IN THE
ARIZONA COURT OF APPEALS
DIVISION ONE

SUNRISE BANK OF ARIZONA, *Plaintiff/Counterdefendant/Appellee*,

v.

BUILDING DEVELOPMENT SYSTEM, L.P., an Arizona limited partnership; LANCE HERNDON and DONNIS J. HERNDON, individually and as husband and wife; RAY PALMER; ERIC NICHOLS and DANIELLE NICHOLS, individually and as husband and wife; FREDERICK G. JAMES and MARGARET L. JAMES, individually and as husband and wife; THOMAS R. FORD and TARA-LYN FORD, individually and as husband and wife,
Defendants/Counterclaimants/Appellants.

No. 1 CA-CV 12-0706
FILED 12-26-2013

Appeal from the Superior Court in Maricopa County
No. CV2008-024712
The Honorable John R. Ditsworth, Judge

AFFIRMED

COUNSEL

Jaburg & Wilk, PC, Phoenix
By David L. Allen, Laura Rogal

Counsel for Plaintiff/Counterdefendant/Appellee

The McBride Law Firm, PC, Scottsdale
By Melanie G. McBride

Counsel for Defendants/Counterclaimants/Appellants

MEMORANDUM DECISION

Acting Presiding Judge Patricia K. Norris delivered the decision of the Court, in which Judge Kenton D. Jones and Chief Judge Diane M. Johnsen joined.

N O R R I S, Judge:

¶1 This appeal arises out of an action for breach of contract and judicial foreclosure brought by Sunrise Bank of Arizona against its borrower Building Development System, L.P. and that company's partners and their spouses as personal guarantors (collectively, "BDS"). As we discuss, each side accused the other of non-performance of their obligations under a series of agreements consisting of a construction loan agreement, promissory note, deed of trust, and commercial guaranties. After a 13-day bench trial, the superior court found in favor of Sunrise and rejected, as relevant here, BDS's arguments that Sunrise had anticipatorily repudiated the loan by wrongfully refusing to fund. On appeal, BDS argues the superior court "rewrote the terms" of the loan and ignored controlling precedent by ruling in favor of Sunrise. We disagree and affirm.

FACTS AND PROCEDURAL BACKGROUND

¶2 In January 2008, the parties entered into a construction loan agreement ("loan agreement") whereby Sunrise agreed to loan BDS $1,774,000 ("loan amount") for it to use to construct a commercial office building ("the project") with the loan proceeds to be disbursed based on draw requests submitted by BDS.

¶3 The loan, secured by a deed of trust on the property, closed on January 8, 2008. Shortly thereafter, on January 18, 2008, Sunrise asked BDS for an Assignment of Construction Contracts ("contractor assignment"). At trial, both parties presented evidence the contractor assignment is a common document in construction lending. If the borrower defaults, the contractor assignment allows the lender to require a borrower's general contractor to complete a project. Accordingly, Sunrise requested BDS to have its general contractor execute the assignment.

¶4 Sunrise funded early draw requests totaling $630,978.16, which included the land payoff of $570,000, during the month of January without delay. Sunrise's loan officer prepared a draw schedule using preliminary estimates for the project's cost provided to him by BDS. A draw schedule breaks up actual construction costs and other costs associated with a project and is an internal document a lender follows for funding as a project progresses.

¶5 On February 22, 2008, the loan officer met with Lance Herndon and other members of BDS.[1] During that meeting, the parties discussed three items "missing" from the draw schedule: the contractor's fee, foreman's fee, and sales tax. These three items totaled $160,000. Although recollections from and testimony about the meeting differ, the loan officer testified at trial that before the loan closed, Herndon had told him the contractor's fee and foreman's fee could be deferred until later in the project. The loan officer admitted, however, that he inadvertently left off the sales tax when he prepared the draw schedule.

¶6 After the meeting, the loan officer revised the draw schedule to include the three items missing and made other adjustments.[2] The cost of constructing the project, as shown on the revised draw schedule, totaled $1,869,131. Shortly thereafter, Thomas Ford, another BDS partner, made minor changes to the draw schedule and returned it to the loan officer. Ford's changes increased the cost of construction to $1,870,570.

¶7 After the loan officer and Ford revised the draw schedule, the cost of construction exceeded the loan amount. Pursuant to the loan agreement, BDS was required to pay this shortfall to Sunrise within 10 days after demand that it do so.[3]

---

[1]Lance Herndon was BDS's general partner and was Sunrise's main contact person for this loan.

