

# LEGAL ALERT

February 12, 2008

## **PURCHASE ORDERS: PROTECTING YOUR INTERESTS**

**By Joseph E. Belsito, Attorney**

**P**urchase orders are a staple of the supply industry. They allow for quick transactions and repeat business without the added time and expenses associated with renegotiating business deals.

Many purchase orders, though, lack clarity and fail to adequately protect the companies using them. Companies using purchase orders to transact business sometimes find themselves embroiled in unnecessary and expensive legal battles. However, a few modifications to your company's standard purchase orders can go a long way toward protecting the company's interests and avoiding legal headaches.

### **Avoid the Battle of the Forms**

Suppliers have a tendency to include additional or different terms at the time of acceptance, or after the goods have been shipped.

First start with what constitutes acceptance. Your company's purchase order should state that written acceptance, commencement of work, performance of services, or shipment of goods constitutes acceptance regardless of whether the supplier returns an acceptance copy.

Second, the purchase order should clearly state that if the supplier attempts to condition its acceptance of the purchase order upon your company accepting additional or different terms, that acceptance of delivery of all or part of the goods, or payment for the goods, does not constitute acceptance of the different or additional terms.

### **Get a Warranty**

Consider adding a warranty (in addition to other warranties under Michigan law) to your purchase orders. This has particular significance for contractors who order supplies for construction projects. The warranty should confirm the supplier's warranty that the goods purchased conform to any specifications or other documents provided to the supplier. The standard lifespan for such a warranty is one year.

### **If Speed is the Key, Say So**

Make sure that your purchase orders clearly state the time for performance. If time is of the essence, then the purchase order should reflect the same.

You might also consider adding a term confirming the supplier's knowledge that you will suffer damage from any late delivery. Indemnification may be appropriate in circumstances where late delivery affects your contracts with third parties. You should reserve the right to change the delivery schedule. Decide, too, whether you need all of the goods in one delivery, or if incremental deliveries will suffice. Your purchase orders should require written notice and explanation from the supplier if they cannot meet your delivery schedule; the written notice and explanation should also include a proposal for curing any late delivery. The supplier should bear any and all expenses incurred by you (and the supplier) to meet new delivery deadlines.

## Control the Terms of Delivery

Similarly, your purchase orders should attempt to control – to the greatest extent possible – the delivery of the goods.

For example, reserve the right to terminate the order for either late deliveries, or a failure to cure a late delivery. You should also take steps to prevent unexpected deliveries, or deliveries that fail to conform to your delivery instructions. Your schedule and instructions should control the transaction! Do not accept changes to an order except when you authorize them in writing. Obligate the supplier to deliver the goods only in the quantities you request; and, deliveries should be clearly labeled and marked. Decide before delivery who will bear the costs of delivery, who bears the risk of damage to the goods in transit, and when the

risk shifts. Although some negotiation on these points is not uncommon, your purchase order should attempt to deflect acceptance of any risk until delivery and acceptance of the goods, especially where delivery and acceptance occur at different times.

The simple fact remains that litigation does happen, no matter how much you try to avoid it. So take action now to protect your interests later. Consider, for example, specifying venue (the place where a trial would take place) or including a provision that permits you to recover attorney fees if you have to sue the supplier for payment. A little effort now can save a lot of time and hassle later.

*Joe can be reached directly at 616.458.2490 or jbelsito@shrr.com.*

## I LOST MY THRILL ON BLUE HILL

*“Non-recourse” not guaranteed if loan agreements breached*

**By Jason R. Thompson, Attorney**

**F**or borrowers, the preferred method of financing large construction or development projects is “non-recourse” financing, where, in the event of non-payment under the loan, the lender agrees to limit its recovery to the collateral, and not to pursue the borrowers for any deficiency.

Even non-recourse loans generally contain exceptions for default that convert the “non-recourse loan” to a “recourse loan” where the lender may pursue the borrower for a deficiency. These exceptions are sometimes known as a “bad boy clause” and lenders and borrowers must be aware of them.

