UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
WINSTON-SALEM DIVISION

IN RE:	)	
	)	
Charlotte Commercial Group, Inc.,	)	
	)	**Case Number: 01-52684**
Debtor.	)	
	)	
	)	
Charlotte Commercial Group, Inc.,	)	**Ad. Proc. No.: 01-6044**
	)	
Plaintiff,	)	
vs.	)	
	)	
Fleet National Bank,	)	
	)	
Defendant.	)	
	)	

MEMORANDUM OPINION

This matter came on for hearing on April 19, 2005 in Winston-Salem, North Carolina upon Fleet National Bank's Motion for Summary Judgment. Herman L. Stephens and H. David Niblock appeared for Charlotte Commercial Group, Inc. ("CCG"). Jean-Marie L. Atamian, Matthew D. Ingber, and Kenneth M. Greene appeared for Fleet National Bank ("Fleet"). William P. Miller appeared as the Trustee for the estate of the Debtor. After considering the pleadings and the arguments of counsel, the court makes the following findings of fact and conclusions of law:

Jurisdiction

This adversary proceeding is related to CCG's bankruptcy case and this court has jurisdiction over the subject matter of this proceeding pursuant to 28 U.S.C. § 1334 and 157(a) and the General Order of Reference entered by the United States District Court for the Middle District of North Carolina on August 15, 1984.

Facts

The Debtor was engaged in the business of purchasing sub-prime automobile financing receivables from retail vendors of motor vehicles. On September 24, 1998, CCG entered into a Loan and Security Agreement with Fremont Financial Corporation ("Fremont") pursuant to which Fremont provided CCG with a revolving loan, in an amount up to $3,000,000. This loan was secured by automobile receivables. The amount of loan availability was based upon formulas relating to the amount of eligible receivables that the Debtor purchased from dealers. This loan was assigned to Summit Bank and, on October 11, 2000, Summit Bank and CCG entered into an amended agreement (the "Finance Agreement"). The Finance Agreement, which was subsequently assigned to Fleet, provided for a maximum principal amount of $7,500,000 with all interest treated as an advance and added to the principal balance on a monthly basis. In addition, the Finance Agreement granted the lender a security interest in CCG's assets. The termination date for the Finance Agreement was September 24, 2003.

1. CCG's Operations

CCG's business plan provided that CCG would purchase receivables from sub-prime automobile dealers. CCG hedged against the inherent risk of the sub-prime lending market by purchasing receivables at a significant discount and only purchasing receivables from dealers that guaranteed the debt. In early 2000, CCG's entire receivables portfolio (the "Portfolio") was purchased at a discount and guaranteed by the dealers that made the loans. The "recourse agreements" with the dealers provided that, if the borrower did not pay CCG in full, the dealership from which the receivable was purchased would be liable for the difference.

During the summer of 2000, one dealer, Steve's Auto Sales, negotiated with CCG to relieve the dealership's liability on the receivables purchased by CCG. In June of 2000 the Board of Directors of CCG (the "Board") granted authority to the President of CCG to purchase non-recourse paper from Steve's Auto Sales and convert the existing recourse portfolio to non-recourse paper. The board stated "it must be clearly understood that approval is granted for this deal only." (Atamian Aff. Ex. 12). As a result of this transaction, approximately five percent of the Portfolio transformed from recourse, where CCG had a right to demand payment from the borrower or, if the borrower defaulted, from the dealer that made the loan, to non-recourse, where CCG could only demand payment from the borrower. As of the date of the Finance Agreement, the Steve's Auto Sales portion of the Portfolio was the only portion of the Portfolio that was non-recourse. The parties never contemplated that CCG would write its own loans.

In late 2000, after the signing of the Finance Agreement, U.S. Auto Sales ("U.S. Auto"), a Florida auto dealership whose loans represented approximately 17% of the Portfolio, ceased operations. U.S. Auto's failure caused a significant percentage of the Portfolio to become non-recourse. In addition to changing the nature of the receivables, U.S. Auto's failure brought about changes in CCG's operations. In response to U.S. Auto's failure, CCG sent its district manager, Don Boggess, to restart and manage the ongoing operations of U.S. Auto. CCG elected to take this step, and underwrite the expenses associated, in order to preserve the value of the receivables purchased from U.S. Auto. Expenses underwritten by CCG included, among other costs, rent for the dealership's premises, insurance premiums covering the dealership's inventory, and repossession fees as a result of defaulting borrowers.

In the spring of 2001, Marshall Leonhardt Auto Sales ("Leonhardt Auto"), a North Carolina dealership representing approximately 23% of the Portfolio, ceased operations. In addition to the further deterioration of the Portfolio's composition, the Leonhardt Auto failure caused CCG to take over the operations, and expenses, of another auto dealership. By May 2001, a total of nine dealerships had failed and those dealerships' recourse obligations became nonexistent. As a result, 55% of the Portfolio was converted from recourse to non-recourse. Due to the expense of operating auto dealerships, CCG's purchase of new loans had slowed dramatically. As a result, CCG's asset base was decreasing as older receivables were collected but a significantly smaller number of receivables were purchased.

