

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

PROVIDENCE, SC.

SUPERIOR COURT

[Filed: April 19, 2016]

FS GROUP RI, LLC, and
JOHANNES ERSKINE FLO

VS.

HIF LENDERS II, LLC,
WESTRIDGE LENDING FUND, LLC,
AND RODEO CAPITAL, INC.

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C.A. No. PC 2016-0290

DECISION

LANPHEAR, J. Before the Court is FS Group RI, LLC (Group), and Johannes Erskine Flo’s (collectively Plaintiffs) Motion for a Preliminary Injunction. Plaintiffs seek to enjoin Defendants HIF Lenders II, LLC, Westridge Lending Fund, LLC, and Rodeo Capital, Inc. from recording a deed of foreclosure in the Land Evidence Records of the Town of Lincoln, Rhode Island and from selling, leasing, mortgaging, or otherwise encumbering a single family residence located at 15 Red Brook Crossing in Lincoln, Rhode Island (the Property).

I

Facts and Travel

Johannes Erskine Flo (Flo) is the owner and principal member of a Rhode Island limited liability company, FS Group RI, LLC (collectively Borrower). HIF Lenders II, LLC (HIF) and Westridge Lending Fund, LLC (Westridge) are both California limited liability companies engaged in the business of making real estate loans. Rodeo Capital, Inc. (Rodeo) is a California corporation, which brokers and services real estate loans on behalf of HIF and Westridge (collectively Lenders). In March 2015, Borrower entered into a loan agreement with Lenders in

order to acquire a single family residence located at 15 Red Brook Crossing in Lincoln, Rhode Island (the Property).¹ On or about March 10, 2015, Borrower executed a Promissory Note (the Lincoln Loan) payable to Lenders in an original principal amount of \$2,275,000. The Lincoln Loan was secured by a Mortgage and recorded in Book 1935 in the Land Evidence Records of the Town of Lincoln, Rhode Island. Borrower negotiated and obtained the Lincoln Loan through Rodeo, which is the servicing agent for the Lincoln Loan. In connection with the Lincoln Loan, Flo signed a Certification of Non-Owner Occupancy and Indemnity (Occupancy Certification) on March 13, 2015, which stated that the Property was not his principal residence and that he never intended to make the Property his principal residence.

On March 13, 2015, Lenders funded the entire amount of the Lincoln Loan. In accordance with the terms of the Lincoln Loan, interest on the unpaid principal accrued from the date the proceeds were distributed to Borrower at an annual rate of 10.99%. Interest only payments were due and payable in consecutive monthly installments of \$20,835.21 on the first day of each month until the debt was fully paid. Borrower made payments to Lenders in May and June of 2015, but failed to make payments in July and August of 2015. Accordingly, on August 3, 2015, Lenders sent Borrower a Notice of Default and Demand (Notice of Default), which stated that Borrower was in default for failing to pay \$91,446.85. The Notice of Default

¹ Flo is also the owner of another Rhode Island limited liability company, the Bard Group, LLC (Bard), which is engaged in the same business as FS Group RI, LLC. Although it is not the subject of this litigation, this Court notes that on June 1, 2015, Bard executed a Promissory Note payable to Lenders in an original principal amount of \$10,000,000 to acquire three parcels of real estate located in Newport, Rhode Island (the Newport Loans). Unlike the Lincoln Loan, before executing the Newport Loans, Bard provided Lenders with a pro forma methods analysis performed by a certified public accountant licensed in Rhode Island, which indicated that the Newport Loans were capable of being repaid pursuant to G.L. 1956 § 6-26-2(e). The Newport Loans were also brokered and serviced by Rodeo. Bard defaulted on the Newport Loans in July of 2015.

advised that Borrower had until close of business on September 3, 2015 to cure the default by paying the full \$91,446.85.

Subsequently, Borrower entered into discussions with Lenders and requested that Lenders forbear from accelerating the Lincoln Loan. Lenders establish that during the default period, Flo repeatedly expressed his desire to avoid the adverse publicity that would accompany a foreclosure proceeding. (Richard Katz Aff. ¶ 32, Feb. 22, 2016.) On October 3, 2015, Lenders and Borrower, through their respective counsel, negotiated a Forbearance and Loan Modification Agreement of the Lincoln Loan (the Lincoln Forbearance). The Lincoln Forbearance reduced the default interest rate on the Lincoln Loan from eighteen percent (18%) to twelve percent (12%) and contained a provision, which released Lenders from any liability it may have garnered under the terms of the original Lincoln Loan. (Ex. E, Brian Dies Aff., Feb. 10, 2016.) The Lincoln Forbearance also required that Borrower make a payment of \$93,260.15—consisting of accrued interest, late fees, attorney fees and expenses incurred by Lenders in connection with Borrower’s default—on or before October 9, 2015. The original debt is not discharged but ratified by the Lincoln Forbearance, supra at 2.

