STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

NEWPORT, SC. **SUPERIOR COURT**

[Filed: August 5, 2015]

CAROL A. SMITH,	:	
Petitioner,	:	
	:	
VS.	:	**C.A. No. NB-2014-0170**
	:	
CAS, LLC, 60 HAMMARLUND WAY,	:	
UNIT NO. 2, LLC,	:	
Respondent.	:	

DECISION

STERN, J. Before this Court is Northeast LP IV, LLC's (Claimant) Motion to Approve its Amended Receivership Proof of Claim. On October 14, 2014, Claimant filed a Proof of Claim (Original Proof of Claim) as the owner and holder of a first Open-End Mortgage (Mortgage) and Promissory Note (the Note) executed by CAS, LLC, doing business as 60 Hammarlund Way, Unit No. 2, LLC (Respondent or Debtor).[1] Claimant has since filed an Amended Receivership Proof of Claim (Amended Proof of Claim) and now petitions this Court to approve its claim. Carol A. Smith (Petitioner) objects to the Claimant's Motion on the grounds that the Amended Proof of Claim fails to adequately establish the amount the Claimant alleges to be owed. Additionally, the Petitioner argues that the Respondent has defenses to the enforcement of the Note under the Uniform Commercial Code that prevents this Court from approving the Claimant's Amended Proof of Claim. Jurisdiction is pursuant to G.L. 1956 § 8-2-14.

[1] The Mortgage and Note were originally executed by the Respondent in favor of Sovereign Bank (Sovereign). In 2012, Sovereign transferred the Mortgage and Note to the Claimant. As part of the transfer, Claimant received additional documents relating to the loan.

I

Facts and Travel

The Respondent is a Rhode Island limited liability company which owned and operated real property (the Property) in Middletown, Rhode Island. During the course of its business, the Respondent took out a $500,000 loan from Sovereign, and in exchange, executed the Note for the amount of the loan.[2] The Respondent executed a Mortgage on the Property in favor of Sovereign to secure payment and performance under the loan provided by Sovereign. On September 6, 2012, Sovereign assigned its right, title and interest in the Note and Mortgage to the Claimant. Claimant is now the holder of the first Mortgage on the Property and the accompanying Note.

The Note was for a term of ten years with a chargeable interest rate of 6.77% for the first five years. After the initial five years, the Note stated that Sovereign could, in its sole discretion, change the interest rate and charge a rate equal to the five-year marginal cost of funds index plus a 2.25% margin per annum. Sovereign did not change the interest rate at the end of the first five years, but instead continued to charge interest at a rate of 6.77%. However, in April of 2011, Sovereign did change the interest rate and began charging a rate of 4.957%. The Petitioner alleges that the change in interest rate occurred six months after the point in time Sovereign was allowed to change the rate.[3] The overcharging of interest for this six month period forms the basis of the Petitioner's objection to the Claimant's Amended Proof of Claim.

After the Respondent was placed into receivership, the receiver planned to sell the

[2] The Note was executed on October 19, 2005.

[3] Petitioner alleges that the overcharging of interest for this six month period began a series of events leading to the failing of the Respondent business, and ultimately resulting in the appointment of a receiver.

Property. As a result, the Claimant filed its Original Proof of Claim.[4] In its objection to the Claimant's Original Proof of Claim, the Petitioner argued that by fraudulently charging an improper interest rate for a six month period in 2010-2011, Sovereign had overcharged the Respondent approximately three thousand dollars in interest. Additionally, the Petitioner alleged that the Claimant's Original Proof of Claim should be denied by this Court on the grounds that the Claimant is not a holder in due course of the Note since the Respondent had defenses to the Note's enforcement at the time of the Note's transfer to the Claimant.