CCG's assumption of dealership operations brought another change to CCG's operations. For the first time, instead of buying receivables from another party at a discount, CCG was making loans directly to borrowers. As a result, CCG could not discount these loans. For these direct loans, CCG had neither the protection of a recourse agreement nor the benefit of purchasing the loan at a discount. For the first time, CCG faced the full risk of the sub-prime lending market.

2. The Finance Agreement

The terms of the Finance Agreement obligated Summit and its successor, Fleet, to make advances to CCG based upon a formula contained within the Finance Agreement.[1] The Finance

[1] The Parties attached a sample BBC to the Finance Agreement. The attachment provided that the Amount Available would be calculated as:

1. Total Accounts per Previous Report
2. Plus: Accounts assigned herewith

Agreement provided for an asset-based loan. An asset-based loan is one in which the amount available for the loan is based upon the amount of collateral available to secure those loans. The Finance Agreement was structured to allow CCG to borrow an amount equal to 85% of eligible receivables. Hence, as CCG's assets increased, CCG could borrow more money under the Finance Agreement. Conversely, when CCG's assets decreased, CCG could borrow less money. The Finance Agreement provided that advances were to be based upon a monthly Borrowing Base Certificate ("BBC") prepared by CCG in accordance with sound accounting practice, as defined in the Finance Agreement. In exchange for these advances, CCG promised to repay loan amounts and granted Fleet a security interest in a wide variety of assets, including deposit and cash accounts.

The monthly BBCs were central to determining the amount available to CCG under the Finance Agreement. Under the Finance Agreement, Fleet and CCG (the "Parties") agreed that the amount available for advance under the Finance Agreement (the "Amount Available") would be reduced by the discount at which CCG purchased receivables from the dealerships (the

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3. No. 1 Plus No. 2
4a. Less: Customer Collections Since Previous Report
4b. Less: Non-customer Repo/Payoff Proceeds
4c. Less: Charge-offs and Other Credits
1. Total Accounts (No. 3 Less 4a, 4b, 4c)
6a. Less: Unearned Finance Charges
6b. Less: Unearned Discounts
6c. Less: Unearned Insurance
6d. Less: Dealer Holdbacks
6ei. Less: Account 45 days or more Past Due, Net
6h. Less: Bankrupt accounts and repos less than 45 days, Net
7a. Total Collateral Value Net (No. 5 Less 6a, 6b, 6c, 6d, 6ei, 6h)
8a. Percentage of Advance, Net
9a. Borrowing Base (No. 7a Times No. 8a)
10. Loan Balance
11. Loan Balance
12. Advance Requested Herewith
13. New Loan Balance (No. 10 Plus No. 12)

"Unearned Discount").[2] Between October 2000 and May 2001, when completing the BBC, CCG reduced the Amount Available by the full amount of the Unearned Discount. In May 2001, CCG borrowed more from Fleet than the Finance Agreement allowed. As a result, CCG paid $152,259 to cure this overadvance. In June 2001, CCG changed the way it prepared the BBCs. CCG began reducing the Unearned Discount by costs incurred in operating the defunct dealerships. These costs included payroll, rent for the dealer's premises, and other costs associated with operating an automobile dealership. The Unearned Discount was inversely related to the Amount Available under the Finance Agreement. Therefore, when CCG reduced the Unearned Discount by subtracting the costs of operating the dealerships, CCG increased the Amount Available under the Finance Agreement. As a result, despite purchasing fewer receivables, CCG certified that the Amount Available increased in June 2001 and July 2001. At the time that CCG filed its bankruptcy petition, CCG owed Fleet approximately $5,742,621.

On August 16, 2001, Fleet asserted that CCG inaccurately and fraudulently prepared the Borrowing Base Certificates for the months of June and July of 2001 (the "June and July BBCs"). Accordingly, Fleet did not make any further advances and, in a letter dated August 27, 2001, demanded that CCG immediately pay the sum of $769,561, which Fleet asserted was an over advance. Fleet further claimed that it was entitled to exercise its powers pursuant to the Finance Agreement upon default to foreclose upon its collateral. On October 16, 2001, counsel for Fleet sent notice that the Borrower (CCG) was in default under, without limitation, sections 8.2 and 8.3 of the Agreement. As a result of the alleged default, Fleet declared all loans made

[2] The Finance Agreement does not provide a definition of the term "Unearned Discount."

pursuant to the agreement immediately due and payable. Sections 8.2 and 8.3 of the Agreement provide as follows:

> Each of the following events shall constitute an event of default by Borrower under this Agreement ("Event of Default"):
>
> 8.2 **<u>Information, Representations and Warranties</u>**.
> Any financial statement, written information furnished or representation or warranty, certificates, document or instrument made or given by Borrower herein or furnished in connection herewith shall prove to be materially false, misleading or incorrect.
>
> 8.3 **<u>Covenants and Agreements</u>**.
> The failure of Borrower to observe, perform or abide by any covenant, warranty, agreement or provision of the Note or this Agreement or any other agreement, document or instrument related hereto, or any of the documents executed by Borrower in connection herewith or referred to herein or in connection with or relating to the Collateral.