[2]The loan officer reduced the contingency and made other minor adjustments. Even as reduced, the contingency was more than sufficient to cover the sales tax.

[3]The loan agreement stated:

> If Lender at any time determines in its sole discretion that the amount in the Loan Fund is insufficient, or will be insufficient, to complete fully and to pay for the Project, then within ten (10) days after receipt of a written request from Lender, Borrower shall deposit in the Loan Fund an amount equal to the deficiency as determined by Lender.

Herndon told Sunrise the numbers could be "value engineered" or "descoped" to bring the cost of construction within the loan amount. In any event, shortly thereafter, on March 4, 2008, the loan officer asked BDS to reconcile the budget to the loan amount. BDS never provided a reconciled budget to Sunrise.

¶8 For reasons unrelated to the BDS loan, Sunrise terminated the loan officer's employment on March 4 -- the same day he had asked BDS for a reconciled budget. As we discuss in more detail below, it was at this point the relationship between Sunrise and BDS began to deteriorate.

¶9 After Sunrise terminated the loan officer, a second loan officer became responsible for the BDS account. The second loan officer worked closely with her loan supervisor and a Sunrise vice president. Collectively, the three continued to request a budget that reconciled to the loan amount. They also continued to request the contractor assignment.

¶10 Sometime after the second loan officer became responsible for the BDS account, BDS requested a draw for $86,124.81 (the "March draw request").[4] The parties met on March 26, 2008 to discuss the March draw request. Again, testimony regarding what happened at the meeting is in conflict. The parties, however, agree Sunrise directed BDS to submit a written draw request on a standard form as required by the loan agreement. The parties also agree that they discussed the shortfall and the contractor assignment.

¶11 The second loan officer sent an email to Herndon and Ford on March 27, 2008 memorializing the March 26 meeting. In the email, the loan officer requested, as relevant here, a revised cost breakdown confirmed by the general contractor, the executed contractor assignment, and a written plan to pay the shortfall. On March 31, 2008, Herndon responded that Ford had the revised cost breakdown and would provide it to Sunrise.[5] Herndon also informed Sunrise the general contractor would not sign the assignment and asserted Sunrise should have asked for it before closing as BDS had no control over a third party and Sunrise's demand for the contractor's signature was "interference with a contract." Herndon stated, however, that the general contractor was willing to "sign an agreement that says if [BDS] defaults the bank can step in our shoes and be bound as we are bound." Herndon also calculated the shortfall as $53,229 and said BDS "will" make it up by an injection of capital from a new partner,

[4]At trial, the parties disputed when BDS submitted this draw request to Sunrise. Ford signed the written draw request, however, on March 31, 2008.

[5]Although Herndon said Ford was going to provide the revised cost breakdown, he nonetheless attached a document to the email entitled "Hard budget" in which the cost of construction had increased to $1,932,032.

additional tenant leases, refinance of part of the property, or from additional capitalization from the existing partners.

¶12 On April 4, 2008, by email, the second loan officer again asked for an updated budget approved by the general contractor. She explained Sunrise had agreed to make the loan expecting the contractor assignment would be provided and asked for the contractor's verbatim response to the request for the assignment. She also stated the shortfall was $97,342, and, pursuant to the loan agreement, Sunrise expected BDS to pay that amount within 10 days.

¶13 On April 7, 2008, Sunrise sent a letter to BDS reiterating the essence of the emails sent on March 27 and April 4. As relevant here, the letter requested first, payment of the $97,342 shortfall within 10 days; second, the executed contractor assignment; and third, a finalized budget signed by the general contractor. Sunrise further notified BDS that its March draw request would not be funded until BDS met the conditions outlined in the letter.

¶14 On April 18, 2008, the loan supervisor sent an email to Herndon following up on the loan officer's requests. The supervisor requested a meeting and, as relevant here, an updated budget signed by the general contractor and a date the shortfall would be paid, offering BDS an option to pay a portion then and the rest later. The supervisor did not, however, ask for the contractor assignment. Herndon responded he would forward the requests to Ford. He also responded that paying the shortfall was a "negotiable item" and suggested Sunrise make the partners personal loans to cover the shortfall.[6]

¶15 On April 23, 2008, Herndon updated his response to the loan supervisor's email. He informed the supervisor that the BDS partners and the general contractor were going to meet the following day to work on the budget and would provide it as soon as possible. Herndon also informed the supervisor that the amount of the shortfall would depend on the final budget BDS prepared. Herndon also said he would put the loan supervisor in contact with the general contractor.

