating to payments made pursuant to the Closing Statement.

Please feel free to telephone me at _____ - _____ - _____ with any questions or comments you may have regarding the Loan or these instructions.

Very truly yours,

The foregoing instructions are accepted and receipt of the foregoing described Escrow Documents is acknowledged by the undersigned Escrow Agent.

Dated: _____, 201__

ESCROW AGENT:

Title Insurance Company

By: _____

Name: _____

Title: _____

JOINDER

The undersigned Borrower joins in the execution and delivery of these instructions, accepts the terms thereof, and directs Escrow Agent to act in accordance therewith, as of _____, 201__.

⁷ States with an electronic filing system may be able immediately to produce copies of the filed financing statement, bearing filing number and time.

BORROWER:

By: _____

Name: _____

Title: _____

§8-6 Payoff Letters

Practice Pointers:

- **Payoff letters should include per diem interest with loan payoff amount, thus eliminating the need to have them reissued if the closing date slips.**
- **Contents of payoff letters may depend on competing interests of lender being taken out and lender doing the take out.**
- **Proof-read wire instructions more than once.**

§8-6(a) Background and Initial Considerations

When one loan is being used to refinance another, the lender that is being paid off or “taken out” should provide a payoff letter to the borrower or to the new lender. The new and old lenders will have different aspirations for the contents of the payoff letter:

§8-6(a)(1) All Payoff Letters

Regardless of who is making or receiving payment, all payoff letters should include the following:

- Statement of amount due with per diem. The letter should state the amount due as of a given date, together with interest and any other charges or premiums payable and should give the amount of interest or other charges that are continuing to accrue on a daily (i.e., per diem) basis. As described at §2-5(f)(2), the per diem allows the payoff amount to be determined with certainty for a few days after the date of the payoff letter. In the case of revolving or line of credit facilities, the borrower’s credit availability may have to be terminated with the old lender some

time before the refinancing so that fixed payoff amounts can be determined. The payoff amount should always be reviewed by the borrower, particularly if it includes components such as prepayment premiums that depend on interpretation of formulae.

- Instructions on where the payment should be sent. These should include the name of the bank to which the funds are being sent, the ABA routing number for that bank, and the name and number of the account at the recipient bank to which the funds should be credited. Often, the instructions will ask that a particular person (for example the escrow agent at the title company that is responsible for disbursement of funds) be notified or upon the bank's receipt of funds, and will include some reference information regarding the purpose of the payment (e.g. "Acme Products, Inc." or "Acme Products, Inc. payoff"). The person who is in charge of the wire (and preferably someone else as well) should carefully proof-read the instructions in order to avoid wiring money to the wrong place.

§8-6(a)(2) Payoff Letters for Lender Doing the Take-Out

The lender that is paying off the old one will want the following:

- An agreement from the prior lender to release all collateral.⁸ The prior lender should not have a problem with this, but will want any such agreement to be conditioned on its receipt of the full payoff, and may also want the borrower or the new lender to do the work and incur the expense of preparing the terminations and discharges.

- Confirmation that there are no other outstanding credit facilities (including credit card facilities) or letters of credit issued on the borrower's behalf. Since the lender may have multiple loans with a borrower, the payoff of one will not get rid of the others.

⁸ As discussed at §8-12, Lenders are under some legal obligation to provide discharges or terminations after payment even in the absence of an agreement to do so in the payoff letter, but the letter is the more efficient way of establishing the prior lender's obligations in this regard.

§8-6(a)(3) Payoff Letters for Lender Being Taken Out

- As noted above, the lender being taken out will want to be paid in full before releasing collateral.
- In the case of revolving and line of credit facilities where the borrower has the right to request and repay loans, the old lender will want to confirm the termination of its credit arrangements with borrower. The lender does not want to release its collateral on day 1 and have the borrower still contractually entitled to request loan advances on day 2.
- Sometimes a lender will base its payoff on the assumption that the loan has been reduced by payments of accounts receivable made by borrower's customers. In some financing arrangements, the proceeds of borrower's accounts receivable are taken or "swept" on a regular basis from one of borrower's accounts at the bank to reduce the borrower's loan balance. If one of these payments is later dishonored, the calculated payoff will be insufficient to satisfy the debt. The prior lender will want some protection against this risk, which will usually come in the form of an indemnity from the new lender and the borrower. Some sample language reads as follows:

For and in consideration of **[Existing Lender]**'s agreements contained herein, the Borrower and **[New Lender]** jointly and severally agree to indemnify **[Existing Lender]** from, and hold **[Existing Lender]** harmless against, all losses, liabilities, charges, expenses and fees (including reasonable attorneys' fees) which **[Existing Lender]** may incur as a result of any non-payment, claim, refund or charge back of any checks or other items which have been credited by **[Existing Lender]** to the Borrower's accounts with **[Existing Lender]** or its affiliates, together with all expenses and other charges incident thereto; provided that **[New Lender]**'s obligations to indemnify **[Existing Lender]** pursuant to this paragraph will terminate on the _____ day following the date **[Existing Lender]** receives the Payoff Amount. The amount of any such losses, charges, fees, expenses or other liabilities for which **[Existing Lender]** is hereinabove

indemnified shall be paid to **[Existing Lender]** promptly upon **[Existing Lender]**'s demand therefor.⁹

- The borrower may also want to include language along the following lines in the letter regarding return of the existing debt instruments:

In addition, please confirm that you will, after receipt of such amount, return to **[Name of Borrower(s) and Guarantor(s)]** any original promissory notes, guarantees, life insurance policies, securities or other evidences of indebtedness or collateral.

A payoff letter that includes agreements by the new lender and borrower (such as the agreement to indemnify the old lender against dishonored items) should be signed by them. A letter from the old lender that just gives a payoff figure can just be addressed to the borrower and need not be countersigned.

In smaller loans, the existing lender sometimes will not produce a letter at all, but just a computer print-out of the loan balance as of a given day. This is a fact of life and the take-out lender or its counsel will need to use judgment in deciding when it is worth pushing for a more complete payoff letter. Where the title company is agreeing to insure the new lender's first mortgage upon disbursement of the amount of the loan balance shown on the print-out, the new lender is relieved of some of the risk of relying on skeletal payoff information.

When attempting to pay off a loan as of a given date, the new lender and borrower must keep in mind both the volume of wire traffic and relevant wire deadlines. If lender A is sending money to the disbursing agent B to pay off lender C, then enough time has to be allowed for the wire to get from A to B and for B to then turn it around to C, all before it gets too late in the day for the funds to be sent or counted as received. Though policies vary, most institutional lenders will not send wires after about 2 p.m. on a business day. As for wire traffic, it is generally heavier (resulting in slower wires) at the end of fiscal quarters.

⁹ The new lender's loan documents will make the borrower liable to the new lender for any amounts paid to the existing lender under such a letter.

§8-6(b) Form of Payoff Letter (for Lender being Taken Out)

[Letterhead of Existing Lender]

[Name of Borrower] [Date]

[Address]

Re: [Name of Borrower]

Ladies and Gentlemen:

We refer to the Loan Agreement dated _____ (the “Loan Agreement”) between _____ (the “Borrower”) and _____ (the “Lender”), for a loan in the original principal amount of [**up to**] \$ _____ (the “Loan”). You have advised Lender that Borrower intends to repay in full its obligations under the Loan Agreement and have requested that the Lender provide payoff figures for principal, interest, and other amounts owing to the Lender by Borrower under the Loan Agreement.

