#### State Court of Fulton County \*\*\*EFILED\*\*\*

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### IN THE STATE COURT OF FULTON COUNTY STATE OF GEORGIA

SPECIALTY FINANCE GROUP LLC,

Plaintiff and Counter-Defendant,

v.

MINOR FAMILY HOTELS, LLC AND HALSEY MINOR,

Defendants and Counter-Plaintiffs,

v.

HOTEL CHARLOTTESVILLE, LLC AND LEE DANIELSON,

Third Party Defendants.

Civil Action No. 2009EV006754F

## MEMORANDUM IN SUPPORT OF DEFENDANTS' (1) MOTION FOR SUMMARY JUDGMENT OR, IN THE ALTERNATIVE, PARTIAL SUMMARY JUDGMENT AS TO COMPLAINT AND (2) MOTION FOR PARTIAL SUMMARY JUDGMENT AS TO FIRST AMENDED COUNTERCLAIM

Defendants Minor Family Hotels, LLC and Halsey Minor (collectively, "Owners"), by

their undersigned attorneys, file this Memorandum in Support of Defendants' Motion for (1)

Summary Judgment Or, In The Alternative, Partial Summary Judgment of Count I (Suit on Note)

and Count II (Suit on Guaranty) of the Complaint filed by plaintiff Specialty Finance Group

("SFG") and (2) Partial Summary Judgment of Count II (Breach of Contract) and Count III

(Breach of the Implied Covenant of Good Faith and Fair Dealing) of the First Amended

Counterclaim ("Counterclaim") filed by Owners.

# I. INTRODUCTION

As proven by numerous admissions made by plaintiff and counter-defendant SFG and

counter-defendants Hotel Charlottesville, LLC and Lee Danielson (collectively, "Developer"), this

action arises out of an agreement between Developer and SFG to enrich themselves at the expense of Owners by creating and presenting a construction budget that they knew to be inadequate to induce Owners to invest \$7 million and obtain a \$23.6 million construction loan ("Loan") for the development of a hotel in Charlottesville, Virginia (the "Project"). Though SFG and Developer knew that the actual construction costs for the Project would exceed \$34 million, they presented a sham construction budget to Owners which misrepresented that only \$30 million – i.e., the \$23.69 million Loan, together with Owners' contribution of approximately \$6.3 million – would be sufficient to construct the Project. The Loan, which SFG knew to be woefully inadequate, was unsurprisingly declared to be "out of balance" by SFG. When Owners discovered SFG's scheme, Developer and SFG colluded to create "Events of Defaults" under the Loan in an effort to oust Owners and capture a windfall. Even before SFG asserted these bogus defaults, Developer and SFG had prospective replacements tour Owners' Project without Owners' knowledge or consent.

With Owners out of the picture, SFG and Developer both stood to profit handily from their scheme. Having extracted a guaranty from Owners under the pretense that its sham construction budget was sufficient to build the Project, and after Owners had already purchased the Project site in reliance upon the Loan being funded, SFG had more than adequate collateral. SFG knew that when the real construction budget came to light, Owners would be required to make up the funding shortfall or risk losing the Project to foreclosure.<sup>1</sup> In the first scenario, SFG would still be compensated by way of fees and interest. In the second scenario, if Owners failed to "balance the Loan" by injecting more equity in the Project, SFG would declare a default, accelerate the Loan and foreclose on the property. In that event, SFG knew it would receive a windfall in the form of Owners' substantial equity stake in the Project. This was no-lose deal for SFG.

<sup>&</sup>lt;sup>1</sup> SFG assumed that given Owner's net worth, Owners would simply issue a blank check to cover any shortfall and turn a blind eye to SFG's shenanigans. SFG was mistaken.

On February 19, 2009, when Owners confronted SFG about its sham construction budget, SFG responded by sending Owners a letter (the "Default Letter"), claiming defaults under the Loan which had no merit. When SFG learned that Owners had filed a motion for leave of court in Virginia (where the Project is located) to add SFG as a defendant to the complaint that Owners had filed against Developer, SFG responded by wrongfully accelerating the Loan and rushed to Court to file this action in Georgia. The undisputed facts demonstrate that <u>all</u> of the defaults alleged by SFG were fabricated and that SFG had no right to accelerate the Loan.

First, SFG claimed a default based on Owners' purported inability to complete the Project by March 7, 2009.<sup>2</sup> The evidence shows, however, that SFG had extended, in writing, the Completion Date to August 30, 2009. Under the terms of the Construction Contract dated March 6, 2008, which SFG approved as a condition to closing the Loan on March 12, 2008, the Project was scheduled to be substantially completed within 15 months after the anticipated start date of April 1, 2008 (i.e. July 1, 2009). The July 1, 2009 completion date was extended to August 30, 2009 in a Change Order dated April 27, 2008, which was also approved by SFG in writing. The contractor's Change Order states: "The date of Substantial Completion as of the date of this Change Order therefore is August 30, 2009." In an E-mail dated April 28, 2008, Dilip Petigara, a Senior Vice President of SFG, demanded that, "The change order must be executed by all parties." The Change Order was executed that day. Thus, the Completion Date was August 30, 2009, not March 7, 2009, as SFG claimed in the Default Letter.

Second, SFG asserted a default based on a lawsuit filed by ML Private Financial LLC ("Merrill Lynch") concerning a line of credit which Merrill Lynch extended to Halsey Minor years ago. Although Mr. Minor disclosed the Merrill Lynch line of credit to SFG at least ten

<sup>&</sup>lt;sup>2</sup> SFG filed the complaint in this action on February 22, 2009, before the alleged March 7, 2009 completion date.

months before the Loan closed, when SFG was investigating Mr. Minor's financial wherewithal to serve as guarantor of the Loan, SFG now claims that this line of credit "substantially impairs" Mr. Minor's ability to pay off the Loan and constitutes a "material change" in his financial condition. In a May 8, 2007 Loan Committee Application that SFG prepared ten months before the Loan closed on March 12, 2008, SFG listed the Merrill Lynch line of credit as one of Mr. Minor's liabilities, and determined that – after deducting the amount owed to Merrill Lynch and other creditors – Mr. Minor had a net worth of \$119,596,700 (twelve times the amount outstanding under the Loan). Mr. Minor's net worth today is nearly double his net worth in 2007. In any event, SFG closed the Loan with full knowledge of the Merrill Lynch line of credit and determined that it did not impair Mr. Minor's ability to pay off the Loan. The Merrill Lynch lawsuit pertains only to that line of credit, is not a new liability and SFG cannot show that it impairs Mr. Minor's ability to pay off the Loan.

Third, SFG claimed an alleged imbalance under Section 3.25 of the Loan Agreement. Section 3.25 of the Loan Agreement, however, places affirmative duties on SFG to (i) specify the factual basis for a claim of imbalance – stating that SFG's notice "<u>must</u> specify the factual basis and contain documents ... as reasonably necessary for Borrower to evaluate SFG's claim," (ii) determine an amount sufficient to "remedy the condition" and (iii) allow Owners 10 days to deposit that amount. SFG's Default Letter met none of these conditions precedent. SFG sent the Default Letter, devoid of facts and documents, and accelerated the Loan four days later.

Fourth, SFG claimed a default under Section 3.10 of the Loan Agreement for failure to provide Lender financial reports for the period ending December 2008, even though such reports were not due under Section 3.10 until 90 days after the end of the calendar year (i.e., by March 31, 2009). For calendar year 2008, "ninety (90) days of the end of each calendar year" is March 31,

2009. Yet SFG sent the Default Letter on February 19, 2009, and its acceleration letter on February 23, 2009. SFG then filed its Complaint the next day, on February 24, 2009 – more than one month <u>before</u> the financial reports were due.

Fifth, SFG asserted a default under Section 3(v) of the Assignment of Project Documents ("Assignment") for firing the Developer with whom SFG had been colluding. SFG claimed that Owners were required to obtain the "consent of SFG". However, SFG's consent was not required. Section 3(v) of the Assignment states that, "<u>no amendments or modifications</u> to any of the Project Documents will be made without the prior written consent of SFG." (Statement of Material Facts As To Which There is No Genuine Issue to be Tried and Statement of Theories of Recovery ("SMF"), filed concurrently herewith, ¶ 56) Under Section 7.2 of the Development Agreement, which had never been amended or modified without SFG's prior written consent, Owners had the right to terminate the Developer upon an Event of Default, and exercised that right. SFG wrote the Assignment, and neither bargained for nor obtained the right under the Assignment to require that its consent be obtained before Owners terminate the Development Agreement in accordance with its terms.