At the hearing on the motion to approve the Original Proof of Claim, the Claimant stipulated to a lower amount from its Original Proof of Claim in order to offset the amount of the alleged overpayment of interest.[5] At the June 10, 2015 hearing, this Court ordered that the Claimant could amend its claim to the stipulated amount of $420,582.28. Additionally, this Court ordered additional briefing from the parties concerning the Claimant's Amended Proof of Claim. Following the Court's directive, the Petitioner has filed an additional objection arguing the Claimant has failed to satisfy its burden of proof supporting its claim.

II

Analysis

A

Burden of Proof

The Petitioner first argues that the Claimant's Amended Proof of Claim should be denied since the Claimant has not attached to its Amended Proof of Claim certain invoice records and

[4] In its Original Proof of Claim, the Claimant alleged to be owed $560,714.85 from the Respondent.

[5] Claimant's Amended Proof of Claim alleged to be owed $423,899.16. At the hearing, Claimant stipulated to a reduction in the amount of its claim, agreeing to seek approval in the amount of $420,582.28. Claimant contends that by stipulating to a reduction in the amount of its claim, it was not admitting to any wrongdoing on behalf of itself or Sovereign.

other documents supporting its claim after the Petitioner had objected to the Claimant's original claim. Alternatively, the Claimant argues that it has complied with this Court's previous order regarding the filing of proof of claims by claimants or creditors.

On May 23, 2014, this Court entered an Order appointing Vincent A. Indeglia, Esq., as the permanent receiver over the Respondent.[6] The Order required all creditors or claimants to file a claim with the receiver by October 23, 2014. A creditor or claimant filing a claim was ordered to include, as part of its claim,

> "a statement setting forth their claims, including, but without limiting the generality of the foregoing, the name and address of the claimant, the nature and amount of such claim, a statement of any security or lien held by the claimant to which such claimant is or claims to be entitled, and also a statement as to any preference or priority which the claimant claims to be entitled to over the claims of any other or all other claimants or creditors." The Order at ¶ 14.

The Petitioner cites to In re Kirkland as the basis for why the Amended Proof of Claim should be denied. 572 F.3d 838 (10th Cir. 2009). In In re Kirkland, the court affirmed the bankruptcy court's determination that a creditor possessed the burden of proof to support its proof of claim, and failing to do so would result in the claim being denied. Id. at 840. Since the creditor was filing in bankruptcy court, its proof of claim was required to "'conform substantially to the appropriate Official Form [10]'" used in bankruptcy proceedings. Id. (quoting Fed. R. Bankr. P. 3001(a)). In disallowing the creditor's proof of claim, the court held that the creditor did not offer any documentation to support its claim, and therefore, "failed to present 'prima facie evidence of the validity and amount of the claim.'" Id. at 840-41 (quoting Fed. R. Bankr. P. 3001(f)) (emphasis added).

This Court agrees with the Petitioner's position that the Claimant has to satisfy a certain

[6] See Order Appointing Permanent Receiver, Stern, J., May 23, 2014 (the Order).

evidentiary burden of proof before its Amended Proof of Claim can be approved. However, this Court takes issue with the Petitioner's arguments that the Claimant has failed to do so in this case. First, the Petitioner relies on a Federal Bankruptcy case as the basis for why this Court should deny the current claim. In a state receivership matter, this Court's rulings are controlled by Rhode Island jurisprudence, and will look to federal bankruptcy court for guidance only when our case law has not ruled on an issue. See Reynolds v. E & C Associates, 693 A.2d 278, 281 (R.I. 1997). Therefore, a proof of claim filed in a Rhode Island receivership action does not have to conform to the proof of claim filing requirements in Federal Bankruptcy court. Instead, the Order clearly stated what was required to be included in a creditor's proof of claim.

In this case, the Claimant has provided this Court with a sworn statement regarding the nature of the claim, and attached an exhibit regarding the amount it believes to be owed. The Amended Proof of Claim also incorporates the exhibits attached to its Original Proof of Claim and supplemental Proof of Claim. As a result, this Court has been provided with a copy of the Note and security agreement between the Respondent and Sovereign, the allonge to the Note, and the assignment of the Mortgage from Sovereign to the Claimant. Unlike in In re Kirkland, the Claimant has clearly produced evidence in support of its claim. 572 F.3d at 841.