The total aggregate principal balance, unpaid accrued interest and other amounts, if any, due the undersigned under the Loan Agreement, if paid on _____, 201____ will be as follows (collectively, the “Payoff Amount”):

Principal	\$ _____
Interest	\$ _____
Prepayment Premium	\$ _____
Legal Expenses	\$ _____
Total	\$ _____

From and after _____, 201____, interest will continue to accrue on the principal amount of the Loan in the amount of \$ _____ per day until paid in full.

The Payoff Amount should be wire-transferred to Lender pursuant to the following wire instructions:¹⁰

¹⁰ Wire instructions are sometimes attached as an exhibit to the letter.

Bank:	
ABA #:	
For Credit to:	
Acct. #:	
Reference:	

Effective upon receipt of the Payoff Amount, the loan arrangements between Lender and Borrower as set out in the Loan Agreement will be terminated. At such time Lender agrees, at the Borrower's expense, to deliver to the Borrower such termination statements, lien releases, cancellations, discharges or other agreements as may reasonably be requested by the Borrower for termination of Lender's security interests, mortgages and liens on collateral securing the Loan, and Lender then authorizes the same to be filed and recorded on its behalf by Borrower.

Very truly yours,

[Existing Lender]

By: _____

Name: _____

Title: _____

§8-7 Insurance Coverage

Practice Pointers:

- **Ideally, the lender will receive the Acord 28 (2003/10) when relying on a certificate as evidence of property insurance, though this is becoming harder to get.**
- **Name the lender as mortgagee and loss payee on property coverage and as additional insured (not additional named insured) for liability coverage.**

§8-7(a) Background and Initial Considerations

A lender will want its borrower to carry insurance for two main reasons: to protect the lender's interest in the collateral and to protect the borrower's financial condition. Both types of protection ultimately improve the lender's chances of being repaid, though guarding the collateral is the more immediately effective way of doing this. The collateral is protected by property and casualty (also known as "p and c") coverage; the borrower is protected from liability by liability coverage.¹¹

Determining the insurance that is in effect is not an easy task and lenders typically have in-house compliance officers who deal with these issues. Institutional lenders will have (or should have) a person or group within their organization that is responsible for establishing insurance requirements and reviewing a borrower's proposed coverage package. Insurance issues can hold up a closing and so it is a good practice to communicate with the borrower, the borrower's risk manager or insurance broker and the appropriate person at the lender's office early in the process.

In addition to questions about coverage amounts, which will vary from deal to deal, the lender will need to determine what evidence of insurance it will accept at closing and how it will be named on the policy.

§8-7(b) Evidence of Insurance

Some lenders will require copies or duplicate originals of the actual insurance policies, and will subject them to the careful review that allows the lender to determine whether the insurance coverage is satisfactory. Policies are often not available at closing, however, and

¹¹ These coverage descriptions merely scratch the surface. The borrower with employees will also need to carry workers' compensation insurance, and borrowers may also be required to carry coverage against loss of business income, against environmental risks, etc. It is also important in this connection to note that lenders are required to make their borrowers acquire flood insurance if mortgaged property is within an identified flood hazard area. Lenders that fail to ensure that flood insurance is in effect when it should be are subject to fines and penalties by regulatory authorities such as the FDIC. *See* 42 U.S.C.A. § 4012a (2003 & Supp. 2010).

insurers are very reluctant to issue duplicate policies. Accordingly, lenders may fall back on the issuance of insurance “binders,” which are usually readily available at closing but which are valid only for limited time periods (up to 3 months), and, therefore, require follow-up to ensure that the policy described in the binder is actually issued.

As an alternative to policies or binders, most lenders will accept a certificate that summarizes the insurance coverage. Although some insurers have issued their own forms of certificate, the most common source of the forms is the Association for Cooperative Operations, Research and Development or “Acord”, a non-profit insurance trade association. The Acord forms are typically identified by the number of the form and the date of the version (e.g., Acord 28 (2006/07)). More information is available at Acord’s website, www.acord.org.

It has become increasingly difficult to obtain adequate evidence of insurance coverage by use of insurance certificates. In 2003, Acord issued a form, the Acord 28 (2003/10), that did the job nicely by providing blank fields in which coverage could be summarized, confirming that the form “conveys all the rights and privileges afforded under the policy” and imposing a requirement that the insurer give written notice of policy cancellation to the lender. Unfortunately, in July of 2006, Acord issued revisions to the Acord 28 that greatly reduced its value to lenders.¹² The revision, the Acord 28 (2006/07), introduced a disclaimer that the certificate is issued for information only and “confers no rights upon the additional interest named below.” In a similar vein, it relieved the insurer of the need to notify named parties of policy cancellation, promising only that “the issuing insurer will endeavor to mail ___ days written notice to the additional interest named below,” but adding that “failure to mail such notice shall impose no obligation or liability of any kind on the insurer, its agents or representatives.”¹³ The 2006 revision of the Acord 28 leaves

¹² Discussions among lenders, insurance companies and agents to make the 2006 Acord forms more useful to lenders were facilitated by Acord during 2007-2009, but ultimately produced no results.

¹³ The language stating that the certificate confers no rights and is issued as a matter of information only has been used to deny the certificate holder notice of cancellation. *Nazami v. Patrons Mutual Insurance Company*, 910 A.2d 209 (Conn. 2006). A helpful summary of the concepts is found in Alfred S. Joseph III and Arthur E. Pape, *Certificates of Insurance: The*

the lender with few good options: It can demand the use of the 2003 form of Acord 28, can require that the policy be produced at closing (often wishful thinking) or can take a binder and follow up later for the full policy.¹⁴

With respect to liability coverage, there is likewise little option but a form designated the Acord 25 (2001/08), which includes similar disclaimer language about the certificate being “issued as a matter of information only” and the same weak promise about “endeavor[ing]” to provide prior notice of cancellation as are found in the 2006 Acord 28.

§8-7(c) How Lender Should Be Named

On property insurance, a first mortgage lender should always be the mortgagee and loss payee, and not an additional insured. The status of mortgagee is superior to that of an additional insured since, for example, a mortgagee has no duty to the insurance carrier to report changes in hazards at the subject location, but an additional insured could be held to this requirement. Also, a mortgagee may be protected from cancellation if the property owner fails to renew or extend the insurance.¹⁵

In the case of general liability coverage, a lender should be named as an additional insured for liability to protect against negligence suits arising from activities at the property that serves as collateral. The

Illusion of Protection, 9-FEB Prob. & Prop. (1995), though at the time the article was written, the preferred form was the Acord 27. Another helpful resource on the Acord property insurance forms is the website of the Mortgage Bankers Association, which includes a question and answer section:

<http://www.mortgagebankers.org/IndustryResources/StandardsandBestPractices/FREQUENTLYASKEDQUESTIONS.htm>.

¹⁴ Many insurance agents will still produce the 2003 Acord 28, but the form is being phased out of use and may run afoul of the requirements of some state insurance regulators (of which Maine is not one) that require language on certificates of insurance to the effect that the certificates are issued as a matter of information only. See, e.g., *Evidence Concerning the Usage of Insurance Certificates*, New Hampshire Bulletin, Docket No.: INS 09-048-AB, July 29, 2009.