Borrower made the October payment in accordance with the Lincoln Forbearance; however, Borrower failed to make its required payment in November. Accordingly, on November 17, 2015, Lenders sent Borrower a Notice of Foreclosure by certified mail with return receipt requested to Group’s primary residence located at 10 Brown & Howard Wharf in Newport, Rhode Island. Lenders did not send a Notice of Foreclosure by certified mail to the Property. However, Lenders contend that it sent a “tenant notice” detailing the Notice of Foreclosure to the Property. The Notice of Foreclosure stated that a foreclosure sale of the Property under the Mortgage’s power of sale would take place on January 15, 2016. The Notice

of Foreclosure also contained a copy of the advertisement Lenders had published in The Providence Journal. Further, the Notice of Foreclosure stated that Borrower had the right to reinstate the Lincoln Loan by paying the amount owed prior to acceleration, plus attorneys' fees and other reasonable costs of proceedings, prior to the foreclosure sale (the Reinstatement Costs).

After receiving the Notice of Foreclosure, Flo sent two texts to Richard Katz, the President of Rodeo, in which Flo indicated that he would pay the Reinstatement Costs by the close of business on November 25, 2015. Borrower failed to make any payment to Lenders before the foreclosure sale, and on January 15, 2016, Lenders purchased the Property at the foreclosure auction for \$1,750,000.²

On January 21, 2016, Borrower filed the instant motion seeking to enjoin Lenders from recording the deed of foreclosure in the Land Evidence Records of the Town of Lincoln, Rhode Island. Borrower also seeks to enjoin Lenders from selling, leasing, mortgaging, or otherwise encumbering the Property. In support, Borrower essentially argues that 1) the original Lincoln Loan was usurious and therefore void; 2) the Lincoln Forbearance is void for lack of consideration; and 3) the foreclosure sale is void for lack of proper notice.

II

Standard of Review

As the Rhode Island Supreme Court has articulated, the purpose of a preliminary injunction "is merely to hold matters approximately in status quo, and in the meantime to prevent the doing of any acts whereby the rights in question may be irreparably injured or endangered."

² Borrower contends that on the morning of the foreclosure sale, Borrower wired Lenders \$97,000 from Norway, which Borrower argues was in excess of the amount it actually owed. However, Lenders did not receive the payment until January 18, 2016, three days after the foreclosure sale had taken place.

Coolbeth v. Berberian, 112 R.I. 558, 564, 313 A.2d 656, 659 (1974). In deciding whether to issue a preliminary injunction, a trial court should consider the following four factors,

“whether the moving party (1) has a reasonable likelihood of success on the merits, (2) will suffer irreparable harm without the requested injunctive relief, (3) has the balance of the equities, including the possible hardships to each party and to the public interest, tip in its favor, and (4) has shown that the issuance of a preliminary injunction will preserve the status quo.” Iggy’s Doughboys, Inc. v. Giroux, 729 A.2d 701, 705 (R.I. 1999).

The decision to grant or deny a preliminary injunction is left to the discretion of the trial justice. Pucino v. Uttley, 785 A.2d 183, 186 (R.I. 2001). Moreover, a preliminary injunction does not require a trial justice to make a final determination regarding the rights of the parties or the merits of the controversy. Coolbeth, 112 R.I. at 565, 313 A.2d at 660. Rather, in order to meet the standard, a party moving for a preliminary injunction need only make out a prima facie case. DiDonato v. Kennedy, 822 A.2d 179, 181 (R.I. 2003).