CCG maintains that the June and July BBCs were prepared in accordance with sound accounting practice, and that those BBCs correctly certified that funds were available to CCG for advance. Further, CCG alleges that Fleet breached their obligations under the Finance Agreement by demanding repayment of the alleged overadvance and by refusing to make further advances to CCG. CCG alleges that Fleet's actions were the proximate cause of CCG's failure and that Fleet is responsible for damages resulting from those actions.

Procedural History

On October 29, 2001, Fleet filed a complaint against CCG and its officers in the United States District Court for the Eastern District of Pennsylvania. The complaint alleged that CCG had fraudulently prepared the June and July BBCs and demanded return of the amount Fleet characterized as an overadvance. On November 13, 2001, CCG filed for protection under Chapter 11 of the Bankruptcy Code. CCG's bankruptcy filing stayed the litigation in the Eastern

District of Pennsylvania. Contemporaneously with its bankruptcy filing, CCG moved for temporary authority to use the cash collateral securing its obligations to Fleet. After notice and hearing, the court granted CCG's motion and allowed CCG the limited use of cash collateral through December 5, 2001. On November 28, 2001, Fleet moved for relief from the automatic stay to exercise its rights in collecting and preserving the value of the collateral, including cash on hand, securing CCG's obligations under the Finance Agreement. On December 5, 2001, the court held a hearing and allowed the use of cash collateral through January 9, 2002. At the same hearing, the court continued Fleet's motion for relief from the automatic stay until January 9, 2002. On January 9, 2002 the court held a continued hearing on the use of cash collateral and, on January 17, 2002, the court denied CCG's motion to use cash collateral and granted Fleet's motion for relief from the automatic stay. On March 14, 2002, the court appointed William P. Miller as Chapter 11 Trustee for the bankruptcy estate of CCG. On April 26, 2002, the court entered a consent order converting CCG's bankruptcy case from Chapter 11 to Chapter 7.

On December 17, 2001, CCG filed the complaint in this adversary proceeding against Fleet and alleged that Fleet breached the Finance Agreement, that Fleet violated its duty of good faith and fair dealing, and that Fleet engaged in unfair and deceptive trade practices as defined by the North Carolina Unfair and Deceptive Trade Practices Act.[3] On April 29, 2002, Fleet filed its answer to CCG's complaint. Fleet's answer contained several affirmative defenses, including that CCG fraudulently prepared the June and July BBCs, counter claims against CCG, and third-party claims against Robert Sauls, CCG's founder and Chief Executive Officer, and Sam Stark,

[3] On February 19, 2002, Fleet filed a motion to dismiss CCG's complaint. After reviewing the briefs and conducting a hearing on the motion, the court granted Fleet's motion to dismiss with respect to CCG's allegation that Fleet engaged in unfair and deceptive trade practices. However, the court denied Fleet's motion to dismiss the breach of contract and violation of the duty of good faith and fair dealing counts of CCG's complaint.

CCG's Chief Financial Officer. The court dismissed Fleet's third party complaint on December 9, 2002.

On February 14, 2005, after extensive discovery, Fleet filed this Motion for Summary Judgment on CCG's claims of breach of contract and violation of the duty of good faith and fair dealing. For the first time, Fleet alleged that CCG violated the Finance Agreement by changing the structure of its business without Fleet's prior written consent.

Choice of Law

Initially, the court notes that the resolution of Fleet's Motion for Summary Judgment requires the court to interpret the Finance Agreement. The Finance Agreement provides that Pennsylvania law will govern the agreement. Neither party disputes the validity of this clause. As such, the court must apply Pennsylvania law when interpreting the Finance Agreement; however, the court will apply federal law when deciding procedural matters.

Discussion

The standard for summary judgment is set forth in Fed. R. Civ P. 56, which is made applicable to this proceeding by Bankruptcy Rule 7056, and provides that the movant will prevail on a motion for summary judgment if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). See also Celotex Corp. v. Catrett, 477 U.S. 317 (1986). In considering a motion for summary judgment, the court is required to view the facts and draw reasonable inferences in a light most favorable to the non-moving party. Anderson v. Liberty

Lobby, Inc., 477 U.S. 242, 255 (1986). The mere existence of a scintilla of evidence in support of the non-movant's position will be insufficient to prevent summary judgment; there must be evidence on which the trier of fact could reasonably find for the non-movant. Liberty Lobby, 477 U.S. at 255; Shaw v. Stroud, 13 F.3d 791, 798 (4th Cir. 1994). While a party moving for summary judgment has the initial burden of showing that no genuine issue of material fact exists and that the moving party is entitled to judgment as a matter of law, once the movant has met this burden, the non-moving party may not rest on its pleadings, but must come forward with specific facts showing that evidence exists to support its claims and that there is a genuine issue for trial. Celotex, 477 U.S. at 323. Trial is unnecessary if "the facts are undisputed, or, if disputed, the dispute is of no consequence to the dispositive question." Mitchell v. Data General Corp., 12 F.3d 1310, 1315-16 (4th Cir. 1993).