¹⁵ See 24-A M.R.S.A. § 3002 (2000) (detailing rights to notice of cancellation due to “designated mortgagee[s]”).

lender should not, however, be an additional named insured for liability, since this coverage extends to all of the lender's operations, something generally not intended by either the lender or the insurer providing coverage.

§8-8 The Closing Statement

Practice Pointers:

- **Familiarize yourself with a simple computer program, like Excel, that will do the math for you.**
- **Delegate primary authority for preparation of the closing statement to an assistant to keep your attention at closing focused on deal issues.**
- **The borrower should sign the statement in order to approve the disbursements.**

§8-8(a) Background and Initial Considerations

The closing statement (a/k/a the settlement statement) shows the funds paid in and out of closing. The “out” part is usually the harder one, as the amounts of the miscellany of loan payoffs, real estate taxes, brokerage commissions, etc. tend to come in at the last minute and to fluctuate when they do arrive. Generally, the simpler the statement can be kept, the better. If acquisition financing is involved, it may be possible to break the settlement statements into two: the purchase and sale statement, for which the buyer and seller are responsible, and the loan statement for which lender is responsible. The buyer and seller can worry about their own adjustments, and when they have finalized the statement, can provide an agreed upon schedule of disbursements to the lender.

Anyone regularly preparing closing statements should familiarize themselves with a software program like Excel that will do the basic math and allow fast revision of the statement when numbers change.

The borrower, and the seller of the financed assets if it is using the same settlement statement, should sign the statement in order to approve the disbursements.

Forms of settlement statement vary from office to office. Though designed for residential closings, the HUD 1 form is also frequently

used for smaller commercial deals since most title companies have it loaded on their computer systems. Some sample forms follow. The first involves just a loan, while the second includes an acquisition as well.

§8-8(b) Form of Closing Statement (Loan Without Acquisition)

Closing Statement
(Loan Without Acquisition)

Lender: Lender Bank, N.A.

Borrower: Acme Products, Inc.

Property:

Date: July 10, 201_____

FUNDS RECEIVED IN ESCROW

Loan amount	\$2,500,000.00
Third party report deposit	\$ 10,000.00
Application fee	<u>\$ 25,000.00</u>
Total Funds Deposit with Lender	\$2,535,000.00

LESS LENDER FEES/CHARGES¹⁶

Interest for payment 7/10/09 to 7/31/09 @ 7.5% (\$520.83 x 22 days)	\$ 11,458.26
Credit report fee (POC) ¹⁷	\$ 224.00
MAI report fee (POC)	\$ 5,000.00

¹⁶ Here, the lender is refunding the application fee, which is not a common practice among Maine banks, but is sometimes done by other lenders. Presumably, the fee was collected in order to strengthen the borrower's commitment to take the loan from this particular lender.

¹⁷ POC means that an expense was "paid outside closing." Here the lender will have paid these items before closing out of the deposits it received for third party reports and other due diligence items.

Property condition report/ Environmental fee (POC)	\$ 4,200.00
Flood certification (POC)	<u>\$ 25.00</u>
Subtotal	(\$ 20,907.26)
NET FUNDS AVAILABLE	\$2,514,092.74
BORROWER CHARGES	
Title exam and premium	\$ 3,750.00
Recording fees to registry	\$ 224.00
UCC Filing at Secretary of State	\$ 10.00
Survey	\$ 3,500.00
Payoff of existing Lender	\$2,375,254.08
Borrower's counsel	\$ 7,649.65
Lender's counsel	<u>\$ 6,500.00</u>
TOTAL FUNDS DISBURSED	\$ 2,396,887.73
TOTAL AMOUNT DUE BORROWER	\$ 117,205.01
LIST OF CHECKS	
_____ Title Company	\$ 3,750.00
_____ County Registry of Deeds	\$ 224.00
Acme Products, Inc.	\$ 117,205.01
Maine Secretary of State	\$ 10.00
_____ Survey Co.	\$ 3,500.00
_____ Bank	\$2,375,254.08
Brilliant & Sharp, L.L.P.	\$ 7,649.65
Astute Lawyers, L.L.P.	<u>\$ 6,500.00</u>
	\$2,514,092.74

The undersigned acknowledges receipt of this Settlement Statement, agrees to the correctness thereof, and authorizes and ratifies the disbursement of the funds by Acme Products, Inc. as stated hereon.

[BORROWER]

By: _____

Name/Title

§8-8(c) Form of Closing Statement (Loan With Acquisition)

Closing Statement
(Loan With Acquisition)

Lender: Lender Bank, N.A.

Borrower: Acme Products, Inc.

Property:

Date: September 10, 201__

I. Seller's Transaction

Purchase price	\$1,000,000.00
<u>Minus</u>	
Recording fees/discharge	\$ 22.00
Rent proration	\$ 6,000.00* ¹⁸
Real estate taxes	\$ 1,972.80**
Security deposits	\$ 1,000.00***
Water and sewer	\$ 350.00 ¹⁹

¹⁸ It is good practice to provide the basis for pro-rations. This makes them easier to remember and explain if any questions arise about them after closing.

¹⁹ A lien is available for collection of assessed sewer charges per 38 M.R.S.A. § 1205 (2001), so these are frequently accounted for in acquisition closing statements. Other miscellaneous property expenses

Fuel oil	\$ 300.00
Transfer tax	<u>\$ 1,100.00</u>
Total Deductions	(\$ 10,744.80)
Total Due Seller	\$989,255.20
II. Buyer's Transaction	
Gross loan amount	\$600,000.00
<u>Minus</u>	
Credit report fee (POC)	\$ 224.00 ²⁰
MAI report fee (POC)	\$ 5,000.00
Property condition report/ Environmental fee (POC)	\$ 4,200.00
Flood certification (POC)	<u>\$ 25.00</u>
Total Deductions	(\$ 9,449.00)
Loan Amount Available for Closing	\$ 590,551.00
Purchase price	\$1,000,000.00
<u>Minus</u>	
Deposit	\$ 75,000.00
Rent proration	\$ 6,000.00*
Real estate taxes	\$ 1,972.80**
Security deposits	<u>\$ 1,000.00***</u>
Total Deductions	(\$ 83,972.80)
Subtotal	\$ 916,027.20
<u>Plus</u>	
Title premiums	\$ 3,750.00
Lender's attorney fees	\$ 5,000.00

such as the charge shown for fuel oil don't implicate lien rights and are sometimes paid outside of closing.

²⁰ See the notes under §8-8(b) on the meaning of "POC."

UCC search and filing	\$ 50.00
Recording fees	\$ 224.00
Transfer tax	\$ <u>1,100.00</u>
Total Expenses	\$ 10,124.00
Total Acquisition Cost	\$ 926,151.20
Minus Available Loan Amount	<u>(\$ 590,551.00)</u>
Total Due from Borrower/Buyer	\$ 335,600.20

III. Total Funds Available and DisbursementsTotal Funds Available

Available loan amount	\$ 590,551.00
Deposit	\$ 75,000.00
Total due from Borrower/Buyer	\$ <u>335,600.20</u>
Total Funds Available	\$1,001,151.20

Disbursements/List of Checks

_____ County Registry (transfer tax)	\$ 2,200.00
_____ County Registry (recordings)	\$ 246.00
_____ (Seller)	\$ 989,255.20
_____ Water District (water and sewer)	\$ 350.00
_____ Oil Co. (fuel oil)	\$ 300.00
_____ Title Co. (premium)	\$ 3,750.00
Astute Lawyers, L.L.P.	\$ 5,000.00
Maine Secretary of State (search/filing)	\$ <u>50.00</u>
Total Disbursements	\$1,001,151.20

The undersigned acknowledges receipt of this Settlement Statement, agrees to the correctness thereof, and authorizes and ratifies the disbursement of the funds by Acme Products, Inc. as stated hereon.