III

Analysis

A

Usury Claim

First, Borrower argues that between July and August of 2015, Lenders charged Borrower an interest rate in excess of twenty-five percent (25%) in violation of Rhode Island’s usury statute § 6-26-2(a). In support, Borrower has provided the affidavit of Brian Dies, a CFA. In his affidavit, Mr. Dies concludes that between the months of August and September of 2015, the Lincoln Loan had an effective interest rate of over twenty-five percent (25%). In response, Lenders dispute Mr. Dies’ findings on the grounds that he incorrectly included certain fees when he calculated the interest rate charged on the loans, which Lenders contend he should have

excluded pursuant to § 6-26-2(c)(1).³ Next, Lenders contend that even if the interest rate on the original Lincoln Loan was usurious between August and September of 2015, Borrower validly waived any usury claims it had in the Lincoln Forbearance. Further, Lenders argue that the Lincoln Forbearance reduced the default interest rate so that it was well below twenty-one percent (21%) and no longer usurious.

It is uncontested that the Lincoln Forbearance did not result in a usurious interest rate. However, Borrower contends that this Court cannot consider the Lincoln Forbearance in determining whether it was charged a usurious interest rate, because it is unenforceable due to lack of consideration. Therefore, as a threshold matter, this Court must determine whether the Lincoln Forbearance is valid and forestalls Borrower's claims of usury.

Rhode Island's usury statute § 6-26-2(a) provides in pertinent part that

“no person, partnership, association, or corporation loaning money to or negotiating the loan of money for another, except duly licensed pawnbrokers, shall directly or indirectly, reserve, charge, or take interest on a loan, whether before or after maturity, at a rate that shall exceed the greater of twenty-one percent (21%) per annum.”

If a lender charges more than the prescribed twenty-one percent rate in interest per annum, then § 6-26-4(a) declares that the loan contract as well as any mortgage made or given as security for the performance of the contract is usurious and void. In determining whether an interest rate is usurious, courts must calculate the maximum allowable interest rate based on the amount of money actually received by the borrower. NV One, LLC v. Potomac Realty Capital, LLC, 84 A.3d 800, 805 (R.I. 2014). The face amount of the loan is irrelevant. Id. “Usurious

³ Section 6-26-2(c)(1)(i)-(viii) provides a list of charges and fees that should not be construed as interest when calculating the amount of interest a lender has charged in the context of usury.

interest rates are to be avoided at all costs and the onus is on the lender to ensure compliance with the maximum rate of interest.” NV One, LLC, 84 A.3d at 808.

Our Supreme Court has described Rhode Island’s usury statute as “draconian” and “strong medicine.” LaBonte v. New England Dev. R.I., 93 A.3d 537, 543 (R.I. 2014). However, in DeFusco v. Giorgio, 440 A.2d 727, 732 (R.I. 1982), the Court held that a borrower may waive a usury defense in limited circumstances. In DeFusco, the defendant instituted suit against the plaintiffs to recover a balance allegedly owed on a promissory note. Id. at 728. In response, the plaintiffs asserted that the defendant had charged them a usurious rate of interest in violation of § 6-26-2. Id. However, on the day that the trial commenced, the plaintiffs presented the trial court justice with a consent judgment drafted by their attorney, in which they agreed to judgment for the defendant. Id. at 729. After the plaintiffs failed to make payments in compliance with the consent judgment, the defendant obtained an execution and levied on the plaintiffs’ property. Id. On appeal of a trial justice’s ruling affirming the consent judgment, the plaintiffs argued that due to public policy considerations, a litigant could never waive a usury defense. Id. at 731. The Court disagreed. Id. at 732.

The Court determined that the legislature had not intended to preclude a borrower from waiving the defense of usury in all circumstances. Id. Rather, the Court held that “waiver of a usury defense should be permitted when it is freely and knowingly made after reasoned reflection for the legitimate purpose of avoiding or settling litigation.” Id. In making its determination that the plaintiffs had voluntarily waived the defense of usury, the Court noted that 1) the note was not usurious on its face; 2) the facts which supported the plaintiffs’ usury claims were hotly disputed by the parties; and 3) the plaintiffs’ decision to consent to the judgment was the result of their desire to avoid adverse publicity. Id. Moreover, the Court found that the

situation regarding the release was not coercive as the parties had not executed the release in exchange for additional advances of funds or contemporaneous with the signing of the promissory note. Id.

