Rescission
Economic Duress

Sequoia Partners v. Rogue River Mtg., Adversary No. 10-6270-fra
Seqouia Partners, LLC, Case No. 10-67547-fra7

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Debtor was developing a golf course and condominium resort in southern Oregon which was being financed largely by Rogue River Mortgage (RRM), which obtained individual loans from investors to be used for construction of the project. Debtor defaulted on the loans, and construction liens were thereafter placed against the property. To provide a chance to obtain outside funding to complete construction of the project, Debtor and RRM entered into a Stand Still Agreement by which RRM agreed to not foreclose against the property for 18 months and Debtor agreed to transfer certain lots of real property to RRM, subject to re-transfer if the terms of the Agreement were complied with. Debtor was ultimately unable to meet the requirements of the Stand Still Agreement and filed for bankruptcy under chapter 11, two days prior to the expiration of the 18-month Stand Still Agreement.

Debtor filed an adversary proceeding against RRM seeking, among other things, rescission of the Stand Still Agreement, which Debtor claimed was entered into under financial duress. RRM filed a motion for summary judgment with respect to the claim for rescission. Eventually Debtor converted the bankruptcy case to chapter 7, and the Trustee succeeded as Plaintiff.

The Court examined Oregon law and the evidence submitted and held that Plaintiff had not made a *prima facie* case for either economic duress or rescission. RRM's motion for summary judgment was granted.

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

IN RE SEQUOIA PARTNERS, LLC, Debtor.	Bankruptcy Case No. 10-67547-fra7
SEQUOIA PARTNERS, LLC Plaintiff, vs. ROGUE RIVER MORTGAGE, LLC, *et al.*, Defendants.	Adversary Proceeding No. 10-06270-fra
ROGUE RIVER MORTGAGE, LLC, *et al.*, Counterclaim Plaintiffs, vs. SEQUOIA PARTNERS, LLC, *et al.*, Counterclaim Defendants.	MEMORANDUM OPINION

BACKGROUND

Sequoia Partners, LLC (Sequoia) was the developer of a commercial real estate project in Josephine County known as Paradise Ranch Resort and Planned Community ("Paradise Ranch"). Its plans included an 18-hole golf course and visitor-oriented accommodations, restaurant, convention and meeting center, pro

shop, retail building, swimming pools, tennis courts, spa and fitness center, 100 overnight accommodations and 200 single family dwellings.

A deed of trust was recorded in favor of Rogue River Mortgage (RRM) to secure $5 million in loans from RRM to Sequoia. Over time, the loan balance was increased and was about $13.4 million as of August 2008. The loan agreement provided that once a final plat was obtained for the development, the individual lenders' liens (liens for loans obtained through RRM from third parties) would be assigned to individual lots in the Paradise Ranch property.

An Operating Agreement for Construction Loan and Security between Sequoia and RRM and Carling of America, Ltd., as Construction Manager and General Contractor was entered into in order provide assurance to the County that the project would be completed. The Operating Agreement, dated September 2, 2008, provided that RRM would loan Sequoia or assist Sequoia in obtaining loans from "Third Party Lenders" up to $25 million to complete the specific projects as required by Josephine County's Decision of Approval. In a letter dated August 29, 2008 from Sequoia's attorney containing a draft of the Operating Agreement, he stated that "[r]ather than provide for a $25,000,000 note to RRM, which we know will not represent an actual loan from RRM, I have created a blanket deed of trust to cover all of RRM's and the third party lenders' responsibilities, up to $25,000,000."

After the county approved the project and the final plat was recorded, RRM facilitated an additional $3,450,000 in loans from individual lenders between September 15, 2008 and December 18, 2008. Pursuant to the Operating Agreement and the Loan Agreement for the June 28, 2007 trust deed, trust deeds for individual lenders were recorded against individual lots and RRM recorded a partial reconveyance of RRM's $5 million deed of trust as to the those lots.

Beginning in December 2008, a number of construction liens were recorded against the project which, according to RRM, prevented it from facilitating any new loans from individual lenders. Lenders were concerned that despite having obtained more than $3 million in new loans between September and December 2008, vendors were not being paid. Moreover, lot sales were not being made and, beginning in January 2009, Sequoia had stopped making monthly interest payments on the $5,000,000 and $1,000,000

notes and deeds of trust and had failed to provide an accounting to RRM and the individual lenders. In a letter to Sequoia's attorneys dated April 30, 2009, Sequoia's attorney disclosed that Sequoia's related entity Carling of America, Ltd. had filed a construction lien in an amount just under $8.2 million to protect its interest in a possible foreclosure by the investor group. RRM states that it was impossible to raise any additional funds from lenders after this construction lien filing as Sequoia could not obtain title insurance to insure the individual deeds of trust as first liens and the first lien status of previously recorded individual trust deeds was now called into question.

Sequoia counters that none of the post-final plat funds raised by RRM through individual lenders was deposited into the various construction trust accounts as required by the Operating Agreement, while RRM states that those funds were obtained for operating costs and, pursuant to the Operating Agreement, were not required to be placed in a construction trust account. In any case, RRM stopped funding the project in January 2009 and Sequoia was in default under the terms of its obligations to lenders.