[BORROWER]

By: _____

Name:

Title:

* Rent is \$9,000/month (divided by 30 = \$300.00 per diem x 20 days between September 10, 201__ and September 30, 201__ = \$6,000.00).

**The property is identified on Tax Map ____, Lot ____.

Real estate tax for the period July 1, 201__ through June 30, 201__ is \$10,000.00 (divided by 365 = \$27.40 per diem x 72 days between July 1, 201__ and September 10, 201__ = \$1,972.80). The next installment in the amount of \$5,000 and all subsequent payments will be the responsibility of Buyer.

***Security deposits and the tenants to which they are attributable are listed on Schedule A to this closing statement.

§8-9 Form 1099-S

Practice Pointers:

- **Reporting is Required for Most Sales of Interests in Real Estate.**
- **No filing need be made when the transfer is made by a corporation.**
- **The person responsible for filing is usually the title company, but can be the lender or the attorneys. The parties should enter into a designation agreement if any doubt exists as to filing responsibility.**

Section 6045(e) of the Internal Revenue Code and related regulations require a person responsible for closing certain real estate transactions to make an information return with respect to the transaction.²¹ The return is made on the Form 1099-S, "Proceeds From Real Estate Transactions," which is filled out with the name, address and taxpayer identification number of the sellers, as well as the gross

²¹ 26 U.S.C.A. § 6045(e) (Supp. 2010).

proceeds of the real estate transaction.²² Generally, reporting is required if the transaction consists in whole or in part of the sale or exchange for money, indebtedness, property, or services, of any present or future ownership interest in real property, including interests in long-term leases (i.e., any with 30+ years remaining in its term), air rights, standing timber, condominiums and cooperative apartments.²³ A sale or exchange may have occurred even if the transaction isn't currently taxable (such as where the taxpayer has the ability to defer recognition of any gain on the sale under Section 1031 of the Internal Revenue Code) or where the sale is involuntary (such as where property is sold under threat of condemnation).

Transactions that are exempt from reporting include those involving a gift, bequest, foreclosure, or a de minimis transfer involving property valued at less than \$600.²⁴ Also, corporations, governmental units and volume transferors are exempt from the reporting requirements.²⁵

The person responsible for providing the information on the Form 1099-S is the "real estate reporting person." Usually, that will be the title company that closes the transaction. If a Uniform Settlement Statement (HUD-1) is used, the reporting person is the person listed on page one at item H of the settlement statement as the settlement agent.²⁶ If a Uniform Settlement Statement is not used, or if no settlement agent is listed, the person responsible for closing is the person who prepares the closing statement. This includes the settlement statement or other written document that identifies the trans-

²² The Form 1099-S and its instructions can be downloaded from <http://www.irs.gov/pub/irs-pdf/i1099s.pdf> and <http://www.irs.gov/pub/irs-pdf/f1099s.pdf>.

²³ 26 C.F.R. § 1.6045-4(b)(2) (2010). A mortgage loan transaction that does not involve the sale of the property is not included among reportable transactions. 26 C.F.R. § 1.6045-4(c)(1)(i) (2010).

²⁴ 26 C.F.R. § 1.6045-4(c)(1)(iii) (2010).

²⁵ 26 C.F.R. § 1.6045-4(d)(1) (2010). Roughly speaking, a volume transferor is one that transfers over 25 parcels per year to different transferees. The regulations contain guidance about the evidence on which a transferee can rely in determining the exempt status of its transferor. 26 C.F.R. § 1.6045-4(d)(2) (2010). Such evidence from a volume transferor comes in the form of a prescribed certification. 26 C.F.R. § 1.6045-4(d)(3)(i) (2010).

²⁶ 26 C.F.R. § 1.6045-4(e) (2010).

feror, transferee, and the real estate transferred, and describes how the proceeds are to be disbursed. If no closing statement is used or if several are employed, then either the purchaser's attorney or the seller's attorney may be the reporting person. If there is no "person responsible for closing the transaction," however, the reporting person is, in order of priority, the mortgage lender, the transferor's broker, the transferee's broker or the transferee.

In order to resolve any uncertainty about filing responsibility, the parties may enter into an agreement that designates the reporting person. The persons eligible to be designated as reporting persons under such an agreement are listed in 26 CFR § 1.6045-4(e)(5)(ii).

The filing is supposed to be made by February 28 (March 31 if filed electronically) of the year following that in which the transfer occurred. The tax code imposes penalties for

- Failure to file information return;
- Failure to furnish a statement to the transferor;
- Failure to include correct information;
- Failure to supply identifying numbers; and
- Willful failure to supply information

These penalties include monetary fines (mostly ranging from \$50 to \$250,000) and, in extreme cases, imprisonment, and are broken down by offense in the statute.²⁷

§8-10 Transfer and Withholding Taxes

Practice Pointers:

- **Closings that involve the purchase and sale of Maine real estate will always include the Declaration of Value form and the REW-4 form (and usually one of the other REW forms).**

²⁷ 26 U.S.C.A. §§ 6721-6723 (2002 & Supp. 2010). 26 U.S.C.A. § 6724 (Supp. 2010) includes definitions and rules relating to waiver and payment. 26 U.S.C.A. § 7203 (2002) includes the penalties for willful failure to supply information.

- **Transfer tax is collected on transfers of controlling interests in real-estate owing entities as well as on transfers of the real estate itself.**
- **It is the responsibility of the escrow agent (which may include mortgage lenders) to notify buyers of the need to comply with the withholding requirement.**
- **Wherever out-of-state sellers are involved in a real estate sale, someone should ask early in the closing process whether they are aware of the withholding requirement and whether they desire to obtain an exemption from it.**

Maine's transfer and withholding taxes are more relevant to a discussion of real estate closings than to commercial finance transactions, but since the two frequently intersect, some familiarity with these taxes is useful.

§8-10(a) Transfer Tax

The transfer tax is aimed at taxing transfers of real estate by deed, but it also gets to real estate conveyances that are accomplished by transfer of controlling interest in the entity owning the real estate.²⁸ This latter part of the tax statute was added in 2001, apparently to stop end-runs around the tax that had been previously accomplished by conveying the equity interests in the real estate owner instead of the real estate itself. For example, if a corporation owned real estate, a pre-2001 buyer could purchase the land itself and pay a transfer tax, or could instead purchase all of the corporate stock (thereby owning acquiring the corporation's assets, including the real estate) and pay none. A transfer of entity interests triggers the tax if more than 50% of capital, profits of beneficial interest or voting interests in the entity are conveyed within any 12-month period.²⁹ Thus, the tax may be triggered by a merger or acquisition having no connection to Maine other than the acquired entity's ownership of Maine real estate. A more detailed description of the applicability of the tax to transfers of real estate and to transfers of controlling interests follows.