After having alleged these bogus defaults, SFG breached its funding obligations under the Loan. SFG insisted that Owners proceed with the construction, even when Owners were reluctant to do so, because their consultants had not yet completed the investigation of SFG's Budget. Having caused Owners to incur additional expenses to proceed with the construction, SFG pulled the plug when it became obvious that the flawed nature of its Budget was coming to light and that Owners were not willing to issue a blank check.

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SFG's Count I (Suit on Note) and Count II (Suite on Guaranty) are dependent on SFG's allegations that Owners were in default under the Loan, but the undisputed facts show that there was no default under the Loan. Accordingly, Owners are entitled to summary judgment.

SFG's failure to fund the Loan, when there was no default, is a breach of the Loan. In addition, SFG's collusion with Developer, and its attempts to replace Owners by asserting baseless defaults under the Loan, constitute breaches of its duty of good faith to Owners and inequitable conduct. Owners are therefore entitled to summary judgment on their claims for breach of contract and breach of the covenant of good faith and fair dealing.

#### II. FACTS

#### A. The Conspiracy Between SFG and Developer

In early 2007, SFG and Developer became involved in the development of an upscale, 101-room, 10-story, boutique hotel in Charlottesville, Virginia ("Project"). (SMF 1) Initially, Developer and SFG intended to use Michael Palmer ("Palmer") of Palmer Hospitality Group and the Beacon Hotel Collection ("Beacon") for the Project. Palmer and Developer would serve as the guarantors, and Glenmont Beacon Charlottesville, LLC would serve as the borrower. (SMF 2) However, the deal with Palmer and Beacon did not go through. When SFG instructed Developer to find a "strong guarantor" for the Project, Developer pursued Mr. Minor. (SMF 3) Developer claimed he had expertise in real estate development and pushed SFG as the lender. (SMF 4-7)

To seal the sales pitch to Owners, Matthew Hick of SFG, together with the Developer, prepared a construction budget ("Budget") on June 19, 2007 stating that the Project could be completed for \$30 million. (SMF 8) A few weeks later, SFG provided its appraisal of the Project to Developer for Developer to forward to Owners, and Developer did so by E-Mail dated July 10, 2007. (SMF 9-10) The appraisal relied on SFG's Budget. (SMF 9)

In July, 2007, Developer presented Owners with a term sheet from SFG ("Original Term

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Sheet") offering financing for the Project which provided, among other things, that the total required equity contribution by Owners would be \$5.9 million and that Mr. Minor's exposure to personal liability as guarantor would be 20% of the Loan following completion of construction of the Project. (SMF 11) Given the Budget prepared by SFG and Developer, both of whom held themselves out as experts in real estate construction, Mr. Minor's primary concerns were not about the financial risks during the construction period, but rather the risk of the hotel's failure to perform after the construction period. Albeit reluctantly, Mr. Minor was willing to accept the 20% cap on his personal exposure after the construction period ended and approved the Original Term Sheet.

In August 2007, in reliance on SFG's Original Term Sheet, SFG's appraisal and SFG's \$30 million Budget, Owners paid \$4.5 million to purchase the site for the Project. Within days of Owners' acquisition of the site, knowing that Owners were now heavily invested in the Project and needed construction financing, SFG whipped out a new term sheet, this time bumping up Mr. Minor's personal exposure under the guaranty to 100% of the Loan post-construction. (SMF 12) After being called out on its bait-and-switch tactics, SFG agreed to reduce Mr. Minor's personal exposure to 50% of the Loan post-construction, but then bumped up the equity that SFG required him to contribute to the Project to \$6.3 million. (SMF 13)

SFG and Developer knew from the outset that Owners had no experience in hotel construction, as shown in a September 10, 2007 E-mail from Matt Hick of SFG to Developer:

3) I understand Mr. Halsey Minor will be the sole owner of the borrowing entity. From what I can tell from his background he does not have hotel or commercial real estate experience. Please explain his interest in the project. (SMF 7)

It was precisely because Owners lacked this experience that they agreed to pay Developer \$900,000 in fees for his expertise and to obtain the \$23.6 million Loan from SFG – as each

professed to have extensive expertise in that area. (SMF 5-7). Thus, in its May 8, 2007 Loan Committee Application, SFG stated:

## Weaknesses:

<u>No Hospitality Experience from Sponsor</u>: The borrowing entity will be wholly owned and guaranteed by Halsey Minor, a technology company tycoon with no current experience in the hotel real estate sector. <u>Mitigating Factors</u>: 1) The property will be developed for a fee by Lee Danielson, a real estate developer with 30-years of experience, most notably in the Charlottesville, VA and Los Angeles, CA areas. (SMF 7)

In that same report, under the heading "Lead Bank Expertise", SFG touted its expertise, stating:

"SFG provides specialty commercial mortgage financing for hotels, restaurants and convenience & gas stores....

As of September 1, 2008, SFG has approved and/or closed \$1.05 billion worth of hotel mortgage financing, with an additional \$535MM in underwriting. (SMF 6)

Knowing that Owners would not be able to tell that the construction budget was a sham,

and that they would be relying on the expertise of SFG and Developer, SFG and Developer pretended that the \$30 million budget would be sufficient to complete the Project and pushed for the Loan to close. SFG sought to capture \$236,900 in Loan origination fees and add another notch to its "hotel mortgage" portfolio (SMF 6), and Developer was "desperately broke" and needed the fees he was going to get from Owners, as stated in its E-mail dated January 16, 2008:

Halsey [Minor] has been great but I am desperately broke and need to get this thing closed. (SMF 16)

One of SFG's conditions to closing the Loan was that Clancy & Theys Construction

Company ("Contractor"), the general contractor, execute and deliver to SFG the Contractor's

Consent and Certificate ("Certificate") prepared by SFG.<sup>3</sup> (SMF 18-20) The Contractor did so

<sup>&</sup>lt;sup>3</sup> The Certificate states that if SFG forecloses, SFG may become a party to the Construction Contract, in lieu of

one week before the closing and, as required by SFG, attached the Construction Contract and the Contractor's budget ("Contractor's Budget") to the Certificate. The Contractor's Budget for hard costs was \$4 million higher than SFG's Budget. (SMF 20) Despite the Contractor's Budget, SFG attached its own sham Budget of \$30 million to the Loan Agreement and closed one week earlier, on March 12, 2008. (SMF 21)

Although SFG knew before the Loan closed that the Contractor's Budget was \$4 million higher than its Budget, SFG tried to cover up the inadequacy of its Budget shortly after the Loan closed. Thus, less than six weeks after the Loan closed, although no change had been made to the Project, SFG suddenly declared a \$4 million "gap" in the Budget and demanded that Owners deposit \$4 million to close the gap. (SMF 23) Dilip Petigara, a Senior Vice President of SFG, wrote in an email dated April 25, 2008:

Please see attached. There is a \$4MM gap between underwriting budget and Broadlands' budget (Broadlands' budget is the current GC contract). (SMF 23)

Broadlands Financial ("Broadlands") – SFG's consultant – had prepared an Initial Project Evaluation ("IPE") dated March 24, 2008. (SMF 22) In the IPE, Broadlands analyzed the Contractor's Budget that SFG received before the Loan closed, acknowledged that the Contractor's Budget was \$4 million more than SFG's Budget, and concluded that the Contractor's Budget was overstated by at least 30%. (SMF 22) Broadlands stated that, although the "room key cost"<sup>4</sup> under the Contractor's Budget was \$192,506, Broadlands believed that the "room key cost" should have been only \$122,898. (SMF 22) Nevertheless, SFG demanded that Owners put up another \$4 million to cover up the inadequacy of SFG's Budget.

SFG had no right to demand another \$4 million. If SFG believed the Contractor's Budget

Owners, and Contractor will complete the Project for SFG in accordance with that contract. (SMF 18-20)

was correct, then SFG knew its Budget was understated by \$4 million before the Loan closed, and SFG had no right to demand \$4 million from Owners six weeks later. If SFG believed Broadlands IPE was correct, then SFG's Budget was not overstated at all, and SFG had no right to demand another \$4 million from Owners. Either way, SFG was acting in bad faith.

