IADC COMMITTEE NEWSLETTER

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IN THIS ISSUE

Val H. Stieglitz and Bruce Wallace use a recent case experience to illustrate the importance of paying close attention to "choice of law" provisions in commercial contracts, especially when these contracts become the subject of litigation.

Check Those "Choice of Law" Provisions!

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The Business Litigation Committee consists of members involved in business and commercial litigation including business torts, contract and other commercial disputes, e-commerce, antitrust issues, trade secrets and intellectual property, unfair competition and business defamation and disparagement. The Business Litigation Committee helps connect members involved in these areas around the world through networking and referral opportunities; developing and keeping current in the substantive, strategic and procedural aspects of business litigation; and affords members an international forum for sharing current developments and strategies with colleagues. Among the committee's planned activities are newsletters, publications, sponsorship of internal CLEs, and Webinars. Learn more about the Committee at www.iadclaw.org.

Every business and commercial litigator has read countless contracts containing "choice of law" provisions. Such provisions are part of the standard boilerplate of virtually every commercial contract. Because "choice of law" is rarely a consideration going to the heart of the business deal at issue, it is not unusual for them to be given scant attention during the negotiation and drafting phase. As a result, "choice of law" clauses are often overlooked in their potential importance, as the parties and counsel concentrate on the more immediate matter of the explicit commercial terms.

When the deal goes sour, however, and it comes time for the parties to assert and enforce their contractual rights, the spotlight often turns to the "choice of law" provision – which perhaps no one had paid much attention to previously.

A recent case experience highlighted how "choice of law" distinctions can become significant once matters enter litigation.

Party A, a South Carolina citizen, is a member of a North Carolina LLC that develops retail shopping centers. Each LLC member executes a personal guaranty of the LLC's commercial loan obligations to its lender. The guarantees are, by their terms, governed by Florida law. The LLC defaults on its loan obligations. These loan obligations are secured by real estate owned by the defaulting LLC. Through a series of transactions, two of the LLC members, through an entity established for this purpose, acquire the underlying Note (which is in default) from the lender. This new entity, owned by two members of the defaulting LLC, then sue Party A (who is also a member of the defaulting LLC) on his guaranty.

It appears to be an open-and-shut case. The Note to which the guaranty applies is in default. The guaranty is valid, and contains the standard waivers of defenses. The entity seeking to enforce the guaranty owns the guaranty. The action has been brought within the applicable Statute of Limitations; there are no issues of jurisdiction or venue.

However, the guaranty is governed by Florida law and, under established Florida law, the guaranty is subject to certain well-defined defenses, irrespective of the defense waivers contained in the language of the guaranty. Specifically, where there is collateral involved as security for the debt, "[t]he party seeking a deficiency judgment has the burden of proving that the fair market value of the property foreclosed upon was less than the total mortgage debt owed." *Estepa v. Jordan, 678 So. 2d 876, 878 (Fla. Dist. Ct. App. 1996)*; see also, *Vantium Capital, Inc. v. Hobson, 137 So.2d 497, 499 (Fla. Dist. Ct. App. 2014).* Furthermore, the Court, in determining whether to enter a deficiency decree <u>at all</u>, may apply "basic equitable doctrines". *Cent. States Se. & Sw. Areas, Pension Fund v. Indico Corp., 401 So. 2d 904, 905–06 (Fla. Dist. Ct. App. 1981).* In certain circumstances, the court may refuse to enter a deficiency at all, where "there are facts and circumstances creating equitable considerations upon which the court should deny the deficiency decree in the exercise of its discretion."

Vantium Capital, Inc. v. Hobson, 137 So.2d 497, 499 (Fla. Dist. Ct. App. 2014.)

This valuation/deficiency rule complemented the general proposition that Florida law "imposes on the creditor an obligation not to deal with the debtor or the security in such a manner as to harm the interest of the guarantors." Schaeffer v. Gilmer, 353 So. 2d 847, 851 (Fla. Dist. Ct. App. 1977)(citing Dorsy v. Maryland National Bank, 334 So.2d 273 (Fla. 3rd DCA 1976)). This general proposition supersedes contractual provisions allowing the lender to impair the security. See, e.g., Warner v. Caldwell, 354 So.2d 91, 96 (Fla. 3d DCA 1977) ("Notwithstanding language in the guaranty agreement to the effect that the contract of guaranty would be 'unconditional,' beyond the duties imposed in the contract of guaranty, the law imposes on the creditor an obligation not to deal with the debtor, or any security for the debt, in such a manner as to harm the interest of the guarantors."). While not an absolute usurpation of the lender's rights, the duty imposed on lenders under Florida law provided another argument in aid of Party A's bid to effectively invalidate the terms of the guaranty.

Moreover, a Florida statute provided for attorney's fees shifting in favor of Party A. The guaranty at issue provided attorney's fees for the lender only, but not for Party A as the guarantor. Under Florida law, however, "[i]f a contract contains a provision allowing attorney's fees to a party when he or she is required to take any action to enforce the contract, the court may also allow reasonable attorney's fees to the other party when that party prevails in any action, whether as plaintiff or defendant, with respect to the contract." This provision, which was not available to Party A client under South Carolina law, created an additional argument against the lender in the event the guarantor were to prevail in the action on the contract. The fact that Florida law not only permits, but requires the trial court to consider equitable factors in assessing the appropriate deficiency judgment (if any), enables Party A to question, and develop evidence concerning, the process by which his former business partners acquired the underlying Note, and their handling of the underlying collateral, which might have had the effect of distorting and inflating the amount claimed under the guaranty. The net effect is that Florida law allows the defendant-guarantor to raise substantial questions regarding both his liability, and the amount actually owed, by invoking the Court's equitable role, the overarching duty owed by lenders, and the potential award of attorney's fees under Florida law. Had the guaranty not been governed by Florida law, such would not have been the case, and the defendant-guarantor would have been deprived of important leverage in the case.

Understandably, the parties concluding a business transaction are typically not particularly focused on choice of law provisions. They can seem like mere boilerplate and be treated as afterthoughts. It is worth a reminder, however, that there are material differences between the laws of the various States on many technical and substantive issues – and it therefore behooves the practitioner both to consider these differences at the outset of a deal, where possible, and especially when the deal ends up in litigation. These differences can matter.

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