²⁸ The transfer tax is detailed in 36 M.R.S.A. §§ 4641-4641-L (2010).

²⁹ 36 M.R.S.A. §§ 4641 (1-A) & 4641-A (2) (2010).

§8-10(a)(1) Transfers of Real Estate

The real estate transfer tax is imposed on each deed by which any real property in the state is transferred.³⁰ When the deed is delivered to the relevant registry for recording, it is accompanied by two duplicates of a separate form called a “Declaration of Value.” The form can be downloaded from the Maine Revenue Services website at <http://www.maine.gov/revenue/propertytax/transfertax/RealEstateTransferTax.pdf>. The form requires that the value of the property be stated. If the transfer is an arm’s length transaction, value will be established by the purchase price. If it is not (such as in cases where a gift has been made or consideration is nominal), the value is based “on the estimated price a property will bring in the open market and under prevailing market conditions in a sale between a willing seller and a willing buyer, both conversant with the property and with prevailing general price levels.”³¹

The rate of tax is \$2.20 for each \$500 or fractional part of \$500, of the value of the property being transferred. Thus, a purchase price of \$860,750 would result in a transfer tax of \$3,788.40, calculated as follows: $\$860,750/500 = 1,721.5$, which would be rounded up to 1,722 owing to the .5 constituting a “fractional part of \$500.” $1,722 \times \$2.20 = \$3,788.40$. The tax is imposed $\frac{1}{2}$ on the grantor, $\frac{1}{2}$ on the grantee unless the parties agree to a different allocation and is paid to the registry at the time of recording. Failure to comply with the requirements for submission of a declaration of value does not affect the validity of any recording, but falsifying a declaration of value constitutes a misdemeanor.³²

Exempt transfers include those by or to governmental entities (though the non-governmental party still owes its half of the tax), mortgages, corrective deeds, deeds between family members for which no consideration is paid, and assorted deeds that are delivered

³⁰ “Real property” means land or anything affixed to land. “Real property” includes, but is not limited to, improvements such as buildings, mobile homes other than stock-in-trade, lines of electric light and power companies and pipelines and other things constructed or situated on land when the owner of the improvements is not the landowner. 36 M.R.S.A. § 4641(2-A) (2010).

³¹ 36 M.R.S.A. § 4641(3) (2010).

³² 36 M.R.S.A. §§ 4641-K, 4641-L (2010).

in connection with changes in form of entity. The full list is set out in 36 M.R.S.A. § 4641-C and the declaration form requires any claimed exemption to be explained.³³

§8-10(a)(2) Transfers of Controlling Interest

Where an entity such as a corporation owned real estate, it once was possible to avoid the transfer tax by transferring the corporation's stock to the buyer instead of conveying the land. In order to close this loophole, the transfer tax is collected in the county where real property is located for each transfer of a controlling interest in an entity owning the property.³⁴ A controlling interest is a majority of the total voting stock of the corporation or of the capital, profits or beneficial interest in the corporation or other entity.³⁵ All acquisitions made within a 12-month period by persons acting in concert are aggregated for purposes of determining whether a transfer or acquisition of a controlling interest has taken place.³⁶ The State Tax Assessor's rules summarize the operation of the controlling interest transfer tax as follows:

In order for the tax to apply when a controlling interest in an entity that has a fee interest in real property in this state has been transferred, the following must all apply: (a) the controlling

³³ Effective June 15, 2009, the mortgagee must pay the full transfer tax on the value of the mortgaged premises if the mortgagee purchases at a foreclosure sale in a civil action foreclosure or takes a deed in lieu of foreclosure. 36 M.R.S.A. § 4641-C(2) (2010). If the property is sold to a third party at such a sale, then the transfer tax is imposed only upon that portion of the sales proceeds that exceeds the amounts necessary to pay in full all of the claims of the mortgagee and all junior claimants that were parties in the civil action. *Ibid.* There is no statutory exemption from the transfer tax where a mortgagee obtains a deed as the result of a power of sale foreclosure.

³⁴ 36 M.R.S.A. § 4641-B(2) (2010).

³⁵ 36 M.R.S.A. § 4641 (1-A) (2010).

³⁶ 36 M.R.S.A. §§ 4641-A(2), 4641(1-A)(C) (2010), The Department of Administrative and Financial Services for the Bureau of Revenue Services has issued rules for application of the transfer tax to the transfer or acquisition of a controlling interest in an entity with a fee interest in real property. Me. Dept. of Admin. and Fin. Serv., 18-125, Chpt. 207, Section .02 (2007). These are found at <http://www.maine.gov/revenue/rules/pdf/rule207.pdf>.

interest must be directly or indirectly transferred by a single person or acquired by a single person or group of persons acting in concert, and if a series of transactions is involved, they must all have occurred within a twelve-month period; (b) a deed must not have been given for the conveyed interest in Maine real property in question; (c) the entity in question must have an ownership interest in real property that is located in this state; and (d) the transfer must not otherwise be exempt under 36 M.R.S.A. § 4641-C. A controlling interest transfer is exempt from the real estate transfer tax if the transfer would qualify for exemption if it were accomplished by deed.

An example of the general operation of the tax is as follows:

A owns 35% and B owns 45% of the voting shares of a corporation. C, D, E and F each own 5% of the voting shares. Within a single 12-month period, C acquires B's 45% interest and D's and E's 5% interests. This is a taxable acquisition because a controlling interest (more than 50%) was acquired by C (45% from B plus 5% from D and 5% from E). However, if C, D and E were to transfer their shares (totaling 15%) to B, those transfers would not be taxable; although B would now own 60% of the corporation, only a 15% interest was transferred and acquired within a 12-month period, so the acquisition by B is not taxable.³⁷

An example of transferees acting in concert is as follows:

A owns 100% of Corporation, which owns Maine real property. As a group, B, C, D, and E negotiate to acquire all of A's interest in Corporation. B, C, D, and E each acquire 25% of A's interest. The contracts of B, C, D, and E are identical and the purchases occur simultaneously. B, C, D, and E also negotiated an agreement binding themselves to a particular course of action with respect to the acquisition of Corporation, and to the terms of a shareholder agreement that will govern their relationship as owners of Corporation. B, C, D, and E are acting in concert and their acquisitions from A are treated as a single acquisition of a controlling interest which is subject to the real estate transfer tax.

³⁷ Me. Dept. of Admin. and Fin. Serv., 18-125, Chpt. 207, Section .02.

A controlling interest transfer must be reported to the register of deeds in the county or counties in which the real property in question is located within 30 days of the date of the conveyance or acquisition, on a “Controlling Interest Transfer Tax Return/Declaration of Value” in affidavit form as prescribed and furnished by the State Tax Assessor.³⁸ In cases where a controlling interest transfer occurs as the result of a series of separate transactions, the return must be submitted within 30 days of the date of the individual transaction that causes the “more than 50%” controlling interest threshold to be met. Valuation of the interests is generally based on purchase price, though this is not dispositive.³⁹ As with real estate, the tax liability is split 50/50 between transferor and transferee, unless the parties agree otherwise.⁴⁰

The legislature regularly tinkers with this statute, so practitioners should be particularly careful to establish that they are looking at the current version.

One of the boxes on the real estate Declaration of Value asks whether the buyer is required to withhold Maine income tax from the sale proceeds or whether any specific exemptions apply. This box refers to the withholding tax, which is the other Maine tax that sellers and buyers of Maine real estate need to concern themselves with.