After SFG had used its Budget and its appraisal to induce Owners to purchase the site for \$4.5 million, fund another \$2 million in Project costs, pay SFG over \$250,000 in loan origination fees and close the Loan, SFG suddenly demanded that Owners put up another \$4 million to conceal the defects in SFG's Budget. SFG did so by falsely stating that SFG had suddenly discovered this "\$4MM gap in Broadlands' budget". (SMF 23)

First, there was no "Broadlands budget". There was only the IPE, and in that IPE Broadlands concludes that there is no "\$4MM gap", stating "Our estimate of project cost is significantly lower than their [Contractor's] estimate." (SMF 22) Second, SFG had received the Contractor's Budget before the Loan closed, and closed without demanding an additional \$4 million. (SMF 18-20) Thus, there was no scenario under which SFG was entitled to demand another \$4 million six weeks after the Loan closed. Indeed, had SFG or Developer disclosed these facts to Owners before the Loan closed, Owners would not have invested \$6.5 million in the Project or closed the Loan with SFG.

Owners balked at SFG's demand for another \$4 million, as it had been less than six weeks since the Loan closed and nothing on the Project had changed. In response, SFG directed Owners to deposit \$400,000 to balance the Loan. (SMF 24) Thus, in an E-mail dated April 28, 2008, Dilip Petigara, a Senior Vice President of SFG, stated:

I do NOT approve the removal of the contingency line item of \$400,000 – please provide a plan for funding this. I am amenable to having this amount funded pari-passu over a 2-4 month period,

<sup>&</sup>lt;sup>4</sup> The "room key cost" is the total cost to construct the hotel divided by the number of hotel rooms.

including this first funding (\$100,000/month for 4 months) – so Lender's funding for this first draw would require \$100,000 contribution from you. (SMF 24)

Owners deposited the \$400,000, in \$100,000 increments, in reliance on SFG's agreement that this would close the "gap".

# B. SFG And Developer Collude To Remove Owners.

SFG reviewed the Development Agreement before the Loan closed, and knew that

Developer was obligated to act as Owners' agent and fiduciary under that agreement with respect

to the Project and the Loan. (SMF 14) Section 2.1 of the Development Agreement provides:

2.1 <u>Agreement to Provide Services</u>. In consideration for Owner's agreement to pay the [Developer's] Fees to [Developer], [Developer] hereby agrees to and shall during the Term-Construction period provide the Services for and **on behalf of, and solely as agent for, the Owner**. (SMF 15, emphasis added.)<sup>5</sup>

Realizing that Owners would soon learn that the Budget was inadequate from the outset, in

November 2008, SFG and Developer decided to replace Owners. SFG began by sending a letter to Owners dated November 13, 2008 ("November Default Letter"), stating that SFG was going to stop funding because Developer had told SFG that there was a "potential" change order request coming from the Contractor. (SMF 26) SFG's November Default Letter claimed that defaults had arisen under sections 3.25, 5.02 and 6.01 of the Loan Agreement due to "material and significant <u>potential</u> change orders in the Budget for the Project in the amount of approximately \$3.5 to \$4 million, which, when approved, will cause a Budget overrun." (SMF 26, emphasis added) These were the same alleged overruns that supposedly had been cured when Owners deposited \$400,000 for the "4MM gap" in SFG's Budget months earlier. (SMF 23) Yet, seven months later, SFG once again demanded that "Borrower deposit an amount equal to the [\$3.5 to

<sup>&</sup>lt;sup>5</sup> As a condition to closing, SFG also obtained the Developer's Consent and Certificate which had attached to it the Development Agreement. (SMF 14)

\$4 million] Budget overruns," admitting that its demand was "based on conversations with Borrower's Developer" with whom SFG had been colluding. (SMF 26). SFG's November Default Letter ignored the fact that no change order had been issued and that SFG had previously induced Owners to advance another \$400,000 to address these cost overruns. (SMF 23-24) Although the November Default Letter is captioned "Default Letter," it does not identify a single "Event of Default" because no Events of Default had occurred. (SMF 26)

When newspapers began calling Owners for comment about rumors they had heard that SFG was not funding the Project, Owners confirmed to the press that SFG refused to fund the Loan. (SMF 25) The next day, without Owners' knowledge or consent, Developer gave an interview to the press stating, "I don't think we have any financial issues with the bank" and that Owners are "confused" about the Project. (SMF 25) Developer, who was supposed to be acting on behalf of Owners as Owners' agent and fiduciary, belittled and disparaged Owners to the press to bolster SFG's image at Owners' expense.

On November 14, 2008, before Owners terminated the Development Agreement, Jon Wright, Managing Director of SFG, sent an E-mail about the bad press that SFG received as a result of its refusal to fund the Loan<sup>6</sup> and the efforts that Developer would take on SFG's behalf:

Every bank has had a tough yr and any intelligent reader knows it ..... They are also googleing Mr. Minor ... It "should" make the press today, that the latest draw request in question was funded as of yesterday afternoon. The developer will stay in touch with the press on our behalf ...

I suggest we refer any future inquiries to the developer who will lobby on our behalf. We are sending the cease and desist letter to Halsey Minor in the next couple of hrs. It should get his attention. (SMF 27, emphasis added).

<sup>&</sup>lt;sup>6</sup> Apparently, SFG was very sensitive to the negative publicity, as its parent company, Silverton Bank, had been severely censured by the OCC for its improper lending practices, and was subsequently taken over by the FDIC.

Tom Bryan, the President and Chief Executive Officer of Silverton Bank, responded to Mr. Wright's November 14, 2008 E-mail by stating that Mr. Minor is "starting to piss me off" for acknowledging in the press that SFG refused to fund the Loan. (SMF 28)

In addition to these E-mails, numerous E-mails were circulated demonstrating the collusion between SFG and Developer and SFG's animosity toward Mr. Minor. For instance, Cristi Kirisits, the Corporate Communications Manager of SFG, sent an E-mail to Jon Wright stating, **"I love how the developer totally discredits Halsey [Minor]!"** (SMF 29) Kathleen Rethelford, SFG's Senior Vice President of Marketing, commented to Ms. Kirisits, "Also check out the blog comments from the locals ... too funny! **They ridicule Halsey!"** (SMF 30) On December 1, 2008, Ms. Kirisits sent an E-mail to Jon Wright attaching an article on Mr. Minor and stating, "Here is some fun reading. It's a long article on Halsey, plus a lot of blogging, including some rebuttals from him. **I'm actually starting to feel sorry for the guy now."** (SMF 31) The animus and collusion between SFG and the Developer against Owners were palpable.<sup>7</sup>

At the same time that SFG and Developer were colluding against Owners in the press, they had prospects tour Owners' Project without Owners' knowledge or consent. On Sunday, November 16, 2008, Developer met with Riverstone Properties, and took them on a tour of the Project. (SMF 32) After the tour, Developer sent an E-mail dated November 17, 2008 to Greg Friedman, Senior Vice President of SFG, telling SFG to call Riverstone Properties immediately.

> Greg – please call Jeff Galanti, VP for Riverstone Properties from Richmond with strong ties to Charlottesville. They are very interested and would like to hear from you. I met them yesterday and went through the Project. 804-643-4200. Good luck. (SMF 32).

<sup>&</sup>lt;sup>7</sup> On September 4, 2009, more than five months after Owners served document requests on SFG, SFG suddenly disclosed for the first time that there were substantial "gaps" in E-mails from early 2007 to April/May 2008 that SFG produced because SFG just happened to migrate its E-mails to a different system during that time period. Owners and SFG are in the process of "meeting and conferring" for SFG to restore the missing E-mails from SFG's backup tapes.

Neither Developer (who still had an obligation to act as agent and fiduciary on behalf of Owners) nor SFG (who knew of Developer's fiduciary obligations to Owners) ever notified Owners of Riverstone Properties' interest in Owners' Project or that Developer had given Riverstone Properties a tour of Owners' Project. (SMF 32)

After discovering Developer's mismanagement of the Project and some of his other

misdeeds, on November 17, 2008, Owner terminated Developer, effective ten days later (as of

November 27, 2008), pursuant to the terms of the Development Agreement. (SMF 33)

Unbeknownst to Owners, Developer and SFG continued to collude behind the scenes to fabricate

Events of Default, oust Owners from the Project.

To that end, Developer sent E-mails to SFG proposing "defaults" for SFG to use against

Owner. (SMF 34). Thus, on November 21, 2008, Developer sent the following E-mails to Greg

Friedman, a Senior Vice President of SFG, suggesting "defaults" for SFG to assert against Owners

so that SFG could continue Developer's engagement under the Development Agreement:

To: Greg Friedman [GFriedman@silvertonbank.com] Cc: Cliff Harrison [cliff@clharrisonconsulting.com] From: lee danielson Sent on behalf of: lee Danielson Sent: Fri 11/21/2008 10:19:58 AM Importance: Low Subject: FW: Default

Greg === this is my understanding of the documents.