---

[6]BDS asserted throughout the trial that the first loan officer promised, both at closing and at the February 22 meeting, that Sunrise would make personal loans in the event the loan amount was not sufficient to cover the construction costs. The superior court found the loan officer had not made any such promise. The court's finding is supported by the loan officer's trial testimony and an acknowledgment by Ford at a tape-recorded meeting with Sunrise in which he said, "I don't think [the loan officer] made a commitment." Although at trial Ford testified he meant only that the loan officer had not made BDS a written commitment, the court was entitled to rely on Ford's tape-recorded statement.

¶16 Sometime on or before April 24, 2008, as evidenced by a "Memo to File" by the loan supervisor, the supervisor contacted the general contractor to see if he would sign the contractor assignment. According to the memo, the general contractor reiterated he would not sign the document. Sunrise did not thereafter ask BDS for the contractor assignment, but continued to request an updated budget and payment of the shortfall, neither of which BDS ever provided. Even though it had not received either an updated budget or payment of the shortfall, Sunrise funded the March draw request on April 25, 2008.

¶17 Thereafter, the parties, then represented by counsel, continued to communicate regarding these matters without resolution. On August 22, 2008, Sunrise sent a notice of default to BDS accelerating the loan balance and demanding payment of $744,704.32 in principal and interest.[7] When BDS failed to pay the accelerated loan balance, Sunrise sued BDS.

DISCUSSION

I. Standard of Review

¶18 Interpretation of a contract is a question of law, reviewed de novo. *Andrews v. Blake*, 205 Ariz. 236, 240, ¶ 12, 69 P.3d 7, 11 (2003). We are bound by the superior court's findings of fact unless they are clearly erroneous or not supported by any credible evidence. *Hale v. Amphitheater Sch. Dist. No. 10 of Pima Cnty.*, 192 Ariz. 111, 114, ¶ 5, 961 P.2d 1059, 1062 (App. 1998) (citation omitted). We are not bound by the superior court's conclusions of law, and we may make our own conclusions from the facts found by the court. *Id*.

II. Altering the Terms of the Loan Agreement

¶19 BDS first argues the superior court abused its discretion in finding BDS had materially breached the loan agreement as of March 26, thereby excusing Sunrise's refusal to fund the March draw request when first requested to do so. As we understand BDS's argument, it asserts the superior court altered or rewrote the terms of the loan by finding it in default for failing to pay the shortfall on March 26 even though Sunrise had not given it 10 days to pay the shortfall. We disagree.

[7]Sunrise declared BDS to be in default because it had, first, failed to provide an approved detailed budget; second, failed to pay the loan shortfall; third, ceased construction on the project for more than 10 days; and fourth, failed to provide final building permits for the project. On appeal, BDS does not dispute the third and fourth grounds for default.

¶20 First, the superior court did not find BDS in default on March 26. The court recognized, based on the evidence, a distinction between default conditions and an actual default. The court found that as of March 26, members of Sunrise and BDS had met to discuss certain events of default and from March 26 through April 25, BDS made repeated promises that it would comply with Sunrise's requests.

¶21 Second, as discussed above, before August 22, Sunrise repeatedly requested BDS to provide an updated budget and pay the shortfall as it was obligated to do within 10 days of Sunrise's notice. Sunrise gave BDS far longer than 10 days to pay the shortfall, but it never did.[8] Sunrise complied with the default provisions in the loan, and therefore, the superior court did not alter or rewrite the terms of the loan as BDS argues.

III. Anticipatory Repudiation

¶22 BDS next argues Sunrise anticipatorily repudiated the loan agreement when it refused for several weeks to fund the March draw request without the contractor assignment. According to BDS, the contractor assignment was a new condition that was not required under the loan agreement, and thus, when Sunrise insisted on it as a condition of funding the March draw request, Sunrise anticipatorily repudiated the loan agreement. *See generally United Cal. Bank v. Prudential Ins. Co. of Am.*, 140 Ariz. 238, 277, 681 P.2d 390, 429 (App. 1983) ("*Prudential*"). We disagree and agree with the superior court the loan agreement authorized Sunrise to request the contractor assignment.