§8-10(b) Withholding Tax⁴¹

Where an out-of-state seller profits by the sale of Maine real estate, there is some risk that this gain will never be subjected to taxation in Maine. In order to protect against this, Maine law places

³⁸ 36 M.R.S.A. § 4641-B (2) (2010). The form is available at:

<http://www.maine.gov/revenue/forms/property/forms/cittform.pdf>.

³⁹ The Tax Assessor’s rules state that, in making a determination of whether an estimate price is reasonable, the Assessor may consider any or all of the following: (a) a fair market value appraisal of the property; (b) an allocation of assets by the seller or the buyer made pursuant to section 1060 of the Internal Revenue Code and reported to the Internal Revenue Service; and (c) the full market value assessment for the property based on the municipal property tax rolls on the date of sale. Me. Dept. of Admin. And Fin. Ser. 18-125, Chpt. 207, Section .06.

⁴⁰ 36 M.R.S.A. § 4641-A(2)(B) (2010).

⁴¹ 36 M.R.S.A. § 5250-A (2010).

on the real estate escrow person the responsibility for notifying the buyer of the need to withhold income tax from certain sales of Maine property. The buyer must then comply with any applicable withholding requirements. If the escrow person fails to notify the buyer or the buyer gets the notice but doesn't comply with the withholding requirements, one or the other will be liable for any tax that should have been withheld.⁴²

The withholding law applies to sales of Maine real property by a nonresident individual, estate or trust or by a business not domiciled in Maine. The withholding is done at the time of the property closing and is claimed as an estimated Maine income tax payment on the seller's Maine income tax return (Form 1040ME, 1041ME or 1120ME). The rate of withholding is 2 ½% of the total consideration (total sales price) unless the State Tax Assessor has approved a reduced rate.⁴³

The criteria for what constitutes a Maine State resident are set forth in 36 M.R.S.A. §5250-A(1)(C). Exemptions from the withholding requirement are available on the basis of Maine residence (as evidenced by a seller certification). They may also be obtained if the consideration for the property is less than \$50,000, if the seller is a governmental entity, in certain transfers by foreclosure or deed in lieu of foreclosure, or if the State Tax Assessor has provided a certificate indicating that no tax or a reduced one is due.⁴⁴ Exemptions or reductions in tax can be requested in advance of closing from the State Tax Assessor and a form, the REW-5, is provided for this purpose. Such requests should be made at least 5 days prior to closing. Exemptions are "generally granted when there is a loss on the sale of the property, a federal exclusion of the gain on the sale of a principal residence, the transaction involves a like kind exchange, or for other situations resulting in no Maine income tax liability."⁴⁵ If a seller will be subject to withholding and is expected to want a tax exemption or reduction, the process of requesting one should start well before the closing. The

⁴² 36 M.R.S.A. § 5250-A(9) (2010).

⁴³ Reductions are treated in 36 M.R.S.A. §§ 5250-A(2), (4) (2010).

⁴⁴ The full list of exemptions is set out in 36 M.R.S.A. § 5250-A(3) (2010).

⁴⁵ The State has a useful list of frequently asked questions about the withholding law, from which this quote is taken, found at: <http://www.maine.gov/revenue/faqs/rew.shtml>.

need to ask about withholding arises wherever an out-of-state seller is involved in a real estate sale.

As noted above, compliance with the law falls to the buyer, but if the buyer is not aware of it, then responsibility (and resulting tax liability) rests with the escrow person. Lenders should be aware of the definition of "real estate escrow person."⁴⁶

"Real estate escrow person" means any of the following persons involved in a real estate transaction in the following order of priority:

- (1) The person, including any attorney, escrow company or title company, responsible for closing the transaction;
- (2) The mortgage lender;
- (3) The seller's broker;
- (4) The buyer's broker; and
- (5) Any other person who receives and disburses the consideration or value for the interest or property conveyed.

What this means in practice is that the lender will always want to be sure that the buyer is notified of the withholding requirement and so will want to see the REW-4 notification form on its closing checklist.⁴⁷ If this notice is given, then the buyer either needs to see evidence that the tax does not apply (such as an REW-3 affidavit indicating that the seller is a Maine resident or evidence of an exemption)⁴⁸ or to see that the withholding is made via a form REW-1.

As should be apparent, compliance with the REW requirements is a forms-intensive business. The relevant forms are as follows and are available on the Maine Revenue Services website at <http://www.maine.gov/revenue/forms/rew/rew.htm>:

⁴⁶ 36 M.R.S.A. § 5250-A(1)(B) (2010).

⁴⁷ In acquisition financings, the lender may wish to include any withholding tax liability among the borrower's obligations to the lender, perhaps by way of inclusion of withholding tax obligations in a general agreement of indemnity contained in the loan agreement.

⁴⁸ Absent actual knowledge of the falsity of this representation, the buyer has no liability for the tax. 36 M.R.S.A. § 5250-A(5) (2010).

- REW-1 – This is the form by which the withheld tax is sent to Maine Revenue Services.
- REW-2 and REW-3 – These are affidavits for an individual and entity seller, respectively, certifying to status as a Maine resident.
- REW-4 – This is the form of notification to the buyer of the withholding tax requirement.
- REW-5 – This is the form by which a tax exemption or reduction may be requested.

§8-11 Opinions

Practice Pointers:

- **Lenders’ counsel should honor the “golden rule” of opinion requests: one should not request a legal opinion that her own firm would not render if it represented the borrower and had sufficient facts.**
- **In transactions involving Maine parties and collateral, enforceability and perfection opinions are rarely requested.**

§8-11(a) Maine Opinion Practice

It is customary in commercial loan transactions for the borrower’s counsel to provide a written legal opinion to the lender. This document becomes a part of the lender’s due diligence and aside from the obvious benefit to the lender of receiving such an opinion the process that borrower’s counsel will go through in preparing the opinion will ensure that another party has reviewed the borrower’s organizational documents and approval process, often uncovering problems that can be resolved before the closing. The legal opinion is not, however, either a guarantee or a substitute for the lender’s independent review of the borrower’s organizational documents.

The basic legal opinion addresses the borrower’s organizational existence and authority and the execution and delivery of the loan documents. A form of such a basic opinion is included in the next section. In many cases, Maine lenders are happy with that basic opinion and do not require any more. However, an opinion that is

acceptable for the typical Maine loan transaction will not suffice for a complex, multi-party transaction involving large loan amounts and correspondingly higher budgets for legal opinions. It is also important to note that there is no fixed standard for legal opinions; requirements vary from lender to lender and sometimes from deal to deal for the same lender. Both lenders and borrowers also need to be aware that opinions beyond the basic ones can be difficult and expensive to give, since they require additional research and due diligence by the law firm giving the opinion. In addition, lenders' counsel should remember the "golden rule" of opinion requests: One should not request a legal opinion that his own firm would not render if it represented the borrower and had sufficient facts. Possible additional opinion requests include the following:

- Opinions on the enforceability of the documents, on the perfection of any liens and on the adequacy of filings and recordings. It has become more common in Maine practice that a Maine lender, represented by a Maine law firm in a transaction involving only Maine documents, will not ask the borrower's counsel to issue an "enforceability" opinion, although an out-of-state lender typically will require such an opinion. The same is true for an opinion on the perfection of any personal property liens and the adequacy of filings and recordings, meaning that Maine staffed and centered transactions usually won't include such opinions, but they may sometimes be required by out-of-state lenders. Neither local nor out-of-state lenders typically require opinions on the subject of perfection of real property liens given the availability of title insurance. However, out-of-state lenders will sometimes request opinions regarding mortgage filing locations or the adequacy of their form of mortgage and other documents for use in Maine.
- Opinions on the lack of any required governmental approvals for the transaction may be required if the borrower is in a regulated industry or if the transaction hinges on significant governmental approvals, but typically not otherwise.
- Opinions on the lack of any conflict caused by the transaction with the borrower's organizational documents or a specific list of contracts.