---- Forwarded Message From: lee Danielson <lee@ldanielson.com Date: Fri, 21 Nov 2008 03:17:51 – 0800 To: Maura O'Connor <u>moconnor@seyfarth.com</u> Cc: Barbara Danielson <u>babs32650@aol.com</u> Conversation: Default Subject: Default

Maura – In reading the documents I believe that I should put forward a notice of default to SFG for Minor Family Hotels.

\* Under the terms of my Developers Consent I am required to notify the bank if the Borrower is in default.
\* Under paragraph 3.25 of the Loan Agreement I believe that the Borrower has demonstrated that they do not have the funds to complete the project
\* Under paragraph 6.01 of the Loan Agreement I believe that the Borrower is in default.

If this is true then the bank should be able to continue my contract and I shouldn't have to leave the project. .... (SMF 34, emphasis added)

These "defaults" are the ones SFG later asserted in its Default Letter and Complaint. (SMF 42)

Two months after Developer had been terminated, Developer continued to send E-mails to

SFG in an effort to fabricate defaults under the Loan. Thus, on January 20, 2009, Developer sent

an E-mail to SFG claiming that he believed he could show that Owner defrauded SFG, stating:

"One page of the notes plus witnesses who will testify that Halsey had every intention of

defrauding the bank and the project." (SMF 35) No such showing was made. Three days later,

Developer sent another E-mail to Greg Friedman of SFG, stating:

I also have a business plan that I believe may work to move Halsey out and protect the property so we can go forward and finish the project. (SMF 34)

Nine days later, by E-mail dated January 29, 2009, Developer sent an E-mail to vendors of

the Project to induce them to record liens against the Project so that SFG could declare a default,

all the while exonerating SFG for its unwarranted failure to fund the Loan. Developer wrote:

Team (or what is left of it).

Many months have elapsed with no payment for legitimate services rendered to Minor Family Hotels and, its sole manager, Halsey Minor. There have been many promises and yet little or no action on the part of ownership. The bank can only pay what is presented to them and then only to the extent of their agreement with MFH. ...

None of us want to lose our lien rights but that is exactly what

# **will happen if we delay and delay in the hopes of being paid....** (SMF 37, emphasis added)

Developer's efforts to "lobby" on SFG's "behalf" were relentless. (SMF 27)

On February 22, 2009, Developer and SFG planned to meet at the Downtown W Hotel in Atlanta (the "W") on March 1, 2009 to see how Developer could "get the Project going again" without Owners. (SMF 38-41) Developer sent an E-Mail dated February 22, 2009 to Greg Friedman of SFG:

Greg----attached is the complaint from Halsey. I think it is very clear where he is going with this. I am looking forward to meeting with you next week to get this thing going again. I will plan on staying in Atlanta on Saturday evening and hopefully meet with Jon [Wright] and you. Please confirm that this is happening and I look forward to meeting Jon. (SMF 39)

On March 1, 2009, Developer, Greg Friedman (Senior Vice President of SFG), and Jon Wright (Managing Director of SFG) met at the W to discuss Owners' claims against SFG and Developer and their plans to remove Owners from the Project. (SMF 38-41) Although Developer testified at his deposition that his meeting with Jon Wright in Atlanta was not a "meeting" and Mr. Petigara characterized the meeting as a "brief passing", the evidence demonstrates that Developer, Greg Friedman and Jon Wright planned the meeting a week in advance, planned to meet at the W on March 1, 2009 and did meet at the W on March 1, 2009. (SMF 41) The emails also show that the purpose of the meeting was to "get this thing going again" without Owners. (SMF 38-41)

## C. SFG Fabricates Defaults And Breaches The Loan Agreement

On February 19, 2009, SFG and Owners held a conference call to discuss the Project. During the call, Owners confronted SFG about the Budget. In tacit admission of its wrongdoing, SFG immediately terminated the call. That same day, SFG sent a letter ("Default Letter") to Owners claiming defaults under Sections 6.01(g), 6.01(k), 6.01(i), 3.25 and 3.10 of the Loan Agreement and Section 3(v) of the Assignment of Project Documents ("Assignment"). (SMF 42) The defaults alleged in the Default Letter were without merit.

First, SFG claimed a default based on Owners' purported inability to complete the Project by March 7, 2009, even though SFG had extended the Completion Date to August 30, 2009. (SMF 42-46) Under the Construction Contract, which SFG approved as a condition to closing the Loan, the Project was to be substantially completed within 15 months of an anticipated start date of April 1, 2008 (i.e. July 1, 2009). (SMF 44) The July 1, 2009 completion date was extended to August 30, 2009 by a Change Order dated April 27, 2008. (SMF 45) In an E-mail dated April 28, 2008, Dilip Petigara, a Senior Vice President of SFG, instructed Owners to execute the Change Order dated April 27, 2008, changing the completion date to August 30, 2009, stating: "The change order must be executed by all parties." (SMF 46) The parties executed the Change Order that day. (SMF 46) Thus, the Completion Date was August 30, 2009 – not March 7, 2009.

Second, SFG asserted a default based on a lawsuit filed by Merrill Lynch concerning a line of credit extended to Mr. Minor. (SMF 42) Mr. Minor notified SFG of this line of credit months before the Loan closed, and SFG took that line of credit into account before the Loan closed. In its May 8, 2007 Loan Committee Application, SFG determined that, after deducting the Merrill Lynch line of credit from his assets, as well as a number of other liabilities, Mr. Minor's net worth was \$119,596,700 – twelve times the amount outstanding under the Loan. (SMF 49) Mr. Minor's net worth is substantially larger today. (SMF 50) Yet in the Default Letter, SFG suddenly alleged that the Merrill Lynch lawsuit "substantially impairs" Mr. Minor's ability to pay off the \$10.5 million Loan and constitutes a "material change" in his financial condition, even though the suit seeks nothing more than repayment of the same line of credit that SFG analyzed months before

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the Loan closed on March 12, 2008.<sup>8</sup> (SMF 42) Clearly, as SFG acknowledged in its May 8,

2007 Loan Committee Application, the Merrill Lynch line of credit presents no new liability and

does not substantially impair Mr. Minor's ability to pay off the Loan. (SMF 49)

As a condition precedent to declaring a default on the basis of the Merrill Lynch lawsuit,

SFG must establish that the lawsuit, if adversely decided against Mr. Minor, would substantially

impair his ability to pay off the Loan. Section 6.01(i) of the Loan Agreement states:

Any **substantial or material change** of an adverse nature shall occur in the financial status of Borrower or its member or Guarantor, or any of them, from that reported and delivered to SFG heretofore which, in SFG's reasonable opinion, would **materially impair the ability** of Borrower or Guarantor to comply with all their obligations hereunder and under the terms and conditions of the Loan Documents (emphasis added) (SMF 47).

Similarly, Section 6.01(k) of the Loan Agreement states:

(k) <u>Litigation Against Borrower or Guarantor</u>. Any suit shall be filed against any Borrower or Guarantor which, if adversely determined, **could reasonably be expected substantially to impair the ability of** Borrower or **Guarantor to perform** each and every one of their respective obligations under and by virtue of the Loan Documents. (SMF 48; emphasis added.)

SFG did not make that showing, and cannot make that showing, as the Merrill Lynch line of credit is not new, and given Mr. Minor's net worth in 2007 and today, that liability has never materially or substantially impaired his ability to pay off the Loan. (SMF 44, 47-50).

Anticipating that the specious nature of this default was bound to come to light, SFG threw into its Complaint allegations that did not even appear in its Default Letter – i.e., a lawsuit in which Sotheby's is demanding that Mr. Minor purchase art for \$15 million and a lawsuit in which Christie Manson & Woods LTD ("Christie's") is demanding that Mr. Minor purchase art for \$7 million. SFG is not only disregarding Mr. Minor's claims against Sotheby's and Christie's, SFG

<sup>&</sup>lt;sup>8</sup> Mr. Minor maintains that Merrill Lynch called the line of credit one year before it came due, in breach of his

is disregarding the value of the art that Sotheby's and Christie's are selling. SFG does not have one shred of evidence that the art being sold is not worth the purchase price demanded.

Regardless, even if Sotheby's and Christie's prevail on every one of their claims, even if Mr. Minor loses on every one of his claims, and even if the multi-million dollar art that is being sold is worthless (which would require SFG to assume that both Sotheby's and Christie's committed fraud), the entire liability alleged against Mr. Minor in these suits is the \$22 million purchase price. When that number is deducted from his net worth of \$119,596,700 in 2007 (SMF 49), disregarding the value of the art that Mr. Minor would obtain and his current net worth (which is substantially greater, SMF 50), Mr. Minor's net worth is still over \$97,000,000 – ten times the amount of the outstanding balance of the Loan. Thus, SFG can make no showing that this litigation will materially or substantially impair Mr. Minor's ability to pay off the Loan.