Here, the Court finds that the Lincoln Forbearance is valid, and therefore, Borrower has freely and knowingly waived the defense of usury. Similar to DeFusco, the original Lincoln Loan—as well as the Lincoln Forbearance—is not usurious on its face. Further, there is evidence in this case that Borrower—a sophisticated and represented corporate entity—entered into the Lincoln Forbearance for the purpose of avoiding litigation. Moreover, like the plaintiffs in DeFusco, Borrower’s attorney negotiated the Lincoln Forbearance. Lastly, Borrower and Lenders executed the release after Borrower defaulted in exchange for a lower default interest rate, as well as Lenders’ agreement not to institute foreclosure proceedings. Therefore, the circumstances surrounding the release were not coercive. See id. (noting that coercive circumstances may exist where parties executed a release in exchange for additional funds, or before funds were released).

Relying heavily on Nazarian v. Lincoln Finance Corp., 77 R.I. 497, 78 A.2d 7 (1951), Borrower argues that the Lincoln Forbearance is unenforceable due to lack of consideration. In Nazarian, the plaintiff signed a contract, which released a loan company from any liability it had on a usurious contract in return for a credit from the loan company of \$135. Id. at 501, 78 A.2d at 8-9. The Court found that the credit of part of a usurious interest collected under the original void agreement did not constitute adequate consideration. Id. at 503, 78 A.2d at 10. In coming to this conclusion, the Court noted that there was no evidence that the parties had attempted to make a new and separate agreement, but instead had insisted on the validity of the old usurious contract. Id. at 504, 78 A.2d at 10. However, Borrower’s reliance on Nazarian is misplaced.

In this case, unlike Nazarian, Lenders made a new, separate agreement which cured the allegedly usurious interest rate present in the original Lincoln Loan contract. Moreover, as consideration for giving up an unproven and contested usury defense, Borrower protected itself from bad publicity a default was delayed, and Borrower received a lower default interest rate which conformed to the maximum permissible rate under Rhode Island law. See NV One, LLC, 84 A.3d at 807 (noting that a lender made no attempt to lower a default interest rate, which was usurious on its face, so that it conformed to the maximum permissible interest rate allowable under Rhode Island law); see also 44B Am. Jur. 2d Interest and Usury § 211 at 203 (2007) (describing a line of cases, which hold that borrowers may validly waive a usury claim by cancelling the contract tainted by usury and creating a new contract free from usury). Therefore, this Court finds that the Lincoln Forbearance was supported by consideration, and that Borrower has validly waived any usury claims which arose out of the original Lincoln Loan.

Accordingly, because Borrower does not allege any claims of usury arising out of the Lincoln Forbearance, Borrower does not have a reasonable likelihood of success on the merits of its usury claim and cannot meet the first factor necessary for this Court to grant a preliminary injunction. Borrower has established that it may suffer irreparable harm without the requested injunction.⁴ A balancing of the equities does not favor a grant of the injunction, as the Borrower accepted the risk, fell into default, negotiated a Forbearance and defaulted again. Borrower waited until after the foreclosure to complain. The injunction merely seeks to stop the recording of the deed. The public interest favors timely payment of financial obligations and an adherence to contracts. Finally, a grant of an injunction would not preserve the status quo as the foreclosure auction is complete, a buyer has purchased the property, and without the recordation

⁴ The elements for injunctive relief are set forth in Allaire v. Fease, 824 A.2d 454 (R.I. 2003).

of the deed the title record is incomplete. The movant has failed to demonstrate by clear and convincing evidence or even by a preponderance of evidence that an injunction is appropriate. Thus, this Court denies the Borrower's Motion for a Preliminary Injunction. Because this Court has determined that the Borrower waived any usury claims that arose out of the original Lincoln Loan, this Court does not reach Borrower's argument that it was charged a usurious interest rate under the original Lincoln Loan.

B

Proper Notice of Foreclosure

Next, Borrower argues that this Court should set aside the January 15, 2016 foreclosure sale because although Lenders sent notice to Borrower's principal address, it failed to send proper notice to the address of the Property in compliance with G.L. 1956 § 34-27-4(b). In response, Lenders contend that any lack of notice to the Property was harmless error because Borrower had actual notice of the pending foreclosure.

The Rhode Island General Assembly has set forth the notice, which is required under a power of sale mortgage, in two statutory sections. McGovern v. Bank of America, N.A., 91 A.3d 853, 859 (R.I. 2014). Section 34-11-22 allows a mortgagee to foreclose under power of sale after

“first mailing written notice of the time and place of sale by certified mail, return receipt requested, to the mortgagor, at his or her or its last known address . . . [and] second, by publishing the same at least once each week for three (3) successive weeks in a public newspaper published daily in the city in which the mortgaged premises are situated.”