After some negotiation, Sequoia, Carling of America, and RRM entered into a Stand Still Agreement on July 2, 2009 by which the parties agreed that RRM had made loans through itself or individual lenders to Sequoia in the principal amount of $17,980,000 which were evidenced by various promissory notes and deeds of trust, with a current balance due of $18,841,924. Sequoia acknowledged that it was in default under the terms of the notes and deeds of trust and that there were no legal or equitable defenses preventing the Lender from foreclosing. In exchange for Lender forbearance from exercising its foreclosure rights against the project, Carling agreed to release its construction lien and Sequoia agreed to execute and deliver to Lender's designee and affiliate, Paradise Ranch Land Development, LLC (PRLD), a bargain and sale deed conveying the residential lots covered by the trust deeds. Sequoia would thereafter be entitled to buy back the lots for an agreed price if it was not in default of the Agreement. By December 31, 2010, Sequoia was required to complete certain specified construction work, for which it was required to obtain its own financing, and thereafter was required to pay off Lender's debt in specified installments.

Sequoia was unable to obtain financing to complete the work required by the Stand Still Agreement and filed for bankruptcy protection on December 29, 2010, two days prior to the deadline contained in the

Stand Still Agreement; this Adversary Proceeding was filed on December 30, 2010. Defendant RRM filed a motion for summary judgment on that part of Plaintiff's First Claim for Relief in which it seeks a declaration from the court that, as a result of economic duress, the Stand Still Agreement should be rescinded, and for summary judgment on Defendant's Second Affirmative Defense alleging that Plaintiff failed to commence an action to rescind within a reasonable time of the complained of actions and had further ratified the Agreement by accepting the benefits thereof.

Subsequent to the filing of Defendant's motion for summary judgment, the Plaintiff's bankruptcy case was converted from chapter 11 to chapter 7 and a trustee appointed to liquidate the estate. The Trustee succeeded to the role of Plaintiff in this action. A hearing was held on June 19, 2013 and the matter was taken under advisement.

SUMMARY JUDGMENT

Summary judgment is appropriate when the pleadings, depositions, answers to interrogatories, admissions, and affidavits, if any, show that there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Fed.R.Civ.P. 56, made applicable by Fed.R.Bankr.P. 7056. The movant has the burden of establishing that there is no genuine issue of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). The court must view the facts and draw all inferences in the light most favorable to the nonmoving party. *T.W. Elec. Serv., Inc. v. Pac. Elec. Contractors Ass'n*, 809 F.2d 626, 630-31 (9th Cir. 1987). The primary inquiry is whether the evidence presents a sufficient disagreement to require a trial, or whether it is so one-sided that one party must prevail as a matter of law. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247 (1986).

A party opposing a properly supported motion for summary judgment must present affirmative evidence of a disputed material fact from which a fact finder might return a verdict in its favor. *Anderson v. Liberty Lobby, Inc.* at 257. Fed.R.Bankr.P. 7056, which incorporates Fed.R.Civ.P. 56(e), provides that the nonmoving party may not rest upon mere allegations or denials in the pleadings, but must respond with specific facts showing there is a genuine issue of material fact for trial. Absent such response, summary judgment shall be granted if appropriate. *See Celotex Corp. v. Catrett*, 477 U.S. 317, 326-27 (1986).

DISCUSSION

A. Economic Duress

To prove economic duress, an aggrieved party must establish the following three elements: "(1) wrongful acts or threats; (2) financial distress caused by the wrongful acts or threats, and (3) the absence of any reasonable alternative to the terms presented by the wrongdoer." *The Oregon Bank v. Nautilus Crane & Equipment Corp.*, 68 Or.App. 131, 142-43, 683 P.2d 95 (1984). However, a threat to do something which a person has a legal right to do does not constitute economic duress. *Id.* at 143. The threat of foreclosure could therefore not be a cause of duress in this case, as Defendant had the legal right to foreclose at the time the Stand Still Agreement was executed.

A "wrongful act" attributed to Defendant is the Defendant's failure to fully fund the construction project as contemplated in the Operating Agreement. "In order to void a contract on the basis of economic duress, the wrongful act or threat must deprive the victim of his unfettered will." *Hungerman v. McCord Gasket Corp.*, 189 Mich.App. 675, 677, 473 N.W.2d 720 (1991). "To establish a *prima facie* claim for economic duress sufficient to withstand summary judgment, a party must present concrete evidence of the particular factors depriving him of his free will and giving him no reasonable alternative. A party must also show that he was coerced by the wrongful conduct." *Pittard v. Great Lakes Aviation*, 2007 WY 64, 156 P.3d 964, 975 (2007). RRM presented evidence that it could not continue to fund the project after Sequoia defaulted and liens were placed on the property. Plaintiff counters with an unsubstantiated allegation by a principal of Sequoia that RRM's plan was to take over the project for its own financial gain. This is not sufficient to establish a material issue of fact to overcome the motion for summary judgment.