Central to this litigation, and Fleet's Motion for Summary Judgment, are Fleet's allegations that CCG violated the Finance Agreement prior to Fleet declaring default under the Finance Agreement. If CCG violated the Finance Agreement prior to Fleet's declaration of default, then CCG cannot recover under its claims in this litigation. However, if CCG did not violate the Finance Agreement, then CCG may be able to recover damages from Fleet.

1. CCG's Preparation of the June and July BBCs

Fleet's first allegation of default by CCG is that CCG's preparation of the June and July BBCs violated § 8.2 of the Finance Agreement. Section 8.2 provides that it will be an event of default on the part of CCG if: "Any financial statement, written information furnished or representation or warranty, certificates, document or instrument made or given by Borrower herein or furnished in connection herewith shall prove to be materially false, misleading, or incorrect." Fleet alleges that the June and July BBCs constitute written information furnished in connection with Finance Agreement that proved to be materially false, misleading, or incorrect. Specifically, Fleet alleges that, by reducing the Unearned Discount by the costs associated with operating the dealerships, CCG fraudulently increased the Amount Available.

CCG contends that the June and July BBCs were prepared in compliance with § 1.2 of the Finance Agreement and, as such, are not in violation of § 8.2. Section 1.2 provides that:

> All accounting terms used herein which are not expressly defined in this Agreement shall have the meanings respectively given to them in accordance with sound accounting practice; all computations made pursuant to this Agreement shall be made in accordance with sound accounting practice. As used in this Agreement, "sound accounting practice" shall mean the use by Borrower of generally accepted accounting principles and practices ["GAAP"]...

CCG argues that, according to § 1.2, GAAP controlled the preparation of the BBCs. CCG states that reducing the Unearned Discount by the costs associated with operating defunct dealerships was done in accordance with GAAP. As such, the June and July BBCs were prepared in accordance with GAAP and, contrary to Fleet's allegations, do not constitute an event of default.

Fleet responds that § 6.2 of the Finance Agreement demonstrates that GAAP does not govern the preparation of the BBCs. Section 6.2 governs CCG's duties to provide financial information to Fleet. The relevant portions of § 6.2 provide that CCG shall deliver to Fleet:

> (1) Within ninety (90) days after the close of each fiscal year, audited financial statement[s] of Borrower's business for the fiscal year then ended consisting of balance sheets, income statements and statements of equity and cash flows of Borrower, if any, as of the end of such fiscal year, all in reasonable detail, prepared in accordance with generally GAAP [sic], including all supporting schedules and comments, compiled by an independent certified public account selected by Borrower and acceptable to Lender;
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> (2) Within thirty (30) days after the close of each calendar month in each fiscal year, Borrower's financial statements, to include a balance sheet

> and income statement subject to year end audit adjustment, all in reasonable detail, prepared in accordance with GAAP, including all supporting schedules and comments, compiled by an independent certified public account selected by Borrower and acceptable to Lender;
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> (3) Within fifteen (15) days of the end of each calendar month, for the prior month, (i) an Availability and Compliance Certificate, Schedule of Receivables and Assignment duly completed; (ii) a report detailing accounts receivable; (iii) a detailed delinquency report; and (iv) such other additional reports requested by Lender, each in detail and format satisfactory to Lender; and
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> …

Sections 6.2(a) and (b) provide that CCG shall furnish yearly and monthly audited financial statements to Fleet. Both sections explicitly require that these statements be prepared in accordance with GAAP. Section 6.2(c) provides that CCG shall furnish a BBC to Fleet within the fifteen days following the end of the prior calendar month. Section 6.2(c) does not mention GAAP or any other standard by which the BBCs should be prepared. Fleet argues that this omission was intentional; the Parties would have included language requiring GAAP to be followed when preparing BBCs, as they did with the yearly and monthly financial statements, if the Parties had intended GAAP to be applicable.

When construing the meaning of a contract, the parties' intent is paramount and the court must interpret the contract in a manner which most closely reflects the intent of the parties. Unit Vending Corp. v. Lucas, 190 A.2d 298 (Pa. 1963). If the contract terms are clear, the court must give effect to the plain language of the contract. Solomon v. United States Healthcare Systems of Pa., Inc., 797 A.2d 346 (Pa. Super. Ct. 2002). Unfortunately, the terms of the Finance Agreement are inconsistent. Section 1.2 requires that all computations performed in connection with the Finance Agreement be done in accordance with GAAP. CCG argues that § 1.2 is clear and should govern the preparation of the BBCs. According to CCG, GAAP validates CCG's accounting practices and, therefore, the BBCs could not constitute an event of default. However, § 6.2(c), as opposed to §§ 6.2(a) and (b), indicates that GAAP is not intended to govern the preparation of the BBCs. Fleet states that the Parties' intent regarding the preparation of the BBCs is clearly evinced by the omission of the GAAP requirement in § 6.2(c). Sections 1.2 and 6.2, when read together, create an ambiguity in the Finance Agreement. Following the reading of either party would require the court to ignore inconsistent terms in the Finance Agreement. As such, the court cannot apply the plain language of the contract.