Third, with regard to SFG's claims of an alleged imbalance under the Loan (SMF 42),

Section 3.25 of the Loan Agreement provides, in pertinent part, as follows:

If at any time during the term of this Agreement, in SFG's reasonable judgment and opinion, the remaining undisbursed portion of Borrower's Equity Contribution and the Loan is insufficient to fully complete the Improvements in accordance with the Plans, and to pay all interest ... and such other indebtedness ... and to pay all other costs ... as shown on the Cost Breakdown, Borrower shall, within ten (10) days after written notice thereof from SFG (which notice <u>must</u> specify the factual basis for said judgment and opinion and contain documents and instruments, to the extent the same are in SFG's possession, as are reasonably necessary for Borrower to evaluate SFG's claim) ... deposit with SFG ... an amount or amounts as SFG determines to be sufficient to remedy such condition.... (SMF 51, emphasis added)

Section 3.25 of the Loan Agreement places an affirmative duty on SFG, stating that SFG's notice to Owners "<u>must</u> specify the factual basis ... and contain documents" supporting its claim of an imbalance as "reasonably necessary for [Owners] to evaluate SFG's claim," determine the amount

agreement with Merrill Lynch.

required to "remedy such condition" and allow Owner 10 days to deposit that amount. SFG's Default Letter did not specify any factual basis for the alleged imbalance, did not provide any documents showing an imbalance, did not determine an amount sufficient to remedy the alleged imbalance and did not provide Owners a 10-day period in which to make the deposit. Instead, SFG sent a Default Letter dated February 19, 2009, devoid of facts and documents, accelerated the Loan four days later, on February 23, 2009, and filed the Complaint the next day. (SMF 52-53) SFG knew that its claim was so lacking in factual basis that on March 3, 2009, two weeks <u>after</u> it had sent the Default Letter, accelerated the Loan and filed its Complaint, SFG requested a change order from the Contractor to create a factual basis for this newly-minted default. (SMF 54).

In addition, under Section 6.01(b) of the Loan Agreement, Owners would be entitled to a 30-day cure period if they failed to make the deposit demanded by SFG within the 10-day notice period set forth in Section 3.25 of the Loan Agreement. (SMF 55) And, if Owners were unable to make that deposit within such 30-day cure period, they would be entitled to a 90-day cure period, provided that they worked diligently to complete the cure. Section 6.01(b) provides:

6.01 An Event of Default shall at SFG's option be deemed to have occurred hereunder if:

(b) <u>Breach of This Agreement</u>. Borrower shall breach or fail to perform, observe or meet any covenant, condition or agreement made in this Agreement or any other Loan Document, provided however:

(i) if said breach or failure (other than a payment default) is capable of being cured within thirty (30) days of Borrower's receipt from SFG of written notice of said thirty (30) day period; however

(ii) if said breach or default (other than a payment default) is not capable of being cured within said thirty (30) day period, then Borrower shall not be in breach or default of this Agreement if Borrower commences to cure said breach of failure within said thirty (30) day period and diligently processes the cure to completion, and actually completes said cure, within ninety (90) days of Borrower's receipt from SFG of written notice of said breach or failure. (SMF 55)

SFG provided Owners with neither cure period before accelerating the Loan. (SMF 52-53) In sum, SFG not only failed to provide the notice required under Section 3.25 of the Loan Agreement, SFG also failed to provide Owners with the 30/90-day cure period required under Section 6.01(b). The failure to comply with the Loan Agreement is fatal to SFG's claims.

Fourth, in the Default Letter, SFG claimed a default under Section 3.10 for Owners' alleged failure to provide financial statements for the period ending December 2008. (SMF 42) However, under Section 3.10(D) of the Loan Agreement, such statements are not due until 90 days after the end of the calendar year – i.e., March 31, 2009. (SMF 56) As a result, SFG accelerated the Loan and filed the Complaint one month <u>before</u> the alleged default even occurred.

Moreover, a default under Section 3.10 of the Loan Agreement also falls under Section 6.01(b) of the Loan Agreement, which requires that SFG provide Owners with a 30-day cure period before accelerating the Loan. (SMF 55) Indeed, if Owners were not able to cure this alleged default within the 30-day cure period, Owners were entitled to a 90-day cure period. (SMF 55) SFG provided neither cure period to Owners, a defect fatal to SFG's claim. (SFM 42)

Fifth, SFG claimed a default under Section 3(v) of the Assignment for firing the Developer "without the prior written consent of SFG". (SMF 42, 57) Section 3(v) of the Assignment states only that, "no amendments or modifications to any of the Project Documents will be made without the prior written consent of SFG." (SMF 57-58) The Development Agreement was never amended or modified without SFG's consent. To the contrary, Section 7.2 of the Development Agreement provides Owners the right to terminate Developer upon an Event of Default. Owners

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exercised that right on November 17, 2008, and SFG's prior written consent was not required. (SMF 33, 59) Accordingly, there was no default under Section 3(v) of the Assignment.

Despite the fact that no defaults existed, on February 23, 2009, SFG sent another letter to Owners incorporating its February 19, 2009 Default Letter and stating that, "As a result of the Events of Default set forth in the Default Letter, the maturity of the Indebtedness evidenced by the Note has been accelerated and the entire indebtedness is now due and payable in full." (SMF 53). SFG had no right to accelerate the Loan.

#### III. ARGUMENT

#### A. Legal Standard

Under O.C.G.A. § 9-11-56, a party may move for summary judgment and "the judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." O.C.G.A. § 9-11-56(c). Additionally, under O.C.G.A. § 9-11-56, a party may move for partial summary judgment on the issue of liability and leave the issue of damages for the jury.

Although this Motion for Summary Judgment and Partial Summary Judgment is factintensive, virtually all the facts are extrajudicial admissions against interest, admissible as an exception to the hearsay rule, and summary judgment granted on the basis of such admissions is proper. O.C.G.A. § 24-3-31 ("The admission by a party to the record shall be admissible in evidence when offered by the other side...."); O.C.G.A. § 24-3-33 ("Admissions by an agent or attorney in fact, during the existence and in pursuance of his agency, shall be admissible against the principal."); <u>Ward v. Humble Oil & Refining Co.</u>, 321 F.2d 775, 779 (5th Cir. 1963) ("the movants were entitled to a summary judgment as a matter of law based upon admissions against interest of plaintiff."); <u>Jacobs v. Spano</u>, 193 Ga. App. 447, 448 (1989) ("It is well established that

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'extrajudicial statements by an opposing party inconsistent with the position of that party are positive evidence of the fact asserted and are admissible as an exception to the hearsay rule.' Such extrajudicial admissions are properly before a trial court on a motion for summary judgment.") (citations omitted); <u>Hardees Food Systems, Inc. v. Bowers</u>, 121 Ga. App. 316, 318 (1970) ("As a general rule, the admission of a party to the record [on summary judgment] is admissible where offered by an opponent.").

# B. Owners Are Entitled to Summary Judgment On Count I And Count II Of SFG's Complaint

Count I (Suit on Note) and Count II (Suit on Guaranty) of the Complaint are dependent on SFG's allegations that Owners were in default under the Loan. Absent such default, SFG had no right to accelerate the Loan and cannot state a claim against Owners. <u>Crawford v. Etheridge</u>, 248 Ga. App. 429, 546 (2001); <u>Sires v. Luke</u>, 544 F. Supp. 1155, 1164 (S.D. Ga. 1982).