Furthermore, filing a proof of claim in Bankruptcy Court requires a creditor to attach supporting documents. The Petitioner in this case argues that the Claimant's failure to include certain invoices sent to the Respondent from Sovereign prevents this Court from approving their claim; however, supporting documents has been defined to include, but not limited to, promissory notes, mortgages, and security agreements. See In re Armstrong, 320 B.R. 97, 103 (Bankr. N.D. Tex. 2005) (citations omitted). Therefore, based on the previous Order issued in this case and the submissions made by the Claimant, this Court finds the Claimant has met its

burden for filing a proper proof of claim. See In re Hughes, 313 B.R. 205, 209 (Bankr. E.D. Mich. 2004) (citing In re Dow Corning Corp., 250 B.R. 298, 321 (Bankr. E.D. Mich. 2000)) (stating a proper proof of claim "consists of (1) a creditor's name and address, (2) basis for claim, (3) date debt incurred, (4) amount of claim, (5) classification of claim, and (6) supporting documents.").

B

Holder in Due Course

The Petitioner next argues that the Claimant's Amended Proof of Claim should be denied since the Claimant did not take possession of the Note as a holder in due course. The Petitioner contends that since the Claimant cannot be seen as a holder in due course, the Claimant's enforcement of the Note is susceptible to the contract defenses the Petitioner could have raised against the original lender, in this case, Sovereign. Here, the Petitioner argues that the interest rate charged by Sovereign for the first six months after the initial five-year term expired amounted to common law fraud and a breach of contract. Conversely, the Claimant argues that it holds the Note as a holder in due course. Additionally, the Claimant agrees that the Petitioner's defenses are based on Sovereign's alleged overcharging of interest under the Note during the period in question, but contends that Sovereign was permitted to charge that interest rate based on the terms of the Note. Alternatively, the Claimant argues that even if Sovereign overcharged interest for this period of time, it lacked notice of any defects in the loan documents when the Note was transferred to them, and therefore, is still a holder in due course.

1

Terms of the Note

The Petitioner's defenses of breach of contract and common law fraud are based on

Sovereign overcharging interest for a period of six months during the years of 2010 and 2011. Before determining whether the Claimant is a holder in due course, which would prevent the Petitioner from raising these contractual defenses, this Court will review the claimed defenses.

To determine the viability of the Petitioner's claimed defenses, the Court must review and determine the rights of each party under the Note. When examining the terms of a promissory note, this Court applies the "well-settled rules for the interpretation of contracts." Rotelli v. Catanzaro, 686 A.2d 91, 94 (R.I. 1996). Whether a contract "is or is not ambiguous is a question of law" for this Court to determine. Young v. Warwick Rollermagic Skating Ctr., Inc., 973 A.2d 553, 558 (R.I. 2009) (citing Gorman v. Gorman, 883 A.2d 732, 738, n.8 (R.I. 2005)). The primary task when interpreting a contract is to "attempt to ascertain the intent of the parties." Woonsocket Teachers' Guild v. Sch. Comm. of the City of Woonsocket, 117 R.I. 373, 376, 367 A.2d 203, 205 (1976). "[T]he intention of the parties must govern if that intention can be clearly inferred from its terms." Id. (citing Hill v. M.S. Alper & Son, Inc., 106 R.I. 38, 47, 256 A.2d 10, 15 (1969)). In Rhode Island, our Supreme Court "adhere[s] to the rule of interpretation that when considering 'whether a contract is clear and unambiguous, the document must be viewed in its entirety and its language be given its plain, ordinary and usual meaning.'" Garden City Treatment Ctr., Inc. v. Coordinated Health Partners, Inc., 852 A.2d 535, 542 (R.I. 2004) (quoting Rubery v. Downing Corp., 760 A.2d 945, 947 (R.I. 2000)).