When the plain language of a contract is unclear or ambiguous, the court may consider extrinsic evidence to determine the intent of the parties. Metzger v. Clifford Realty Corp., 476 A.2d 1, 10 (Pa. Super. Ct. 1984). Pennsylvania courts have long recognized the probative value of industry practice when determining the parties' intent in a contract. See Guillon v. Earnshaw, 32 A. 545 (Pa. 1895). In this matter, each party relies on an expert to establish industry practice and, therefore, what the Parties intended. Fleet's expert, Morris R. Mashburn, stated during his deposition that, despite extensive experience in the sub-prime auto lending industry, he had never seen a loan agreement that allowed the accounting practice that CCG employed when preparing the BBCs. CCG responded with expert testimony from Robert N. Pulliam. Mr. Pulliam disagrees with Mr. Mashburn's opinion and, instead, opines that GAAP does control the preparation of the BBCs. In addition, these experts have conflicting opinions as to whether, if GAAP does control, the BBCs were prepared in accordance with GAAP.

When a material fact is in dispute, summary judgment is not appropriate. Celotex, 417 at 322-23; Mitchell, 12 F.3d at 1315. CCG has demonstrated that there are material facts at issue with regard to the preparation of the BBCs. If the Parties intended the BBCs to be prepared in accordance with GAAP, then CCG could be justified in its accounting practices and Fleet might not be entitled to judgment at trial on this issue. However, if the Parties did not intend GAAP to govern the preparation of the BBCs, then CCG may not be justified in their accounting practices and, as such, Fleet might be entitled to judgment at trial on this issue. CCG has demonstrated that the Parties contest the central fact of this issue: the Parties' intent. It is well accepted that intent is a uniquely factual issue. Agnew v. United States, 165 U.S. 36, 57 (1897); Johnson v. Jones, 515 U.S. 304, 316 (1995); Ford v. Poston, 773 F.2d 52, 55 (4th Cir. 1985). Without determining the intent of the Parties, the court cannot properly interpret the Finance Agreement. The Parties' disagreement as to their intent constitutes a material fact in dispute and forecloses the possibility of summary judgment on this issue. Mellon Bank v. Aetna Business Credit, Inc., 619 F.2d 1001, 1011 (3d Cir. 1980) ("Under Pennsylvania law, ambiguous writings are interpreted by the fact finder…"); Hutchinson v. Sunbeam Coal Corp., 519 A.2d 385, 390 (Pa. 1986) ("A contract is ambiguous if it is reasonably susceptible to different constructions and capable of being understood in more than one sense."). Therefore, when viewing the facts in the light most favorable to CCG, the court cannot find that Fleet is entitled to summary judgment on this issue.

2. Change in Business

Fleet's second allegation of default by CCG relates to alleged changes in CCG's business. On October 16, 2001 Fleet gave written notice to CCG that the loan was in default under, without limitations, Sections 8.2 and 8.3 of the Agreement. Section 8.3 deals with the failure of the Borrower to observe, perform or abide by any covenant, warranty, agreement or provision of the Note or this Agreement.[4] Section 7 of the Finance Agreement contains the negative covenants of CCG. Under § 7, CCG agreed not to take certain actions without the prior written consent of Fleet. Section 7.3 provides that, without Fleet's prior written consent, CCG will not: "Engage in any business other than the business in which it is currently engaged and will not make any material change in the nature of the financings which Borrower extends, including, without limitation, the generality of the foregoing, matters relating to size, type, term, nature and dollar amount." Section 8.3 provides that the CCG's violation of a negative covenant shall constitute an event of default.[5] Fleet alleges that the conversion of the Portfolio from recourse to non-recourse receivables and CCG's operation of failed dealerships constitutes a violation of § 7.3 and, therefore, an event of default under the Finance Agreement.

Fleet bases its claim of default on uncontested items on the record. The first item Fleet relies upon to demonstrate a default is Schedule A to the Finance Agreement. Schedule A, entitled "Current Policies Regarding Purchase of Retail Installment Sales Contracts," provides that, when CCG was purchasing receivables from dealers, CCG would investigate, among other things, the strength of dealer guarantee. Fleet argues that Schedule A shows that, at the time the Finance Agreement was signed, the Parties contemplated that the loans extended by CCG would

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[4] Negative covenants are common features in loan documents. Negative covenants serve a legitimate purpose by assisting lenders in controlling their credit risk after entering into a lending agreement. In re Model Imperial, Inc., 250 B.R. 776, 804 (Bankr. S.D. Fla. 2000).