There have been very few court decisions interpreting such clauses. However, a recent Massachusetts case – *Blue Hills Office Park LLC v J.P. Morgan Chase Bank* – provides guidance for borrowers and lenders in non-recourse loans. In this case, the court converted the non-recourse loan into a recourse loan due to breaches of the mortgage and guaranty agreements. The court imposed recourse liability against both the LLC/borrower, as well as its

members, who guaranteed the non-recourse loan.

Two investors created Blue Hills Office Park LLC. The LLC obtained non-recourse financing for its operations at the commercial property. The financing was secured by the commercial property. The loan agreement required that the LLC be established as a single purpose entity; its sole purpose being to acquire, own and manage the subject commercial property.

While the owner of the commercial property, the LLC pursued a cause of action related to a zoning dispute with the neighboring property and the municipal government. That litigation ultimately resulted in a \$2 million settlement, which was subsequently distributed to the LLC members without passing through the LLC.

After the loss of the commercial property’s primary tenant, the LLC was unable to pay its property taxes, and defaulted under the mortgage agreement.

In the ensuing litigation, the lender asserted that its note should be converted to a recourse loan from a

non-recourse loan because of the LLC's breaches of the mortgage agreement. The court held that the settlement proceeds from the zoning claim were part of the "mortgaged property" because the agreement defined "mortgaged property" to include causes of action relating to the subject property.

The non-recourse loan contained provisions, common in such loans, providing that the loan would convert from non-recourse to recourse upon certain conditions of default. These conditions included an unauthorized assignment, transfer or conveyance of the mortgaged property. The court determined that the LLC members' receipt of the settlement funds constituted an unauthorized transfer of mortgaged property, thus converting the loan to a recourse loan.

The court also held that the LLC violated the agreement by selling approximately \$100,000 worth of office equipment. Under the agreement, the court held that the office equipment, as fixtures, were part of the "mortgaged property."

The bank also pursued other theories of breaches of the mortgage agreement. The court held that the LLC violated the agreement's requirement that it act as a single purpose entity by commingling funds and assets. The court also held that the LLC violated the agreement's requirement that it maintain an independent director. The "independent director" for the LLC was a paralegal in their attorney's office, who exercised no oversight or control of the company.

In an economic climate with increasing business failures and stagnant growth in real estate values, it is anticipated that more and more lenders and borrowers may face default situations involving non-recourse loans. The *Blue Hills Office Park LLC* decision is an important warning to borrowers regarding the need to comply with all of the terms of lending agreements. The favorable result for the lender in the *Blue Hills Office Park LLC* case will likely embolden other lenders to assume aggressive litigation postures aimed at converting non-recourse loans to recourse loans.

Lenders should also review the facts and application of the *Blue Hills Office Park LLC* case. While the case allows the lender to pursue collection against the individual guarantors, it is likely that the mortgage is only a perfected security interest as to the real property. It is less clear whether the recorded mortgage would be determined to be a perfected security interest in assets such as settlement proceeds, office equipment or other property secured by the agreement. As such, lenders who attempt to secure personal property associated with real property should consider whether they are required to file UCC Financing Statement or otherwise perfect their security interest in said property.

*Jason can be reached directly at  
jthompson@shrr.com or 231.486.4543.*

## **Smith Haughey Rice & Roegge's Business and Individual Planning Team**

George F. Bearup, Co-Chair 231.486.4510	Rachel Brochert Roe, Co-Chair 231.486.4503	James G. Black 616.458.4253	Charles B. Judson 231.486.4519	Robert C. Stone 616.458.3622
Jeffrey R. Wonacott 231.486.4509	Aileen M. Leipprandt 616.458.5298	Robert W. Parker 231.486.4504	Randall L. Velzen 616.458.3644	Jeffrey J. McManus 231.486.4554
Daniel M. Morley 231.486.4538	Stephanie A. Neal 616.458.9481	Adam M. Lett 231.486.4507	Kirk W. Morgan 616.458.3319	Mary R. Pigorsh 616.458.9463
Melissa E. Whitman 231.486.4540	Kristen A. Campbell 231.486.4542	Scott D. Harvey 231.486.4545	Jason R. Thompson 231.486.4543	Joseph E. Belsito 616.458.2490
Sharon M. Kelly Of Counsel 734.730.2048	Patrick J. Wilson Of Counsel 231.486.4541	Stephen C. Chambers Of Counsel 231.486.4546		