- Opinions on the absence of any litigation relating to the borrower or the loan transaction.⁴⁹ These are difficult to give without qualification, particularly if the opinion-giver isn't the long-time counsel to the borrower, and it can be expensive to do the work necessary to be able to give the opinion. Usually, these opinions will be qualified as being to the "knowledge" of the opinion-giver, and/or will rely on a factual certificate from the borrower.⁵⁰
- Transactions involving new construction will typically require some form of zoning and land use opinion. These can be very time-consuming and, therefore, expensive. If such an opinion is required it should be requested early in the transaction in order to allow adequate time for it to be prepared and reviewed. In addition, such an opinion should be sufficient to allow the title insurance company to issue a so-called zoning endorsement to the lender's title insurance policy and this should be coordinated with the title insurance agent.

⁴⁹ Legal opinions on the existence of litigation have come under increasing scrutiny by lawyers and there is much discussion about the circumstances in which such an opinion should be requested and given, and whether they should be given at all in ordinary commercial lending transactions. Some of this discussion was accelerated after the well-known example of a law firm that represented the seller in an acquisition transaction and that was sued successfully after issuing a "no litigation" opinion. *Dean Foods Company v. Pappathanasi*, 2004 WL 3019442 (Mass. Sup. Ct. Dec. 3, 2004). In this case, the opinion made no note of a pending federal grand jury investigation that had subsided by the time the opinion was issued; prosecutorial action stemming from the prior investigation arose later and caused damage to the acquirer after the closing. Whether this is best characterized as an example of bad luck, a poorly drafted opinion letter, a failure of appropriate investigation by the opinion-giver or a combination of those factors, the court found the firm liable for more than \$9 million, which underscored the potential liability in giving opinions such as this. For a discussion of the case (and some possible lessons to be learned) by two experts in the field of legal opinions, see Donald W. Glazer and Arthur Norman Field, *No-Litigation Opinions Can Be Risky Business; Looking at the Facts — and Beyond*, 14-AUG Bus. L. Today 37 (2005).

⁵⁰ The "knowledge" qualification is subject to a great deal of variation and is discussed in the literature. See Committee on Legal Opinions, *Guidelines for Preparation of Closing Opinions*, 57 Bus. Law 875, 878-79 (2002).

Land use or zoning opinions may also be required where a governmental agency is the lender or is providing some credit enhancement or where governmental programs (such as those pertaining to subsidized or affordable housing) are implicated.

Where the improvements on the real estate are not newly-constructed or substantially renovated, and absent governmental program or agency requirements, however, zoning opinions are uncommon in Maine commercial transactions.

- In addition, special situations may require special opinions, such as a tax law opinion or a securities law opinion.

Opinion letters can become very expensive to produce and a party requesting a legal opinion should take into account the cost of producing the opinion in light of the expected benefits. A more complicated transaction, or one with larger loan amounts, will justify a more extensive legal opinion than will a less complicated loan or one involving smaller amounts of money. The borrower should pay attention to controlling the scope and resulting cost of opinions and should also be sure that its counsel is willing and able to provide the opinions required. Some lenders will not require any legal opinions in the case of smaller loans or extensions or modifications to existing loans. Transactions involving more than one state law, or property in more than one state, may require more than one legal opinion and more than one law firm. The same is true for transactions involving more than one party, including transactions with multiple borrowers and transactions involving guarantors.⁵¹

The person to whom the opinion is addressed is the one that may rely on it, although there may be cases where a court allows non-addressees to rely on an opinion.⁵² Sometimes the opinion will be directed to several such addressees, such as where the loan is being made by a lender group. Also, the last paragraph of the opinion will often define the categories of persons that can rely on the opinion, including successors and assigns of the lender, its counsel and some-

⁵¹ The topic of legal opinions for matters outside the United States (borrowers, lenders or collateral) is not addressed here.

⁵² See Donald W. Glazer, et al., *GLAZER AND FITZGIBBON ON LEGAL OPINIONS: DRAFTING, INTERPRETING, AND SUPPORTING CLOSING OPINIONS IN BUSINESS TRANSACTIONS* § 2.3.2 (3d ed., 2008).

times rating agencies involved in the securitization of the loan. A properly drafted opinion will expressly prohibit reliance by any other parties, or for any other purpose, as provided in the attached form. The opinion-giver is usually a law firm, and questions of expertise and financial solidity will come into play in determining whether a given firm is qualified to give a reliable opinion. In this regard, lenders should be aware that attorneys acting in their capacity as municipal counsel may be immune from liability for defective legal opinions under Maine law, and lenders should accordingly require opinions on important deal points from non-governmental counsel.⁵³

The primary aspects of opinion letters given in commercial loan transactions follow a standardized format and are the subject of extensive discussion in the literature.⁵⁴

§8-11(b) Form of Opinion

Brilliant & Sharp, L.L.P.
One Main Street
Warner, Maine 04999

June 1, 2010

Lender Bank, N.A.
One Bank Street
Cashland, Maine 04000

Attention: D. E. Warbucks, Senior Vice President

Re: \$1,600,000 Term Loan and \$1,000,000 Revolving Line of Credit
to Acme Products, Inc.

Ladies and Gentlemen:

⁵³ *Preti, Flaherty, Beliveau & Pachios v. Ayotte*, 606 A.2d 780 (Me. 1992) (city solicitor immune under Maine Tort Claims Act from liability on opinion as to enforceability of municipal guaranty notwithstanding that attorney was also in private practice and served only part time as municipal counsel).

⁵⁴ See, e.g., Committee on Legal Opinions and the Tribar Opinion Committee, *The Collected ABA and Tribar Opinion Reports 2009* (2009); Donald W. Glazer, et al. *GLAZER AND FITZGIBBON ON LEGAL OPINIONS: DRAFTING, INTERPRETING, AND SUPPORTING CLOSING OPINIONS IN BUSINESS TRANSACTIONS*, (3d. ed. 2008).

We have represented Acme Products, Inc., a Maine corporation (the “Company”) and Robert T. Principal, an individual (“Guarantor”) in connection with financing consisting of a term loan in the original principal amount of \$1,600,000 and a revolving line of credit in the aggregate principal amount of up to \$1,000,000, being provided by Lender Bank, N.A. (the “Lender”) to the Company and being guaranteed by the Guarantor (the “Transaction”). This opinion is provided to you at the request of the Company and the Guarantor. Except as otherwise defined herein, capitalized terms contained in this opinion have the same meanings as set forth in the Loan Documents (as hereinafter defined).