[5] While the Parties did not argue this point, the court notes that § 8.3 of the Finance Agreement altered the Pennsylvania common law rule regarding the violation of negative covenants in a contract. Without § 8.3 of the Finance Agreement, Fleet would be required to show that CCG's violation of § 7.3 was a material failure to perform the contract. See Lane Enterprises, Inc. v, L.B. Foster Co., 700 A.2d 465, 471 (Pa. Super. Ct. 1997); Oak Ridge Const. Co. v. Tolley, 504 A.2d 1343 (Pa. Super. Ct. 1985). However, the Finance Agreement does not require that the breach of a negative covenant be a material failure to perform. The Finance Agreement provides that CCG's violation of any covenant in the agreement shall constitute an event of default. Absent a showing of fraud or unconscionability, Pennsylvania law will not set aside the terms of a contract that sophisticated parties have agreed upon. John B. Conomos, Inc. v. Sun Co., 831 A.2d 696, 708 (Pa. Super. Ct. 2003). Neither party has alleged fraud or unconscionability in the instant matter and, therefore, the court will not set aside the terms of the Finance

be recourse loans. CCG does not dispute that this was the Parties' intent.[6] In fact, prior to the execution of the present Agreement, CCG had one dealer, Steve's Auto Sales, that requested it be allowed to switch from recourse to non-recourse. So drastic was this request that approval from the Board of Directors was obtained and the Board was quite emphatic that it was only granting approval for this dealer only. (Fleet's Motion for Summary Judgement Ex. 12).

The sworn testimony of the Chief Financial Officer, Sam Stark, provides a clear picture of CCG's operations at the time that it entered into the Finance Agreement with Fleet:

> Q. What was the nature of CCG's business?
> A. CCG purchased loans directly from dealers, not dealing directly with consumers. Purchased them at a discount and then retained those loans in a portfolio and worked those loans out and never sold -- I shouldn't say never, very, very rarely sold those loans. That was the nature of the business.

(Atamian Aff. Ex. 4, Deposition of Sam Stark 24:9-15).

> Q. Who was responsible for collecting the payments from the customer? Was it CCG, the dealer or both?
> A. Both. Since the dealer guaranteed the loan, it was certainly within his great interests to ensure that the customer remained current.

(Atamian Aff. Ex. 4, Deposition of Sam Stark 35:13-18).

> Q. Were you involved in any way in negotiating contracts with the dealers?
> A. There really wasn't a negotiation process. There was really just -- there really was in most instances a standard contract that was dictated to us by the bank.
> Q. And in that standard contract, was there a clause that assigned to either CCG or the dealer the responsibility to collect the loan?

Agreement.

[6] At the hearing on this matter, the court asked all parties to certify that the attachments to the Finance Agreement were accurate copies of the original. The Parties asked for, and received, time to review the documents and make objections. No party made an objection to the validity of the attachments and the court therefore finds that the copies are accurate.

A. I don't recall. I consider that to be a moot question, because again, the dealer, all paper that we purchased from dealers, as mandated by the bank, must be guaranteed by the dealer. There was no option.

(Atamian Aff. Ex. 4, Deposition of Sam Stark 36:7-20).

Q. Do you have an understanding as to why the dealer discounted the loans that CCG purchased?
A. Basically he wanted cash so he could go out and buy another car and sell it.
Q. Did it have anything to do with the credit quality of the loans that were being purchased?
A. Sure. The credit quality of the loans was such that if he was unwilling to hold the paper and collect the funds over this 30 month equivalent period; he had to sell the paper to get cash up-front. In order to get cash for that paper up-front, he had to sell that paper. The worst [sic] the quality of that paper, the greater the discount. Since the bank had always demanded from the outset of the agreement - the bank had always demanded from the outset that our business model was such, that the only paper we could only purchase was guaranteed paper by the dealer, the credit quality of the paper was less rather than more.

(Atamian Aff. Ex. 4, Deposition of Sam Stark 75:21-76:16).

Q. When you say that CCG and Fleet had an agreement that CCG would just take on these recourse dealers, was that an agreement in writing?
A. No. That is not reflected -- that's part of the issue here. The finance agreement, the loan agreement between CCG and Fleet is, of course, not all inclusive in terms of describing exactly the situation as it existed at the outset, and similarly, it didn't provide, which really is no surprise, it didn't provide for any adaptations as a result of changing conditions. So the agreement did not dictate that all paper we purchased was guaranteed, but there is no doubt we received those instructions at the very outset from Paul Cottone. The only paper we were to purchase was paper which was guaranteed by dealer, and as a further indication of the level of involvement between us and Fleet to ensure that the occurred, when Steve's Auto in June of 2000 indicated - again, he was an honest man and indicated I can no longer operate the dealership. I want out of the guarantee and I'm willing to in effect pay to get out of the guaranty. We went directly to Fleet and requested their approval in writing that that wouldn't be an issue with this going forward.

(Atamian Aff. Ex. 4, Deposition of Sam Stark 215:9-216:10).

The sworn testimony of the Chief Financial Officer, Sam Stark, clearly describes a transformation in CCG's operations after the failure of several dealerships, particularly that of

Marshall Leonhardt Auto Sales:

> ...after the economy soured, more and more of the paper became without recourse. The guaranty failed. Until ultimately when Marshall failed in "May of 2001" our business had been transformed not at our request, not due to our action, but our business had simply been transformed as a result of the economy from one in which we were simply equivalent to Bank of America in which they ultimately had no obligation, but were lending money, to one in which we now in effect became the manager of a number of dealerships...So basically what happened as a result of Marshall, in May the business was transformed and we now became one in terms of collecting the collateral an operator of a number of dealerships.