Copies of e-mails and other correspondence between the attorneys for Sequoia and RRM in negotiating the terms of the Stand Still Agreement were provided in Defendant's submissions. They evidence a deliberative process in arriving at terms acceptable to both sides and, while the parties were under pressure to reach an agreement in order to complete the project, they do not provide evidence of economic duress. Sequoia's attorney approved the final terms of the Agreement in which the parties agreed at ¶ 15 that

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they were aware of the terms and effects of the Agreement, that they entered into the Agreement freely, and that such execution and delivery was not the result of duress.

While it is true that the Operating Agreement provided that RRM would loan or assist Sequoia in finding third-party lenders to fund construction up to $25 million, it is clear from the evidence submitted that Plaintiff knew that RRM itself would not actually be making a loan to Sequoia in that amount, but would be obtaining the funds from third-parties. Whether the failure to fully fund the project pursuant to the Operating Agreement constituted a breach of contract, or was justified under the circumstances, would be more appropriately considered in a legal claim seeking damages for breach of contract, as Plaintiff's Second Claim for Relief in this action seeks to do. There was no credible evidence presented by Plaintiff as to why such a breach of contract action, combined with injunctive relief to prevent foreclosure, was not a reasonable alternative to entering into the Stand Still Agreement. Plaintiff argues in its response to the Defendant's motion that there was no alternative to the Stand Still Agreement because RRM had overencumbered the real property with a $25 million trust deed which it had not funded and which prevented Plaintiff from obtaining outside lending. However, the evidence shows that it was Plaintiff's attorney which chose to encumber the property with a $25 million trust deed, before actual funding had occurred, as part of the plan to induce the County to sign off on the project.

B. Rescission

A party seeking rescission of a contract must establish entitlement by "clear and convincing evidence." *Venture Properties v. Parker*, 223 Or.App. 321, 350, 195 P.3d 470 (2008). That party "must act promptly to disaffirm the contract. *First Western Mortg. Co. v. Hotel Gearhart, Inc.*, 260 Or. 196, 202, 488 P.2d 450 (1971).

> He cannot retain the fruits of the contract awaiting future development to determine whether it will be more profitable for him to affirm or disaffirm it. Any delay on his part, and especially his remaining in possession of the property received by him under the contract, and dealing with it as his own, will be evidence of his intention to abide by the contract.

Id. See also Engelking v. Field, 268 Or. 537, 522 P.2d 493 (1974)(suit for rescission must be brought promptly after the plaintiff has knowledge of the facts constituting the grounds for rescission). Plaintiff

points to *McDonald v. Shore*, 285 Or. 151, 590 P.2d 218 (1979) in arguing that delay alone does not constitute a waiver of the right to rescind a contract; that there must be other extenuating circumstances. *McDonald*, however, is inapposite with regard to the facts of this case. In *McDonald*, the plaintiffs gave notice to rescind a contract to purchase a grocery store within four and one-half months after executing the contract, after learning of undisclosed problems with the sewer connection, bad merchandise, and the misrepresentation of profit. The vendor rejected the vendees' offer to rescind and the vendees thereafter stayed on at the store for a time and continued to operate it in order to protect both the vendor's and vendees' interests in the operation. The court held that under the circumstances, four and one-half months from execution of the contract was not an unreasonable time to rescind or to have discovered the misrepresentations made. The court also held that the plaintiffs' conduct in staying on at the store was not inconsistent with an intention to promptly rescind the contract, as the "rule is that once defendants rejected plaintiff's offer to rescind, the plaintiffs may, but need not, abandon the property." *Id.* at 157.

In the present case, Plaintiff entered into the Stand Still Agreement and waited 18 months before filing bankruptcy and seeking rescission. The parties now accuse each other of violating the Stand Still Agreement, as well as the Operating Agreement. Plaintiff argues that a letter sent from Sequoia's attorney to the Defendant's attorney on September 28, 2009, which states that Defendant had not complied with the terms of the Operating Agreement requiring Defendant to subordinate its lien to that of an outside lender[1], provided sufficient notice to Defendant for purposes of rescission. However, the letter did not seek rescission and the parties continued to work together under the Stand Still Agreement. The letter does not constitute an offer to rescind the contract, but, rather, the Plaintiff continued to work under the Stand Still Agreement and to enjoy its benefits, i.e. Defendant's forbearance in instituting foreclosure proceedings. Under the circumstances of this case, 18 months does not constitute a prompt disaffirmance of the contract.

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[1] Defendant thereafter complied with the subordination.

CONCLUSION

For the reasons stated, the Court finds that there are no outstanding issues of material fact and that Plaintiff has not established a *prima facie* claim for economic duress or that it is entitled to rescission of the Stand Still Agreement. Accordingly, Defendant's motion for partial summary judgment with respect to Plaintiff's claim for rescission and on its Second Affirmative Defense will be granted. Counsel for Defendant should submit a form of order to the court consistent with this Memorandum Opinion.

FRANK R. ALLEY, III
Chief Bankruptcy Judge