### 1. <u>There Was No Default Under Section 6.01(g)</u>

SFG cannot demonstrate an Event of Default under Section 6.01(g) of the Loan

Agreement. Section 6.01(g) of the Loan Agreement provides that an Event of Default occurs if:

Subject to items of Force Majeure, the Improvements, in the sole and commercially reasonable judgment of SFG, are not and cannot reasonably be, completed on or before the Completion Date.... (SMF 43)

In SFG's Default Letter and its Complaint, SFG wrongly asserts that "SFG and the Construction Inspector had determined that completion by March 7, 2009 will not be possible." (SMF 42). The Completion Date, however, was not March 7, 2009. (SMF 42-46)

Under the terms of the Construction Contract, which SFG expressly approved, the Project was originally scheduled to be substantially completed within 15 months of an anticipated start date of April 1, 2008 (i.e. July 1, 2009). (SMF 44) The July 1, 2009 completion date was further extended to August 30, 2009 by a Change Order dated April 27, 2008, which was also expressly

approved by SFG, and which states: "The date of Substantial Completion as of the date of this Change Order therefore is August 30, 2009." (SMF 45) Dilip Petigara of SFG instructed Owners to execute the Change Order, changing the completion date to August 30, 2009, stating: "The change order must be executed by all parties." (SMF 46) The Change Order was executed that day. (SMF 46) As the Completion Date was August 30, 2009, not March 7, 2009 as SFG wrongly represented in its Default Letter, SFG had no right to accelerate the Loan. <u>Williams v.</u> Sessions, 171 Ga. App. 662, 663-64 (1984).<sup>9</sup>

In <u>Williams</u>, the Court held that "no default had occurred due to defendants' failure to pay interest on the note" because "plaintiffs waived their right to insist upon the time limit named in the note, by reason of their failure to insist upon it at the time and because of their subsequent conduct." <u>Id.</u> Plaintiffs in <u>Williams</u> had waited seven months, then engaged an attorney who, on plaintiffs' behalf, had declared a default and accelerated the note. The <u>Williams</u> court held:

Hence the trial court, sitting as the trier of fact, was authorized to hold that no default had occurred based upon its finding that plaintiffs had established a practice of accepting late payments in the past and then declared a default without granting "reasonable notice" of its intention to rely on the strict terms of the note.

<u>Id.</u> at 664.

No less is true here. SFG approved the Change Order on April 28, 2008, which extended the completion date to August 30, 2009 and acted in accordance with that Change Order. (SMF 46) SFG waited ten months, until February 19, 2009 – which was only three weeks before the alleged completion date of March 7, 2009 – to suddenly declare a default and accelerate the Loan. (SMF 42) By then, there was no longer any way for Owners to complete the Project, as only two weeks remained between the notice of acceleration and alleged completion date of March 7, 2009.

<sup>&</sup>lt;sup>9</sup> See Nutting v. Wilson, 75 Ga. App. 148, 152 (Ga. Ct. App. 1947) ("When a plaintiff's right to recover on a contract depends upon a condition precedent..., he must allege and prove the performance of such condition precedent....")

'Reasonable notice [of intention to rely on the exact terms of the agreement after having departed therefrom] *requires more than the assertion of an acceleration clause, for the party must be given a reasonable opportunity to cure any deviation from the exact terms before [an action on the note] can be commenced due to defaults which were tolerated under the quasi new agreement.* 

Williams, 171 Ga. App. at 664 (citations omitted; italics in original.) Thus, as a matter of

Georgia law and principles of equity, SFG's acceleration was invalid. Id.

# 2. <u>There Was No Default Under Section 6.01(i) or (k)</u>

Second, SFG cannot demonstrate a default under Sections 6.01(i) and 6.01(k) of the Loan

Agreement. Under Section 6.01(i), a default occurs if:

Any **substantial or material change** of an adverse nature shall occur in the financial status of Borrower or its member or Guarantor, or any of them, from that reported and delivered to SFG heretofore which, in SFG's reasonable opinion, would **materially impair the ability** of Borrower or Guarantor to comply with all their obligations hereunder and under the terms and conditions of the Loan Documents. (SMF 47, emphasis added)

Similarly, Section 6.01(k) of the Loan Agreement provides than an Event of Default occurs if:

Any suit shall be filed against Borrower or Guarantor, which if adversely determined, could reasonably be expected **substantially to impair** the ability of Borrower or Guarantor to perform each and every one of their respective obligations under and by virtue of the Loan Documents.... (emphasis added) (SMF 48).

In SFG's Default Letter, SFG bases its Section 6.01(i) and 6.01(k) Events of Default on

the fact that a complaint had been filed by Merrill Lynch against Mr. Minor on a line of credit that Merrill Lynch had extended to Mr. Minor years earlier. (SMF 42, 49). Mr. Minor notified SFG of this line of credit before the Loan closed, and SFG took that line of credit into account when it assessed Mr. Minor's financial wherewithal ten months before the Loan closed. (SMF 49) In its May 8, 2007 Loan Committee Application, SFG determined that, after deducting the Merrill Lynch line of credit from his assets, as well as a number of other liabilities, Mr. Minor's net worth was \$119,596,700 – twelve times the amount outstanding under the Loan. (SMF 49) Mr. Minor's net worth today is nearly double his net worth in 2007. (SMF 50) Accordingly, this liability does not constitute a change, let alone a material change, as required under Section 6.01(i) of the Loan Agreement, or substantially impair Mr. Minor's ability to pay off the Loan, as required under Section 6.01(k) of the Loan Agreement.

Yet in the Default Letter, SFG alleged that the Merrill Lynch lawsuit "substantially impairs" Mr. Minor's ability to pay off the \$10.5 million outstanding under the Loan and constitutes a "material change" in his financial condition, even though the suit seeks nothing more than repayment of the line of credit SFG analyzed ten months before the Loan closed. (SMF 42) SFG, with knowledge of the Merrill Lynch line of credit, decided that Mr. Minor's net worth, after deducting the Merrill Lynch line of credit and all of his other liabilities, was more than sufficient to repay the Loan and elected to close the Loan on March 12, 2008. (SMF 49) Accordingly, SFG waived the right to use the Merrill Lynch line of credit as a basis to declare a default eleven months later. <u>Williams</u>, 171 Ga. App. at 663 ("plaintiffs waived their right to insist upon the time limit named in the note, by reason of their failure to insist upon it at the time and by their subsequent conduct"); <u>see also James v. Mitchell</u>, 159 Ga. App. 761 (1981) ("A waiver of rights under a contract may be express or implied from acts of conduct.")

Recognizing the weakness of using the Merrill Lynch Lawsuit as a default, SFG added allegations to its Complaint that did not even appear in its Default Letter – i.e., a lawsuit between Mr. Minor and Sotheby's in which Sotheby's is demanding that Mr. Minor purchase art for \$15 million and a lawsuit between Mr. Minor and Christie's in which Christie's is demanding that Mr. Minor purchase art for \$7 million. SFG is not only disregarding the nature and merit of Mr. Minor's claims against Sotheby's and Christie's, SFG is disregarding the value of the art that

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Sotheby's and Christie's are demanding that Mr. Minor purchase. SFG does not have one shred of evidence that the art being sold is not worth the purchase price demanded.

Regardless, even if Sotheby's and Christie's prevail on every one of their claims, even if Mr. Minor loses on every one of his claims, and even if the multi-million dollar art that is being sold is worthless (which would require SFG to assume that both Sotheby's and Christie's committed fraud), the entire liability alleged against Mr. Minor in these suits is the \$22 million purchase price. When that liability is deducted from his net worth of \$119,596,700 as of 2007, disregarding the value of the art that Mr. Minor would obtain, his net worth is still over \$97,000,000 – nearly ten times the outstanding balance of the Loan. Today, his net worth is even greater. (SMF 50) Thus, SFG has no evidence that the litigation will materially or substantially impair Mr. Minor's ability to pay off the Loan. Hilton v. Millhaven Co., Inc., 158 Ga. App. 862, 863 (1981) ("Without question, the defendant's right to accelerate must be determined by the terms of the instrument under which he seeks to exercise such right."); Nutting, 75 Ga. App. at 152 ("When a plaintiff's right to recover on a contract depends upon a condition precedent..., he must allege and prove the ... condition precedent...."). As SFG cannot produce evidence that the above referenced lawsuit would have a material or substantial impact on Mr. Minor's ability to pay off the Loan, there was not and cannot be a default under Sections 6.01(i) and 6.01(k). Id.

#### 3. <u>There Was No Default Under Section 3.25</u>

SFG cannot demonstrate a default under Section 3.25 of the Loan Agreement. (SMF 51-55) As a threshold matter, an "imbalance" under Section 3.25, without proper notice or an opportunity to cure, does not constitute an "Event of Default" under the Loan. The "Events of Default" are outlined in Sections 6.01(a) - (r) of the Loan Agreement. Section 3.25 provides:

If at any time during the term of this Agreement, in SFG's reasonable judgment and opinion, the remaining undisbursed portion of

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Borrower's Equity Contribution and the Loan is insufficient to fully complete the Improvements in accordance with the Plans, and to pay all interest projected by SFG to accrue under the Note and such other indebtedness under the Loan Documents, .... Borrower shall, within ten (10) days after written notice thereof from SFG (which notice must specify the factual basis for said judgment and opinion and contain documents and instruments, to the extent the same are in SFG's possession, as are reasonably necessary for Borrower to evaluate SFG's claim) or such other times as agreed to by SFG in writing, in SFG's sole discretion, deposit with SFG or such other party SFG shall require an amount or amounts as SFG determines to be sufficient to remedy such condition..... (SMF 51, emphasis added).

