

Lending Law Update



by
Brent C. Shaffer, Esq.
Commercial Real Estate, Banking
and Land Use Department
Young Conaway Stargatt & Taylor, LLP

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New Interest in Default Rate Interest Provisions

Delaware bankers know that promissory notes must be drafted with great precision. A recent court decision is a great example of this. The case involves default interest, which is the additional interest above the loan’s regular rate of interest that banks seek to collect after a commercial loan default. Default interest serves as an additional incentive for borrowers to keep payments current or quickly cure defaults if they occur, as compensation for extra time of bank personnel in dealing with the default, and sometimes as a very useful item to be traded in loan workout negotiations.

In *JCC Development Corp. v. Levy*, 146 Cal. Rptr. 3d 635 (Cal. Ct. App. 2012), a loan had matured and the lender attempted to collect default interest under the following language: “if (i) maker shall default in the payment of any interest, principal, or any other sums due hereunder . . . then at Lender’s option, all sums owing hereunder shall at once become immediately due and payable. Thereafter, interest shall accrue at the maximum legal rate.” The court ruled that the lender could not collect the additional interest at the legal rate because the lender could not exercise the option to declare the loan immediately due. In other words, the lump-sum payment of principal and interest already was

due and the “acceleration clause” could not be triggered because there was nothing to accelerate. The court said the language made acceleration a precondition to the collection of any default interest. Though the decision seems to defy common sense, it follows another case in which the lender tried to collect default interest before the loan matured, *In re Crystal Properties, Ltd.*, 268 F.3d 743 (9th Cir. 2001). In that case the note provided that upon default at the option of the lender the entire balance became immediately due and payable and bore interest at the default rate after that. The lender had not affirmatively accelerated the debt and therefore waived the default interest.

The results of these cases can easily be avoided by good drafting. The note should state that the default interest is triggered automatically upon an event of default and upon non-payment at the maturity. Delaware courts have shown that in the commercial content they will generally enforce similar contractual language, if the wording is clear and unambiguous.

For further information on this topic, please contact Brent C. Shaffer, Esq. at (302) 571-6663.