"[A] court must find that a contract is ambiguous before it can exercise judicial construction of the document." W.P. Assocs. v. Forcier, Inc., 637 A.2d 353, 356 (R.I. 1994). A "[contract] is ambiguous only when it is reasonably and clearly susceptible to more than one interpretation." Garden City Treatment Ctr., 852 A.2d at 541-42. If a contract is unambiguous, "the task of judicial construction is at an end and the agreement must be applied as written."

W.P. Assocs., 637 A.2d at 356. When determining if a contract is ambiguous, the Court should "'refrain from engaging in mental gymnastics or from stretching the imagination to read ambiguity into [a contract] where none is present.'" Cheaters, Inc. v. United Nat'l Ins. Co., 41 A.3d 637, 643 (R.I. 2012) (quoting Mallane v. Holyoke Mut. Ins. Co. in Salem, 658 A.2d 18, 20 (R.I. 1995)).

This Court must decide whether Sovereign was permitted under the Note to charge a 6.77% interest rate for the first six months following the Note's initial five-year term. The controlling language on this issue is found in the Payment section of the Note.[7] The Note states:

> "[t]he term of the Note shall not exceed 10 years. Borrower will make 60 consecutive monthly payments of principal and interest in the amount of $3,837.75 each, commencing one month from the date of the Note and continuing on the same day of each month thereafter for five [5] years. Interest will be calculated on the unpaid principal balance at a fixed interest rate of 6.77% per annum for five years. Payments are based on a 20-year amortization schedule. At the end of the 5th loan year, the Bank shall, in its sole discretion, have the right to change the interest rate and adjust Borrower's monthly payments accordingly based upon a new interest rate as determined by the Bank's prevailing 5-year marginal cost of funds index plus a margin of 2.25% per annum. Borrower's final balloon payment will be due on the Maturity Date of October 19, 2015 and will be for all principal, accrued unpaid interest, and fees, if any not yet paid." (Exhibit D.) (Emphasis added).

It is beyond dispute that the interest rate to be charged by Sovereign for the first five years was fixed at 6.77%. Following our well-settled rules for the interpretation of contracts, this Court finds the terms of the Note to be unambiguous. Following the fifth year, Sovereign had the sole discretion to change the interest rate, which it did in April of 2011. No reasonable interpretation of the terms of this Note leads this Court to believe that if Sovereign was going to change the

[7] See Exhibit D to Claimant's Mem. in Supp. of Mot. to Approve Am. Receivership Proof of Claim (hereinafter Exhibit D).

interest rate, it was restricted—by the terms of the Note—to do so exactly at the end of the fifth year. See City of East Providence v. United Steelworkers of America, Local 15509, 925 A.2d 246, 251-52 (R.I. 2007) (quoting Garden City Treatment Ctr., 852 A.2d at 542) (stating courts should not read ambiguity into a contract where none exists).

The Petitioner's reliance on the meaning of the introductory phrase "at the end of the 5th year" does not create an ambiguity in the interpretation of the Note, but rather, attempts to create one where it would otherwise not exist. See Mallane, 658 A.2d at 20 (citing Aetna Cas. & Sur. Co. v. Sullivan, 633 A.2d 684, 686 (R.I. 1993)). It is apparent that Sovereign had discretion to charge a different interest rate following the first five-year term of the Note. As stated above, the only restriction regarding the changing of the interest rate was during the first five years. If Sovereign was required to change the interest rate exactly upon the conclusion of the five-year fixed interest rate term, such conditional language would have been included as part of the Note; however, such a condition was not included. Sovereign's decision to voluntarily adjust the interest rate does not create for the Respondent defenses to the enforcement of the Note since Sovereign's actions were permissible based on the clear language of the Note. Therefore, the defenses of breach of contract and common law fraud cannot be raised to prevent Claimant's enforcement of the Note.