In SFG's Default Letter, SFG wrongly claimed that a default had occurred under Section 3.25 of the Loan Agreement. (SMF 42) However, as expressly stated in Section 3.25, SFG was required, in its written notice, to (i) specify the factual basis and provide documents showing an imbalance so that Owners could "evaluate SFG's claim," (ii) provide written notice of the amount that SFG determined "sufficient to remedy such condition," and (iii) allow Owners "ten (10) days after written notice thereof from SFG" to deposit that amount. As demonstrated in SFG's Default Letter, SFG failed to provide any factual basis or documentary evidence of an imbalance, did not specify an "amount sufficient to remedy such condition" and did not afford Owners 10 days to deposit the funds, as required under Section 3.25 of the Loan Agreement. (SMF 42, 51-55)

In <u>Sires</u>, 544 F. Supp. 1155 (S.D. Ga. 1982), the parties filed dueling summary judgment motions in relation to, among other things, a promissory note held by the defendant. The defendant alleged that plaintiff's conduct in not maintaining collateral constituted "a breach of plaintiff's agreements with defendant" and authorized defendant to accelerate the balance due under the note. The Court granted plaintiff's summary judgment holding that defendant's failure to provide proper notice as required by the note was "fatal to his claim," stating,

there is no evidence that the defendant has complied with the terms and conditions of the Security Agreement in accelerating the note. According to the Agreement, " the remedies [of acceleration of

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payments and the filing of suit] shall not be available . . . until the expiration of the grace period [of twenty days after written notice of default is given to the plaintiff]." There is no evidence that written notice of default was sent to the plaintiff. The pleading states that the "defendant hereby accelerates all monies owed to him by defendant (sic) and demands payment thereof." The defendant could not make such a demand until notice under the agreement had been given to the plaintiff. **The giving of notice was a condition precedent to the exercising of the right of acceleration. The giving of the notice must be pleaded and proved. The failure of the defendant to do so is fatal to his claim.** 

Id. at 1164 (citations omitted, emphasis added).

No less is true here. Section 3.25 of the Loan Agreement requires that SFG provide Owners with no less than 10 days notice (i) specifying the factual basis and documents supporting SFG's claim of an imbalance as "reasonably necessary for [Owners] to evaluate SFG's claim," (ii) state the amount allegedly required "to remedy such condition" and (iii) afford Owners an opportunity to deposit that amount. SFG ignored its duties under Section 3.25 of the Loan Agreement and filed this lawsuit against Owners before the ten-day notice period had started to run. (SMF 42, 51-55)

SFG's Default Letter, which was devoid of facts and documents, was sent on February 19, 2009. (SMF 50) Four days later, by letter dated February 23, 2009, SFG claimed it was accelerating the Loan, and the next day, February 24, 2009, SFG filed its Complaint. (SMF 52-53) Pursuant to the notice provisions in Section 8.12 of the Loan Agreement, SFG's Default Letter was not even deemed received until three days after the postmark of date of mailing, or February 22, 2009. (SMF 17) Yet the next day, SFG accelerated the Loan, and two days later, SFG filed the Complaint. As a matter of well established Georgia law, SFG's failure to meet the

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conditions in Section 3.25 is fatal to SFG's claims. <u>Sires</u>, 544 F. Supp. at 1164; <u>Hilton</u>, 158 Ga. App. at 863 ("right to accelerate must be determined by the terms of the instrument").<sup>10</sup>

Moreover, a default under Section 3.25 invokes the 30 and 90-day cure periods required under Section 6.01(b) of the Loan Agreement. (SMF 55) Here, too, SFG failed to provide Owners with the requisite cure periods before accelerating the Loan and filing the Complaint. As a result, this claim – as is true of the other claims asserted by SFG – is fatally defective. <u>Id.</u>

## 4. There Was No Default Under Section 3.10

SFG cannot demonstrate a default under Section 3.10 of the Loan Agreement. Sections

3.10(B) & (D) of the Loan Agreement provide as follows:

B. Throughout the term of the Loan, Borrower shall furnish to SFG within ninety (90) days after the end of each calendar year of Borrower an unaudited, management prepared financial statement of Borrower and a statement of income and expenses of the Premises.

D. Throughout the term of the Loan while the Guaranty remains in effect, Guarantor shall provide his annual personal financial statements within ninety (90) days of the end of each calendar year. (SMF 56)

SFG's Default Letter states that "Borrower is not in compliance with the financial

reporting requirements set forth in Section 3.10 of the Loan Agreement." (SMF 42) SFG's February 19, 2009 Default Letter also states that SFG should have received reports for the period ending December 31, 2008. (SMF 42) However, such financial reports were not due until 90 days after the end of the calendar year, or March 31, 2009. (SMF 56). As the financial reports were not due until March 31, 2009, SFG could not invoke Section 3.10 to declare a default on February 19, 2009 and had no right to accelerate the Loan on February 23, 2009. (SMF 42, 56)

<sup>&</sup>lt;sup>10</sup> SFG's failure to meet its duties under Section 3.25 prevents SFG from using Section 3.25 as a basis for its claims against Owners. "If the nonperformance of a party to a contract is caused by the conduct of the opposite party, such conduct shall excuse the other party from performance." Larkins, Ga. Contracts Law and Litigation § 11-8.1 (2009); see also English v. Muller, 270 Ga. 876 (1999) ("A party to a contract cannot cause a breach or delay in compliance by the other, and then set up the breach or delay so caused as freeing him from the contract").

Nevertheless, SFG accelerated the Loan on February 23, 2009 and filed its Complaint on February 24, 2009, only five days after the date of its Default Letter. (SMF 53) Assuming *arguendo*, that there was some duty to provide financial reports before March 31, 2009, SFG's failure to provide the 30-day or 90-day cure period required by Section 6.01(b) of the Loan Agreement is fatal to its claim. (SMF 17, 55) <u>Sires</u>, 544 F. Supp. at 1164 ("The giving of notice was a condition precedent to the exercising of the right of acceleration. The giving of the notice must be pleaded and proved. The failure of the defendant to do so is fatal to his claim."); <u>Hilton</u>, 158 Ga. App. at 863 ("Without question, the defendant's right to accelerate must be determined by the terms of the instrument under which he seeks to exercise such right."). <u>English</u>, 270 Ga. at 876. ("A party to a contract cannot cause a breach or delay in compliance by the other, and then set up the breach or delay so caused as freeing him from the contract").

#### 5. There Was No Default Under Section 3(v) of the Assignment

SFG cannot demonstrate a default under Section 3(v) of the Assignment of Project Documents ("Assignment"). (SMF 57) Section 3(v) of the Assignment provides as follows:

3. <u>Representations and Warranties.</u> Borrower further hereby covenants, represents and warrants to SFG that .... (v) except as provided in the Loan Agreement, no amendments or modifications to any of the Project documents will be made without the prior written consent of SFG. (SMF 58)

In SFG's Default Letter and Complaint, SFG claims that Owners defaulted under the Assignment by firing the Developer, even though Owner did so in accordance with the terms of the Development Agreement. (SMF 42) Section 3(v) of the Assignment applies to "amendments or modifications" of the documents. Nothing in Section 3(v) prevents Owners from exercising its rights under the Development Agreement. (SMF 57)

Under Section 7.2 of the Development Agreement, Owner had the right to terminate the

Developer upon the occurrence of an Event of Default.

7.2 <u>Termination by Owner for Event of Default.</u> If Agent commits or causes or permits the occurrence of an Event of Default, Owners shall have the right but not the obligation to terminate this Agreement, by delivery of written notice thereof to Agent. In said event, this Agreement shall be terminated immediately upon, and said termination shall be effective as of, the date Owner delivers said notice of termination to Agent.... (SMF 33, 59)

Pursuant to sections 2.1 and 4.6 of the Development Agreement, Developer had a duty to act as the sole and exclusive agent on behalf of Owners. (SMF 14) Due to Developer's conduct as outlined herein, among other things, on November 17, 2008, Owners terminated Developer pursuant to the terms of the Development Agreement. (SMF 33).

As Owners were authorized to terminate the Developer under the Development

Agreement, there was no "modification" or "amendment" of the Development Agreement under Section 3(v) of the Assignment. (SMF 14, 33) Nothing in the Assignment requires Owners to obtain SFG's consent before exercising their right to terminate Developer under the Development Agreement. Thus, SFG's attempts to use the termination of its co-conspirator to declare a default under the Loan is unavailing. <u>Hilton</u>, 158 Ga. App. at 863 (the "right to accelerate must be determined by the terms of the instrument under which he seeks to exercise such right.").

