Judgment Reversed for Including Improper Prepayment Penalties

By: Robin Mashal

What is the consequence of a lender attempting to collect prepayment penalties when the loan had not been prepaid? According to U.S. Bank Nat’l Ass’n v. Yashouafar, 232 Cal. App. 4th 639 (2d. Dist. 2014), improper inclusion of prepayment penalties may be grounds for reversal of judgment.

Yashouafar involved a bank’s (“Plaintiff’s”) efforts to collect on a defaulted commercial real estate loan. Plaintiff’s predecessor loaned $62 Million to three real estate companies (“Borrowers”), which loan matured August 1, 2016. The loan was evidenced by a promissory note (“Note”) and secured by a trust deed (“TD”) against the real properties. Defendants personally guarantied the loan.

The loan documents contained inconsistent provisions. Note required a prepayment premium if the debt was paid before its maturity date. TD provided the Note’s provisions were controlling, yet a different clause of the TD required a prepayment premium if the loan was accelerated.

Borrowers defaulted on the loans. On June 24, 2011, Plaintiff’s counsel sent Borrowers a demand letter declaring the loan due and payable. On July 14, 2011, Borrowers filed petition for Chapter 11 bankruptcy protection. Plaintiff sued Defendants to collect on their guaranties. Trial court granted summary judgment in favor of Plaintiff, including prepayment premium calculated from the demand letter’s date.

Defendants appealed the judgment contending Plaintiff is not entitled to prepayment penalty as of the date of the demand letter, because prepayment occurred on January 24, 2013, when Defendants purchased the underlying real estate at a foreclosure sale for a full credit bid.

The court of appeal reversed and remanded, directing the trial court to determine if and when Defendants had prepaid the loan.

Editor’s Note: The court distinguished the date of acceleration from the date of prepayment, and perhaps, actual prepayment from credit bid on foreclosure. The court said “we do not hold here that a creditor can recover a prepayment fee upon a loan default only when there has been an actual prepayment of the loan. Instead….we hold that….no prepayment fee was due until defendants actually prepaid the …indebtedness….Because we hold that the wrong date was used in calculating the prepayment fee, we need not reach defendants’ alternative claim that the prepayment fee constituted an unenforceable penalty if the… [acceleration date were] the correct date for calculating the prepayment fee…” Very interesting case. For another recent case regarding penalties on default, see Jade Fashion & Co, Inc. v. Harkham Industries, Inc., et al., 229 Cal.App.4th 635 (2014), holding that penalties on default under a settlement agreement can be enforceable under certain conditions.

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