

# THE KFP COMMERCIAL *BULLETIN*

## COMMERCIAL LAW DEVELOPMENTS RELEVANT TO YOUR BUSINESS

### In This Issue:

Illinois Credit Agreements Act	1
Liability Insurance	2
Delayed Collateral Sale	2

#### For more information, contact:

Mark E. Wilson

[mwilson@kpfplaw.com](mailto:mwilson@kpfplaw.com)

(312) 261-4572

Terry M. Hackett

(312) 261-6322

[thackett@kpfplaw.com](mailto:thackett@kpfplaw.com)

[www.bankandfinancelaw.com](http://www.bankandfinancelaw.com)



### THE ILLINOIS CREDIT AGREEMENTS ACT — AID FOR THE LOOSE-LIPPED LENDER

By: Mark E. Wilson and David A. Argay

In the midst of our current international economic crisis and continuing frozen credit markets, commercial loan defaults will in all likelihood continue to climb during the next year. Given the current negative political mood towards banks, creditors, and all friends of Wall Street, there will also no doubt be a corresponding increase in defenses raised to avoid repayment of those commercial loans, as well as lender liability claims filed in an attempt to offset borrower losses. Commercial lenders and borrowers that have engaged in, or expect to engage in negotiations regarding a new or existing loan should be reminded and take heed of Section 2 of the Illinois Credit Agreements Act (the "Act").

It is a common scenario: borrowers cry foul when a lender tries to collect on a loan, pointing to representations that were made by the lender to extend additional credit, restructure the loan, forego enforcement, waive an event of default, refrain from calling the note, delay processing a check, or otherwise modify the terms of the underlying loan documents. There is no limit to the potential spoken promises made, actions taken, and deals brokered in favor of the borrower (but not reduced to a signed writing) that may be raised to justify an event of default or attempt to avoid collection. In some jurisdictions, a lender may find that a verbal representation has created an agreement or modification without any physical loan documents or commitment letters having been prepared. In Illinois however, the Credit Agreements Act will step in and cut off

any claim or defense based upon an oral agreement relating to a "credit agreement," even though the result may be entirely unfair to the borrower who is left with no legal recourse.

Before 1989, just like every other jurisdiction, the Illinois statute of frauds required certain oral agreements be in writing to be enforceable - including contracts which cannot be performed within one year, contracts for the transfer of an interest in land, and contracts in which one party becomes a surety (acts as guarantor) for another party's debt or other obligation. The statute of frauds, however, was applied on an agreement-by-agreement basis, may not reach every credit agreement, and contained several common-law exceptions that could nevertheless allow a borrower to assert a defense or lender liability claim based upon a verbal promise or representation.

Through the efforts of the banking lobby and in response to a concern that borrower-lender litigation was becoming frivolous, the Illinois legislature enacted the Illinois Credit Agreements Act. The Act operated to plug any borrower "loopholes," provide certainty to parties to a commercial loan agreement, and create a stronger, more water-tight version of the statute of frauds. The Act contains sweeping language in favor of lenders, and Illinois courts have broadly construed and applied it despite acknowledging the potential for "disastrous" consequences to borrowers. Although courts have yet to weigh in definitively, the Act also bars only claims of borrowers - leaving intact a lender's right to assert claims and defenses against debtors based on oral or written loan agreements.

Our current political environment does not yet appear to affect the manner in which judges apply the Act. Illinois cases up to the present have held that the Act bars a wide variety of claims and

defenses relating to a credit agreement, including borrower and/or guarantor claims for fraud or constructive fraud, breach of contract, equitable or promissory estoppel, partial performance, economic duress, tortious interference with a business relationship, breach of fiduciary duty, breach of covenant of good faith and fair dealing, wrongful dishonor of a check, negligent and intentional misrepresentation, and violation of the Illinois Deceptive Trade Practices Act. Even a claim based on oral credit agreements under which one party had fully performed has been barred.

The underlying credit agreement must of course be signed by both parties for the Act to apply. Though it is well settled that verbal agreements will be barred, Illinois courts have yet to address squarely whether electronic transactions, communications, or emails are sufficient to create a "signed" writing that could be viewed as an enforceable agreement that would satisfy the Act, and upon which a borrower may base a claim or defense.