As SFG had no right to accelerate the Loan, it cannot prevail on Count I and Count II of its Complaint. <u>Id.</u> As such, Owners are entitled to Summary Judgment on these claims.

# B. Owners Are Entitled To Summary Judgment On Counts II And III Of The Counterclaim

Owners are entitled to partial summary judgment on Count II (Breach of Contract) and Count III (Breach of the Implied Covenant of Good Faith and Fair Dealing) of their Counterclaim.

# 1. SFG Breached The Implied Covenant Of Good Faith And Fair Dealing

A lender's "discretion whether or not to advance funds is limited by the obligation of good

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faith performance, so too would be its power to demand repayment." <u>K.M.C. Co., Inc. v. Irving</u> <u>Trust Co.</u>, 757 F.2d 752, 760 (6th Cir. 1985). A lender breaches that obligation when it acts in contravention of the purpose of the parties' agreement. <u>West v. Koufman</u>, 259 Ga. 505 (1989)

In <u>West</u>, 259 Ga. at 505, the lender could declare a default if mechanics' liens were filed against the property, accelerate the debt and foreclose on the property. Borrower alleged that lender solicited others to file liens against the property so that lender could use the liens as a pretext to foreclose, and sought to enjoin lender's foreclosure of the property. The Supreme Court of Georgia upheld an interlocutory injunction preventing foreclosure, holding that if the lender solicited others to file mechanics' liens against the property, "it would constitute a breach of the duty of good faith and fair dealing that is implied in all contracts." <u>Id.</u> The Supreme Court of Georgia held that such conduct would even preclude the lender "from insisting on strict compliance with the default provision in the deed." <u>Id.</u>

Just as the lender in <u>West</u> sought to solicit defaults under the loan, SFG and Developer colluded to fabricate defaults in an effort to oust Owners from the Project. Developer even sought to have vendors record liens against the Project to enable SFG to push Owners aside. First, Developer sent a number of E-mails to SFG proposing potential defaults. (SMF 34-41). At the same time, Developer and SFG had new prospects tour Owners' property. (SMF 32). Then, SFG appointed Developer to "lobby" on behalf of SFG. (SMF 27). Next, Developer solicited contractors who had worked on the project to file liens against the Project. (SMF 37)

Indeed, two months after Developer had been terminated, Developer continued to send Emails to SFG in an effort to fabricate defaults under the Loan. To this end, on January 20, 2009, Developer sent an E-mail to SFG claiming that he believed he could show that Owner defrauded SFG. (SMF 35) Three days later, Developer sent another email to SFG stating:

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I also have a business plan that I believe may work to move Halsey out and protect the property so we can go forward and finish the project. (SMF 36)

In March 2009, Developer, Greg Friedman (a Senior Vice President of SFG), and Jon Wright (the Managing Director of SFG) agreed to meet in Atlanta, Georgia to discuss Owners' claims against SFG and Developer, and their plans to replace Owners. (SMF 38-41) Although Developer misrepresented at his deposition that his meeting with Jon Wright in Atlanta was not a "meeting" and Mr. Petigara classified the meeting as a "brief passing", the evidence demonstrates that Developer, Greg Friedman and Jon Wright planned the meeting a week in advance, for the express purpose of seeing how to "get this thing going again" without Owners. (SMF 38-41)

SFG's collusion with Developer to replace Owners by asserting baseless defaults under the Loan constitute a breach of its duty of good faith to Owners and inequitable conduct. <u>West</u>, 259 Ga. at 505; <u>see also Brown v. Avemco Investment Corp.</u>, 603 F.2d 1367, 1376 (9th Cir. 1979) (holding that some courts do "not permit enforcement of acceleration clauses when the debtor's default was due to debtor's accident or mistake or to the creditor's own fraudulent or inequitable conduct."). Thus, partial summary judgment on Count III of the Counterclaim should be granted.

### 2. SFG Breached The Loan Agreement.

Under the Loan Agreement SFG was required to fund the Loan upon the submission of a

Draw Request by Borrower. To this end, Section 5.01 provides:

SFG agrees to make disbursements to Borrower against the Note up to the face amount thereof in accordance with the cost breakdown and estimate attached hereto as <u>Exhibit "C"</u> ... in accordance with the following procedures:

\*\*\*

(a) At such time as Borrower shall desire to obtain, subject to the other requirements hereof, a disbursement of any portion of the proceeds of the Loan, Borrower shall complete, execute and deliver to SFG and Construction Inspector [Broadlands] a request for an advance on SFG's standard form ... (SMF 17) Despite the fact that there were no defaults under the Loan, SFG breached its obligation to fund the Loan a number of times without justification.

First, on April 25, 2008, SFG notified Owners that the Loan was "out of balance" and requested that Owners deposit another \$4 million to rebalance the Loan before SFG would agree to fund any portion of the Loan. (SMF 23). SFG informed Owners that it was making this call due to "Broadlands' budget" which it claimed was the Contractor's GC contract (i.e. the Contractor's Budget, which SFG accepted before the Loan even closed). (SMF 23) Unbeknownst to Owners, Broadlands did not claim that the Loan was out of balance. To the contrary, in Section 5.0 of Broadlands' IPE, Broadlands informed SFG that it believed the Contractor's Budget exceeded the amounts necessary to complete the Project by over 30%. (SMF 22) Broadlands stated that the "room key cost" under the Contractor's Budget was \$192,506.81, whereas Broadlands estimated the room key cost to be only \$122,898.45. (SMF 22) Accordingly, Broadlands concluded that, "Our estimate of project cost is significantly lower than [Contractor's] estimate" – an amount even lower than that shown in SFG's Budget. (SMF 22) In good faith reliance on SFG's representations that Broadlands determined that the Loan was out of balance, and because SFG refused to fund the Loan after Owners had invested \$6.5 million, Owners agreed to reallocate certain soft costs and deposit with SFG an additional \$400,000. (SMF 24). As evidenced by Broadlands' IPE, SFG's statements were false and misleading when made.

Second, seven months later, in November 2008, SFG again refused to fund, and served its November Default Letter claiming another \$4 million imbalance under the Loan. (SMF 26) SFG's November Default Letter states that Developer (with whom SFG had been colluding) claimed that there were "material and significant <u>potential</u> change orders in the Budget for the Project in the amount of approximately \$3.5 to \$4 million, which, when approved, will cause a

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Budget overrun." The November Default Letter stated that SFG would cease funding the Loan. (SMF 26) It is undisputed that no change orders had been issued that caused the Budget to "overrun" or that would allow SFG to stop funding. (SMF 26) As admitted in SFG's November Default Letter, which refers only to a "potential" change order, no change order had been issued and SFG was not entitled to stop funding. Regardless, SFG stopped funding and wreaked havoc at the Project. SFG's letter was simply part of its scheme to replace Owners. When Owners refused to capitulate and the press got word of SFG's strong-arm tactics, SFG had Developer tell the press that SFG would fund the Loan and that Owners' were "confused". (SMF 25)

Then, on February 25, 2009, SFG again refused to fund Hard Draw Request No. 11. Instead, SFG filed its Complaint in this action. (SMF 60) As demonstrated above, each and every alleged default in its Default Letter and Complaint was baseless and unsupported by any evidence. SFG's repeated attempts to avoid funding the Loan and its failure to fund Hard Draw Request No. 11 when there are no defaults under the Loan constitute a breach of the Loan Agreement as well as a breach of SFG's duty of good faith and fair dealing.

Thus, Owners are entitled to Summary Judgment on Counts II and III of the Counterclaim.

#### **IV. CONCLUSION**

Owners respectfully request that the Court grant Owners' Motion for Summary Judgment or, in the Alternative, Partial Summary Judgment on Count I and Count II of SFG's Complaint, and Counts II and III of Owners' First Amended Counterclaim. Respectfully submitted this 21st day of September, 2009,

### **DLA PIPER LLP**

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## **CERTIFICATE OF SERVICE**

I hereby certify that I have this day served a copy of the within and foregoing

Memorandum In Support Of Defendants' (1) Motion For Summary Judgment Or, In The

Alternative, Partial Summary Judgment As To Complaint And (2) Motion For Partial Summary

Judgment As To First Amended Counterclaim upon all parties to this matter via the Lexis Nexis

File and Serve System to counsel of record as follows:

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This 21st day of September, 2009.

/s/ Betty Shumener