2

Notice of Defenses

Based upon this Court's ruling that the terms of the Note are unambiguous and that Sovereign's actions do not support the defenses the Petitioner alleges the Respondent has to prevent the Note's enforcement, this Court will only briefly discuss the other arguments raised by the parties. Since this Court has found the Respondent is not able to raise the defenses of

breach of contract and common law fraud, it follows that the Claimant took possession of the Mortgage and Note as a holder in due course.

To be recognized as a holder in due course, a holder must have:

> "[taken] the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (iv) without notice that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument . . ., and (vi) without notice that any party has a defense or claim in recoupment . . . ." G.L. 1956 § 6A-3-302(a)(2).

Subsection (a) of 6A-3-305 states, in pertinent part, that:

> "the right to enforce the obligation of a party to pay an instrument is subject to the following:
>
> . . .
>
> (2) a defense of the obligor stated in another section of this chapter or a defense of the obligor that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract . . . ." Sec. 6A-3-305(a)(2).

A holder in due course has the right "to enforce the obligation of a party to pay the instrument [ ] subject to the defenses of the obligor stated in subsection (a)(1), but is not subject to defenses of the obligor stated in subsection (a)(2) . . . ." Sec. 6A-3-305(b).

In this case, the Petitioner has argued that the Respondent's personal defenses of common law fraud and breach of contract are the type of defenses falling under subsection (a)(2) of § 6A-3-305. Even though the Petitioner is correct, this Court earlier held that these defenses cannot be raised by the Respondent based on the facts of this case. Further, the Petitioner's only basis as to why the Claimant is not a holder in due course is that the Claimant could not have taken possession of the Note "without notice that any party has a defense" to the enforcement of the instrument. Sec. 6A-3-302(a)(2). However, Sovereign's actions were in compliance with the

terms of the Note. As a result, when the Claimant took possession of the Note, the two defenses that the Petitioner now seeks to raise could not have been raised and are without merit. By failing to show that the other elements of § 6A-3-302(a)(2) have not been satisfied, this Court finds that the Claimant is a holder in due course.

C

Amount of the Claim

Lastly, the Petitioner argues that this Court should approve the Claimant's claim only for an amount equal to the cost the Claimant paid to purchase the Note from Sovereign plus a reasonable rate of return on its investment. However, the Petitioner has not provided this Court with any case law in support of such position. The case cited by the Petitioner, Giordano v. Mt. St. Francis Assocs., L.P., does not hold that a senior secured creditor, who validly bought a promissory note, is limited in a receivership proceeding to collecting only the amount it cost the creditor to purchase the note. No. C.A. 08-48 S, 2010 WL 3703404, at *1 (D.R.I. Sept. 10, 2010). Therefore, this Court approves the Claimant's Amended Proof of Claim in the amount which reflects the actual indebtedness of the Respondent under the Note.

III

Conclusion

For the reasons stated above, this Court grants the Claimant's Motion to Approve its Amended Proof of Claim. Based on the submissions of the Claimant, the Claimant's Amended Proof of Claim is approved in the amount of Respondent's actual indebtedness of $420,582.82. Claimant shall prepare the appropriate Order for entry.

RHODE ISLAND SUPERIOR COURT

Decision Addendum Sheet

TITLE OF CASE:	Carol A. Smith v. CAS, LLC 60 Hammarlund Way, Unit No. 2, LLC
CASE NO:	NB 2014-0170
COURT:	Newport County Superior Court
DATE DECISION FILED:	August 5, 2015
JUSTICE/MAGISTRATE:	Stern, J.
ATTORNEYS:	
For Plaintiff:	Brendan P. Smith, Esq.
For Defendant:	Richard M. Coen, Esq.; Benjamin C. Caldwell, Esq.; Vincent A. Indeglia, Esq.