**The Point: Commercial lenders should be reminded of the strong leverage they possess with the Illinois Credit Agreements Act when their credit agreements are signed and fall within the scope of the Act. In turn, commercial borrowers should never rely on any representation made by a lender, unless it has been reduced to a signed writing.**

## COURT BROADLY INTERPRETS VENDOR'S ENDORSEMENT IN PRODUCT LIABILITY CASES

By: Terry M. Hackett

In a recent decision, an Illinois Appellate Court broadly interpreted a vendor's endorsement on a general liability insurance policy and required an insurance company to provide a defense to a component parts manufacturer named as a vendor on the policy. In *St. Paul Fire & Marine Insurance Company v. Antel*, vinyl acetate exploded when it was heated, causing personal injuries. The injured parties blamed the explosion on several factors, including a defective heat controller. They sued the manufacturer of the heat controller and the distributor of that heat controller. Even though the distributor was named on the manufacturer's vendor's endorsement, the insurer sought a declaratory judgment that it did not have to provide a defense to the distributor. The court rejected all of the insurer's arguments against coverage. In making its finding of coverage, the court reiterated that under Illinois law, an insurer is obligated to defend its insured even if the allegations are groundless, false or fraudulent if "the underlying Complaints allege facts within or potentially within policy coverage." The court also rejected the

insurer's argument that the distributor was not a vendor under the endorsement because it acted as a "manufacturer's representative" in the sale of the product. The court described the insurer's argument on this point as "incredible at best and disingenuous at worst."

**The Point: Illinois courts continue to liberally construe duty to defend insurance policies in favor of the insured and have little patience for "creative" arguments to avoid coverage.**

## ISSUE OF ARBITRABILITY DELAYED A COLLATERAL SALE

By: Mark E. Wilson and Meghan A. Welch

Sometimes a lender's right to sell collateral gets delayed because other agreements get in the way.

Shermans and Trax Records, Inc. and Casablanca Trax, Inc. signed agreements for production and distribution of music recordings. Their Joint Venture Agreement (JVA) contained a broad arbitration clause, while the Loan Agreement and the Security Agreement, memorializing Sherman's loan to Trax, did not contain arbitration clauses.

Trax defaulted on the loan. Casablanca sued Trax to replevy the collateral, obtain a judgment for any loan deficiency after the collateral sale and obtain a judgment for breach of the JVA. Casablanca won an order of replevin from the trial court and Casablanca seized most of the collateral. Before the collateral sale, however, Casablanca moved to compel arbitration based on the arbitration clause in the JVA. The trial court held that the JVA's arbitration clause did not apply to the loan agreement or the security agreement, thus permitting the collateral sale to go forward notwithstanding the arbitration issues surrounding the joint venture.

The Illinois Appellate Court reversed. In *Casablanca Trax, Inc. v. Trax Records, Inc.*, the Appellate Court held that the arbitrator rather than the court had to decide whether the JVA's arbitration clause applied to disputes under the loan agreement and the security agreement. Furthermore, the appellate court held that the Loan Agreement and the JVA were so interrelated that judicial economy favored a stay of all court proceedings and claims related to the Loan Agreement pending the arbitrator's decision. Accordingly, the court stayed the collateral sale pending the arbitrator's decision on arbitrability.

**The Point: Agreements signed at the same time will often be construed as one agreement. Rights to replevy and dispose of collateral coming from a security agreement can be delayed while the court resolves issues under other parts of the deal.**

For additional news and commentary, be sure to bookmark *The Bank and Finance Law Chronicle*: [www.bankandfinancelaw.com](http://www.bankandfinancelaw.com).

The KFP Commercial *Bulletin* is published solely for the benefit of clients and friends of Kerns, Frost & Pearlman, LLC, and should in no way be relied upon or construed as legal advice. For specific information on recent developments or particular factual situations, the opinion of legal counsel should be sought. Kerns, Frost & Pearlman is a limited liability company. Copyright © 2008 by Kerns, Frost & Pearlman, LLC.

You have received this newsletter because you are on the firm's distribution list. This message is sent by a law firm and may contain information that is privileged or confidential. If you have received this transmission in error, please notify the sender by reply email and delete the message and any attachments. These materials may be considered ATTORNEY ADVERTISING in some states.

### Chicago

Three First National Plaza  
70 West Madison  
Suite 5350  
Chicago, Illinois 60602  
Telephone: (312) 261-4550  
Fax: (312) 261-4565  
[www.kfpflaw.com](http://www.kfpflaw.com)

### Bannockburn

2201 Waukegan Road  
Suite E-200  
Bannockburn, Illinois 60015  
Telephone: (312) 261-4570  
Fax: (312) 261-4585  
[www.kfpflaw.com](http://www.kfpflaw.com)