However, § 34-27-4(b) states that “no notice shall be valid or effective unless the mortgagor has been mailed written notice of the time and place of sale by certified mail return receipt requested at the address of the real estate and, if different, at the mortgagor's . . . last

known address.” The Rhode Island Supreme Court has stated that the purpose of notice in the context of mortgage foreclosures is to enable a mortgagor “to take measures to protect his interests.” Woonsocket Inst. for Savings v. Am. Worsted Co., 13 R.I. 255, 257 (1881); see also 55 Am. Jur. 2d Mortgages § 508 at 230 (2009) (“The purpose of the notice requirements in nonjudicial foreclosure and sale statutory provisions is to inform persons with an interest in the property of the pending sale of that property, so that they may act to protect those interests”).

Here, Lenders contend that a tenant notice of foreclosure was sent to the Property. However, it is undisputed that Lenders failed to send written notice of the time and place of the sale by certified mail to the Property. Although Lenders failed to strictly comply with the provisions of the statute, it is also undisputed that Borrower received actual notice of the foreclosure sale and immediately contacted Lender in response. Moreover, Borrower does not argue that it was prejudiced or injured by Lender’s failure to send notice to the Property in compliance with § 34-37-4(b). Rather, Borrower received actual notice of the foreclosure at its principal residence in accordance with his stipulation; that the Property was not his principal residence; and, that he never intended to make the Property his principal residence.

Our Supreme Court has not specifically addressed whether the formal requirements of § 34-37-4(b) must be strictly construed to invalidate a foreclosure sale even in the event that a borrower has received actual notice of foreclosure well in advance of the sale and does not allege prejudice or injury as a result. However, in the context of tax sales, the Court has held that an allegation of inadequate notice will not invalidate a tax sale if the interested party has actual notice of the sale. See Johnson v. QBAR Assocs., 78 A.3d 48, 53 (R.I. 2013) (holding that because plaintiff received actual notice of the tax sale, the plaintiff could not claim that she was deprived of due process due to inadequate notice); Izzo v. Victor Realty, ---A.3d---, No. 2014-

165-Appeal, 2016 WL 640673, at *4 (R.I. Feb. 18, 2016) (holding that plaintiff could not allege inadequate notice when it was undisputed that he had actual knowledge of the tax sale); see also Flynn v. Al-Amir, 811 A.2d 1146, 1152 (R.I. 2002) (“Although legislative enactments concerning service of process should be strictly construed . . . in situations . . . in which the defendant has received actual notice of the suit, this Court has interpreted such service-of-process rules broadly-especially when the method of service is not inconsistent with the rules”) (internal citations omitted).

It is noteworthy here to note that Borrower’s challenge to the debt and foreclosure itself came very late in the process. Actual notice was received by the Borrower in November 2015 (Am. Verified Compl. ¶ 15). Borrower had been represented by counsel with each of their prior transactions. Borrower waited until January 21, 2016, five days after the actual foreclosure auction of January 16, 2016, to protest the adequacy of notice.⁵ By then notices had been issued, advertisements had run, an auction was held and the buyer gave a deposit—the foreclosure was complete. Waiting until after the foreclosure and praying for an order to prohibit the recordation of the deed is simply unfair.

Here, Borrower—a sophisticated corporate entity—had actual notice of the foreclosure action. Moreover, Borrower was not prejudiced due to lack of adequate notice. Thus, it appears to this Court that the purpose of the notice statute requirements was met in this case. Thus, Lenders’ failure to strictly comply with the notice requirements of § 34-37-4(b) constitutes harmless error. Accordingly, this Court holds that the foreclosure sale was valid.

⁵ Neither the Complaint nor the Amended Complaint of February 5 questions the adequacy of notice. The original complaint focuses on the inability of the parties to reach an accord as the auction date approached.

IV

Conclusion

For the reasons stated above, this Court denies Borrower's Motion for a Preliminary Injunction and holds that the foreclosure sale of January 15, 2016 was valid. Lenders may record the mortgage foreclosure deed.



RHODE ISLAND SUPERIOR COURT

Decision Addendum Sheet

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CASE NO: PC 2016-0290

COURT: Providence County Superior Court

DATE DECISION FILED: April 19, 2016

JUSTICE/MAGISTRATE: Lanphear, J.

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