(Atamian Aff. Ex. 4, Deposition of Sam Stark 82:8-83:17).

> Well, first of all, in terms of how would we operate all these dealerships? What would the cost be involved in operating all of these dealerships? What would happen if we didn't operate those dealerships. The best way I would characterize it is, again, you are looking at a situation in which our business was completely transformed. We went from a situation where we were a bank to one in which we are now responsible for the nitty-gritty detailed operations of each of these dealerships. So it couldn't be more transforming. It would be akin to Bank of America next door here lending money and suddenly being in a position of which they are in all the time in terms of work-out where they have to operate this business, that business, this business.....basically what happened is our paper which as mandated by the bank are [sic] being fully guaranteed by the dealer, as it stood now the majority of our business was really completely subject to the credit and operational risk of each and every dealership.

(Atamian Aff. Ex. 4, Deposition of Sam Stark 229:16-231:17). As a result of this transformation, CCG incurred huge costs. When asked about CCG's operations after several dealers had gone under and CCG had taken over the operation of these businesses, Stark responded that:

> ...direct costs which were incurred by Charlotte Commercial Group to operate failed dealerships in which the dealer was no longer willing to honor his guaranty and operate the dealership, were now taken over by Charlotte Commercial Group. We incurred whatever direct expense was economical to incur to operate the

> dealership to liquidate the portfolio to the greatest extent possible, which included the payment of salaries. It included the payment to collect and repossess autos. It included the payment to repair autos and included, of course, whatever was necessary to refurbish the car, which was the last line of defense in terms of collateral and resell that car back to a customer to use that funds to offset the fail of the loan contact.

(Atamian Aff. Ex. 4, Deposition of Sam Stark 229:16-231:17).

Throughout his deposition, Stark refers to the "massive change" and "transformation" of CCG's business. CCG does not dispute the accuracy of Stark's testimony. While disagreeing with the conclusions drawn by Fleet, CCG has not taken any measure to dispute the facts that Stark's testimony establishes.

The second deposition relied upon by Fleet is that of Robert Sauls. Sauls was the founder, Chief Executive Officer, and majority shareholder of CCG. In his deposition, Sauls recounted the same story as Stark. Sauls testified at length to the change in the nature of the receivables and operations of CCG. On each material point, the testimony of Sauls and Stark agree. Sauls is adamant that CCG only had a recourse portfolio:

> Q. Is it true that dealers can enter into non-recourse arrangements with companies like CCG?
> A. No.
> Q. They cannot?
> A. No. They can enter into non-recourse arrangements with other companies, but not CCG.

(Atamian Aff. Ex. 4, Deposition of Robert Sauls 121:3-8).

CCG presented two responses to Fleet's allegations that CCG violated § 7.3 of the Finance Agreement by altering its business. CCG's first response is procedural: that Fleet did not allege a default under § 7.3 in its Answer and, therefore, the defense is waived. The court finds that this contention is without merit. Fleet's first allegations that CCG violated § 7.3 of

Finance Agreement were contained in Fleet's Motion for Summary Judgment. The Fourth Circuit, as CCG itself noted in its brief, has repeatedly held that, absent unfair surprise, a defendant's affirmative defense is not waived when the defense is first raised in a pre-trial dispositive motion. Brinkley v. Harbour Recreation Club, 180 F.3d 598 (4th Cir. 1999); Peterson v. Airline Pilots Ass'n, 759 F.2d 1161 (4th Cir. 1985). However, when a defendant's pleading of an affirmative defense denies the plaintiff an opportunity to respond, the court must not allow the defense. Brinkley, 180 F.3d at 613. CCG had ample opportunity to respond to Fleet's allegation that CCG violated § 7.3 of the Finance Agreement. Indeed, CCG responded directly to the allegation by raising this issue. As such, the Court can find no prejudice to CCG by allowing Fleet to assert this defense.

CCG's second response to Fleet's allegations that CCG violated § 7.3 is that its operation of the dealerships was not a change in the nature of its business. CCG does not argue that the testimony or documentation relied upon by Fleet is inaccurate. Rather, CCG stated that, in the context of the sub-prime automobile lending industry, its actions were normal. Despite having ample time to review the facts and allegations presented by Fleet, CCG introduced no evidence to support their arguments. Instead, CCG relied solely upon the arguments of counsel. Such arguments, regardless of their quality, are not enough to prevent summary judgment in favor of Fleet. When the moving party has shown that there are no material facts at issue, the non-moving party must respond with specific evidence demonstrating facts that support the non-moving party's claims and showing that there is a genuine issue of material fact. Celotex, 477 U.S. at 323. The non-moving party cannot "create a genuine issue of material fact through mere speculation or the building of one inference upon another." Harleysville Mut. Ins. Co. v. Packer, 60 F.3d 1116, 1120. In the absence of pointing to a specific fact on the record, CCG's arguments that its business activities are typical in the sub-prime automobile lending industry do not demonstrate a genuine issue of material fact.

