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Please note:

This sample document is redacted from an actual research and writing project we did for a customer some time ago. It reflects the law as of the date we completed it. Because the law may have changed since that time, please use it solely to evaluate the scope and quality of our work.

If you have questions or comments, please contact Jim Schenkel at 415-553-4000, or email [info@quojure.com](mailto:info@quojure.com).

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## FACTS

On June 1, 2000, borrower gave lender a promissory note under which he promised to repay \$10 million over fifteen years. The original interest rate was 5.91%; Paragraph 7 called for renegotiation of the interest rate after three years. Lender was to propose in writing a new rate at least ninety days before the three-year anniversary of the first payment, or August 1, 2003. Within thirty days borrower was required to accept the new rate in writing. If borrower did not accept the renegotiated rate, all unpaid principal and interest would become due, with no prepayment premium. If borrower accepted the renegotiated rate, he was to pay lender's reasonable attorney's fees for preparing the necessary documents, and to execute any necessary documents assuring lender a continued first lien.

Paragraph 8 called for similar renegotiations after six, nine, and twelve years. Paragraph 9 allowed prepayment of principal on the interest renegotiation dates. Otherwise, borrower could prepay only after giving written notice and paying a prepayment premium.

On April 1, 2003, lender notified borrower that, in accordance with the stipulated renegotiation, the interest rate was increasing to 6.25%. Lender further stated that “[a]ll other terms, covenants, and conditions of said Note and Deed of Trust shall remain unchanged.” Borrower was to accept the note by signing the bottom of it and thereby certifying that lender's first position was protected. On acceptance, borrower was to contact lender's counsel, who would prepare the

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necessary documents and charge him appropriately. In a separate paragraph, lender stated that if borrower did not accept this proposed rate, then the remaining balance would be due August 1, 2003, with no prepayment premiums. On the other hand, “[i]f you do accept this new rate, your right to prepay this loan without premium is hereby waived until the next interest rate renegotiation date on July 1, 2000.”

On June 28, borrower accepted the new rate by signing the bottom of lender’s letter. But on June 6, borrower told lender through counsel that it would not accept the new rate and would instead pay the balance, with no prepayment premium. Borrower stated that his earlier acceptance was signed in error, creating no obligation on his behalf. Borrower further stated that he revoked the letter.

### **ISSUE**

May borrower prepay the loan obligation now without premium after having agreed to the new rate?

### **SUMMARY**

Yes. The last sentence of the April 1 letter does not change borrower’s ability to prepay under the promissory note. The note does not make rejection of the prepayment terms a condition precedent to repayment.

### **DISCUSSION**

Whether borrower agreed to waive the right to prepay in 2003 depends on whether the terms of the original note required him to prepay. A contract must be interpreted to give effect to the parties’ mutual expressed intent. *Ben-Zvi v. Edmar Co.* (1995) 40 Cal.App.4th 468, 473. In this case, the April 1 letter was expressly intended to change only the interest rate, not any of the note’s other terms. But the

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final sentence appears to state that, by accepting the new rate, borrower would waive the right to prepay without premium for three years. If the note itself does not prohibit payment in full after acceptance of the new terms, then this provision is ambiguous because it contradicts the contract's express purposes.

Various rules of interpretation shed light on the ambiguity. First, interpretation should, insofar as reasonably practicable, give effect to every provision of the contract. Civ. Code §1641; *Beverly Hills Oil Co. v. Beverly Hills Unified School District* (1968) 264 Cal.App.2d 603, 610. But construing this provision to allow borrower to prepay without penalty would not render it meaningless. Rather, the sentence implicitly states that borrower would waive the right to prepay without penalty by accepting the terms of the loan and continuing to pay beyond August 1.

Other rules of interpretation support this conclusion. First, the contract is to be read as a whole. Civ. Code §1641. Every provision of the April 1 letter is consistent with the note. It states the new interest, states what is required to assure the lender of its continuing adequate security, and states that the borrower must contact the lender's lawyer and pay his fees. The final paragraph has two sentences. The first informs borrower that, if he rejects the new terms, he must pay by July 1, without penalty. The second sentence is the one in question.

Under the rule of *noscitur a sociis* (it is known by the company it keeps), words or phrases in a series assist the interpretation of other words or phrases combined with it in the series. 3 CORBIN ON CONTRACTS (1960) §552, at 203; see *Smedley Co. v. Employers Mutual Liability Ins. Co.* (1956) 143 Conn. 510, 123 A.2d 755, 758. Thus, that paragraph's first sentence was merely declaratory of borrower's existing rights. It would make sense that the second would be, too, unless the letter stated otherwise. This rule's force may easily be overcome by evidence of words and circumstances indicating a contrary intention. 3 Corbin, *supra*, at 206. But no words

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or circumstances here overcome the inference.

Even if any did, borrower could always fall back on the interpretation against the drafter. 3 Corbin, *supra*, §559, at 265-268. This rule is applied only as a last resort. *Id.*, at 268; *Mogil v. California Physicians Corp.* (1990) 218 Cal.App.3d 1030, 1040 (even an adhesion contract is interpreted against the drafter only if the established rules of interpretation do not successfully remove the uncertainty). But here, it shows that lender's interpretation would fail.

This analysis shows only that the April 1 letter imposes no obligations on borrower not found in the original contract, not that borrower has the right to prepay without penalty after accepting the new rate. But the contract itself implies that. Section 4, which contains the rate renegotiation provisions, states that, on declining the rate renegotiation, borrower must prepay without penalty. Section 7 states, “Prepayment of the principal shall be permitted without premium on the interest renegotiation dates, in whole or partial payment. Otherwise [borrower may prepay, with a penalty.]” The first sentence of section 9 does not refer to or incorporate section 7. If the contract is read as a whole, borrower’s ability to prepay does not depend on his rejection of the renegotiated rate.

A second reason the right to prepay without premium is not dependent on rejection of the renegotiated rate is that section 9 allows prepayment “in whole or in partial payment” on the interest renegotiation dates. Borrower cannot reject the new interest rate and then make a *partial* prepayment. Under section 7, if borrower rejects the renegotiated rate he must pay the entire outstanding principal and accrued interest. A partial repayment must therefore depend on borrower’s accepting the new interest rate. But the contract does not differentiate between repaying partially on acceptance of the new rate and repaying the entirety only on rejection of it. Rather, the note must allow repayment on the renegotiation dates regardless of whether

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borrower has agreed to the new interest rate.

In order to ensure that other borrowers who have signed similar notes cannot, in the future, pull out of a renegotiated loan without penalty, lender can insert the following language in its renegotiation letters:

If you accept this proposed new rate, you waive your right to prepay this loan without premium until the next interest rate renegotiation date.

Regardless of any rights stated or implied in the note, you shall then have no right to prepay without premium on or before the August 1, 2003, interest renegotiation date, or at any time until July 1, 2006.

This specific phrasing would overcome the first paragraph's general statement that the letter did not alter any of the note's terms. (Deleting that earlier sentence would render the letter clearer still.)

In future notes, lender should change the first sentence of section 9 to incorporate section 7, as follows:

Prepayment of the principal shall be permitted without premium on the interest renegotiation dates in partial payment or, on borrower's rejection of the renegotiated interest rate, in full.

## **CONCLUSION**

Borrower is not liable because he is acting within the agreement's terms.