In rendering this opinion, we have examined executed originals of the following documents and agreements between the Company and the Lender, in each case dated as of June 1, 2010, or as otherwise noted (the “Loan Documents”):

1. Loan Agreement;
2. Term Note in the original principal amount of \$1,600,000;
3. Revolving Line of Credit Note in the original principal amount of up to \$1,000,000;
4. Mortgage and Security Agreement concerning certain property located in the Town of Warner, Piscataquis County, Maine;
5. Assignment of Lease and Rentals;
6. Security Agreement;
7. Security Agreement (Short Form for Patents and Trademarks);
8. Environmental Indemnity Agreement; and
9. Guaranty from the Guarantor.

We have examined and relied upon originals or copies of such records of the Company, certificates of officers of the Company and public officials, and other documents as we have deemed relevant and necessary as a basis for this opinion. In such examination, we have assumed the genuineness of all signatures, the legal capacity of all individual signatories, the authenticity of all documents submitted to

us as originals, the conformity to originals of documents submitted to us as copies, and the authenticity of the originals of such documents.

As to questions of fact material to this opinion, we have relied without independent verification upon representations contained in certificates of officers of the Company and public officials.

Based upon the foregoing, and subject to the qualifications set forth below, we are of the opinion that:

1. The Company is a corporation validly existing and in good standing under the laws of the State of Maine.

2. The Company has the corporate power to perform its obligations under the Loan Documents to which it is a party.

3. The Company has taken all necessary corporate action to authorize the execution, delivery and performance by the Company of the Loan Documents to which it is a party and the Company has duly executed and delivered the Loan Documents to which it is a party.

4. The Guarantor has executed and delivered the Loan Documents to which he is a party.

This opinion is limited to Maine law and the federal law of the United States, is rendered as of the date hereof and is based upon Maine and federal law as currently in effect. This opinion is intended for use by you in connection with the Transaction and is not to be relied upon by any other person or in any other context.

Very truly yours,

Brilliant & Sharp, L.L.P.

By: _____

L. Hand, a Partner

§8-12 Post-Closing

Practice Pointers:

- **Lenders are liable for damages in Maine if they fail to record a discharge of mortgage within 60 days after full performance of the mortgage conditions.**
- **Lenders are also liable for damages in Maine if they fail to execute a release of a lien on a registered motor vehicle and return the certificate of title within 14 days after receipt of funds.**
- **Lenders are also liable for damages in Maine if they fail to file a UCC termination, or authorize the debtor to do so, within 20 days after receiving the debtor's valid request.**

A commercial loan closing in Maine will sometimes occur even though all of the required documents are not available. This is not true in larger transactions or transactions involving out of state lenders, or with respect to any of the essential closing documents, and it is always in the lender's discretion whether to close before everything is ready. The borrower should assume that a closing will not occur until all items are complete and that if it wants to close before that time it should ask the lender as soon as it knows there will be a problem. The lender that agrees to close without all of the required documentation should make sure that it is able to collect, at a minimum, the items needed to satisfy internal and regulatory requirements. The lender should be aware that trying to get items post-closing is a frustrating and often time-consuming task.⁵⁵ Human nature being what it is, all of the parties tend to move on to the next matter and can sometimes fail to follow up diligently on post-closing matters. Although some lenders have employed various means to retain the interest of the borrower, including a letter signed at the closing table that specifies what is to be provided, by what time, and alternately providing that default will result or that the interest rate will increase if the items are

⁵⁵ Some good tips on reeling in post-closing items and a reminder of the importance of persistence in those efforts are found in Joshua Stein, *After the Closing: A Legal Tragedy That Didn't Need To Be*, 15-DEC Prob. & Prop., available at http://www.real-estate-law.com/infoFrame.php?pdf=After_the_Closing_-_1313.pdf.

not delivered, the typical approach is more informal. We do not advise closing without all of the required documentation, and we think it is an inefficient way to proceed that puts additional stress and risk on the lender, but the fact is that it does happen.

Certain loans require post-closing activity by their very nature, most notably construction loans. In such cases, the lender needs to make sure that it has adequate resources and procedures in place to perform its role correctly and to monitor the progress of the matter.

Even where all agenda items are complete at closing, there is usually some post-closing activity required. For example, it will typically take some time before documents that have been sent for recording or filing are returned with the filing or recording information. This includes mortgages, UCC-1 financing statements, liens on registered motor vehicles and evidence of acceptance by a life insurance company of a collateral assignment of a life insurance policy. It also takes some time for the title insurance company to issue a final title insurance policy.

Some lenders perform post-closing title searches to verify that their UCC-1 financing statements have been properly filed or that UCC-3 termination statements for terminating a prior lender's UCC-1 have been filed. In addition, the UCC requires that most UCC-1 financing statements be renewed every five years (within a statutorily prescribed time period) and most lenders have in-house systems for making sure that this is done timely or rely upon outside contractors to do so. Counsel should confirm at the outset of the relationship with a given lender, whether that lender has the machinery in place to prevent UCC filings from expiring.

Lenders should also be aware of their post-closing obligations. Maine law requires mortgage holders to record discharges of mortgage within 60 days after "full performance of conditions of the mortgage," or be liable for damages; there are additional requirements on the borrower if the mortgage secures an open-end line of credit. There are statutorily-specified financial penalties for failing to do so (the greater of the actual damages suffered or "exemplary damages" of \$200 per week after the expiration of the 60-day period, up to a

maximum of \$5,000).⁵⁶ It had been fairly common practice among banks merely to deliver the discharge to the debtor and leave it to them to do the recording; the new law expressly requires the mortgage holder (and if there is a separate servicer, the servicer is jointly and severally liable with the mortgage holder) to record the discharge.

Similarly, Maine law requires that a lien holder with a lien on a registered motor vehicle “shall, within 14 days of receipt of funds intended to satisfy the security interest of the lienholder, execute a release of the security interest in the space provided on the certificate.”⁵⁷ That statute goes on to give the owner and any subordinate lienholder the right to “recover \$1,000 in each case from a lienholder who fails to release the security interest and deliver the certificate of title...within 14 days of receipt of funds intended to satisfy the security interest of the lienholder” unless the lienholder notifies the owner that the satisfaction of the security interest is in dispute.⁵⁸

The 2001 revisions to the UCC also address this issue, but in non-consumer cases require that the debtor must first request a termination and allow the secured party either to file the UCC-3 termination statement or to forward it to the debtor for filing.⁵⁹ A secured party is liable for damages “in the amount of any loss caused” if it fails to file or provide a termination statement when it is required to do so,⁶⁰ and, in addition, is liable for \$500 “in each case” for such failure to comply.⁶¹

⁵⁶ See *Currier*, 2008 ME 19, 940 A.2d 1058 (statutory penalties for failure to discharge mortgage are mandatory, not discretionary).

⁵⁷ 29-A M.R.S.A. § 705 (Supp. 2009).

⁵⁸ 29-A M.R.S.A. § 705(4)(A) (Supp. 2009).

⁵⁹ 11 M.R.S.A. § 9-1513(3) (Supp. 2009). This provision requires that the secured party file or send the termination notice “within 20 days after a secured party receives an authenticated demand from a debtor” so long as “there is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation or otherwise give value.”

⁶⁰ 11 M.R.S.A. § 9-1625(2) (Supp. 2009). This provision specifies that damages may include losses resulting from the inability to obtain financing or the increased cost of financing.

⁶¹ 11 M.R.S.A. § 9-1625(5) (Supp. 2009).