The undisputed facts support a finding that, at the time that the parties entered into the Finance Agreement, CCG's business was limited to purchasing recourse loans from automobile dealers. The failure of numerous automobile dealerships resulted in a change in the nature of CCG's business, including the conversion of the Portfolio from recourse to non-recourse receivables and CCG's operation of failed dealerships.

Taken together, the depositions of Stark and Sauls paint a clear and undisputed picture of CCG's operations from late 2000 to July 2001. CCG, due to the failures of the obligor dealers, faced previously uncontemplated levels of risk in its Portfolio.[7] As the Finance Agreement shows, the Parties did not anticipate this level of risk when the Finance Agreement was signed. In short, the nature of the receivables in the Portfolio changed from one where other entities, namely the dealerships, bore all risk, to one where CCG bore the majority of the risk. In addition to this increased risk, CCG's costs were increasing dramatically. CCG's assumption of the operations of the defunct dealerships was a significant change in CCG's business model. As opposed to operating as a lending institution, the majority of CCG's operations were that of an automobile dealer, including making loans directly to consumers when reselling repossessed collateral. CCG's officers describe the changes in CCG's operations in detail. Despite filing an

[7] Although one dealership, Steve's Auto Sales, negotiated a release from its recourse obligations, the level of risk in the Portfolio changed dramatically between October 11, 2000 and August 27, 2001. When the Parties entered into the Finance Agreement, non-recourse paper constituted less than five percent of the Portfolio. When Fleet declared default, non-recourse paper constituted over half of the Portfolio. Further § 9.3 of the Finance Agreement provides that "Neither failure nor any delay on part of Lender to exercise any right, power or privilege, under the Note or the Agreement shall operate as a waive thereof."

extensive response to Fleet's Motion for Summary Judgment, CCG could not identify a material fact that was in dispute with regard to the changes in CCG's operations or the increased level of risk in the Portfolio. Given the undisputed testimony of CCG's officers, the court finds that CCG entered into a business in which it was not engaged as of October 11, 2000. The court finds that CCG entered into this business prior to August 27, 2001. Further, the court finds that, after October 11, 2000 but prior to August 27, 2001, there was a material change to the nature of the financings that CCG extended. According to the terms of the Finance Agreement, both of these changes violated § 7.3 of the Finance Agreement.[8] Pursuant to § 8.3 of the Finance Agreement, the violation of § 7.3 constitutes an event of default. Therefore, the court finds that Fleet was justified in declaring default under § 8.3 of the Finance Agreement.[9]

Given the court's findings with regard to CCG's violation of the Finance Agreement, the court finds that, even when viewing the facts in the light most favorable to CCG, CCG is not entitled to recover under its claims in this litigation. Fleet did not breach the contract when it

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[8] The court finds that the language of § 7.3 prohibited CCG from making a material change in the financing it offered, including altering the recourse status of the financing. If the court were not convinced that § 7.3 prohibited the conversion of the financing from recourse to non-recourse, the court would look to see if the contract contained an implied prohibition against CCG offering non-recourse financing. When one party asserts that a contract contains an implied prohibition against an activity, that party must meet a very high standard of proof before a court will imply that prohibition. Burlington Industries, Inc., v. Solutia, Inc., 256 F.Supp.2d 433, 438 (M.D.N.C. 2003).

> "As a general rule, covenants may only be implied into an integrated agreement 'when the implied term is not inconsistent with some express term of the contract and where there arises from the language of the contract itself, and the circumstances under which it was entered into, an inference that it is absolutely necessary to introduce the term to effectuate the intention of the parties.'"

Id. (quoting *Williston on Contracts*, § 1295 at 34-36 (1968)). In this matter, if the court were to assume that § 7.3 did not prohibit the alteration of the recourse status of the financing offered, the court would find that the conditions for implying a prohibition against non-recourse lending were present. First, implying such a term is not inconsistent with any other term of the Finance Agreement. Second, given the language of the contract, the schedules attached to the contract, the evidence on the record, and the testimony of CCG's officers, the court would find that implying a prohibition against non-recourse financing would be absolutely necessary to effectuate the intent of the parties. As such, regardless of the court's finding in relation to § 7.3 of the Finance Agreement, the court would find that CCG had breached an implied prohibition of the Finance Agreement.

[9] The Finance Agreement did not provide either party with an opportunity to cure any default under the Agreement.

sent the August 27, 2001 that declared that CCG was in default under the Finance Agreement. As such, there is no breach for which CCG may recover. Additionally, as the court has found that Fleet was justified in declaring that CCG was in default under the Finance Agreement, CCG cannot recover under its claims of breach of duty of good faith and fair dealing.

It is therefore ORDERED, ADJUDGED, and DECREED that Fleet's Motion for Summary Judgment is hereby GRANTED.

July 6, 2005

Catharine R. Carruthers

UNITED STATES BANKRUPTCY JUDGE