¶23 A breach of contract action may be maintained where one party anticipatorily repudiates a contract by a "positive and unequivocal manifestation" that the repudiating party will not perform when the time for performance becomes due. *Diamos v. Hirsch*, 91 Ariz. 304, 307, 372 P.2d 76, 78 (1962) (citations omitted). Such a manifestation excuses the performance of the non-repudiating party and gives rise to a claim for damages. *Prudential*, 140 Ariz. at 283, 681 P.2d at 435 (citations omitted). "The insistence by one party upon terms not contained in a contract constitutes an anticipatory repudiation." *Id.* at 277, 681 P.2d at 429 (emphasis omitted).

[8]BDS argues Sunrise waived its right to request payment of the shortfall because beginning in April and through July, Sunrise requested BDS to provide a date the shortfall would be paid and provide a plan to pay the shortfall. We disagree. Sunrise did not waive the requirement for BDS to pay the shortfall by requesting it to provide a date and a plan to pay the shortfall. Further, the loan agreement specifically stated that "[n]o delay or omission on the part of Lender in exercising any right shall operate as a waiver of such right or any other right."

¶24 Although the loan agreement does not specifically require BDS to provide a "contractor assignment," the agreement required BDS to "[m]ake, execute and deliver to Lender such . . . assignments . . . as Lender or its attorneys may reasonably request to evidence and secure the Loans and to perfect all Security Interests in the Collateral and Improvements." Moreover, the loan agreement broadly required as a condition precedent to each draw "other . . . documents . . . as Lender or its counsel, in their sole discretion, may require."

¶25 Additionally, at trial, both parties presented evidence the contractor assignment was not only common, but reasonable in the context of construction lending. *See* Restatement (Second) of Contracts § 222(3) (1981) (usage of trade used to give meaning to, supplement, or qualify terms in a contract); *cf.* A.R.S. § 47-1303(D) (Supp. 2013) (Arizona's version of U.C.C. § 1-303(d) (2013)) ("[U]sage of trade . . . is relevant in ascertaining the meaning of the parties' agreement, may give particular meaning to specific terms of the agreement and may supplement or qualify the terms of the agreement."). Each party's expert witness testified it was reasonable and appropriate for a lender to request a contractor assignment for this type of loan. Given the language of the loan agreement and this evidence, we agree with the superior court that Sunrise had the right to request the contractor assignment pursuant to the loan agreement.[9]

¶26 Because Sunrise had the right to request the contractor assignment under the loan agreement, it was therefore reasonable for Sunrise to refuse to fund without it. There is nothing in the loan agreement that required all documents to be provided before the loan closed. BDS had an ongoing obligation to provide documents pursuant to the loan agreement as evidenced by Sunrise's ability to request additional documents as a condition precedent to each draw.

¶27 Additionally, when Sunrise contacted the general contractor and independently confirmed it would not sign the assignment, Sunrise abandoned its request for the contractor assignment and funded the March draw request on April 25, 2008. Thus, even if Sunrise repudiated the loan agreement by requesting the contractor assignment -- an argument we reject -- Sunrise sufficiently retracted any alleged repudiation when it abandoned its request for the contractor assignment and funded the draw. *See Prudential*, 140 Ariz. at 281, 681 P.2d at 433 ("[T]he repudiator has a power of retraction as long as there has been no substantial change of position by the injured party." (quoting 4 Arthur L. Corbin, Corbin on Contracts § 981 (1951))).

[9]We therefore also reject BDS's argument that requesting the contractor assignment rendered the loan agreement unconscionable or that Sunrise materially breached the agreement by requesting it.

¶28 In summary, we conclude Sunrise did not anticipatorily repudiate the loan by threatening to withhold the draw payment until it received the contractor assignment. But, even if we agreed with BDS, Sunrise sufficiently retracted its alleged repudiation. The record therefore supports the superior court's findings regarding BDS's default and its judgment in favor of Sunrise. We therefore do not need to address BDS's remaining argument on appeal that the superior court should have allowed its damages expert to testify at trial.[10]

IV. Attorneys' Fees and Costs

¶29 Sunrise requests its attorneys' fees and costs on appeal as provided for in the construction loan agreement, promissory note, deed of trust, and commercial guaranties. We grant its request contingent upon its compliance with Rule 21 of the Arizona Rules of Civil Appellate Procedure and our review. *See generally Geller v. Lesk*, 230 Ariz. 624, 627-30, ¶¶ 10-14, 19, 285 P.3d 972, 975-78 (App. 2012).

CONCLUSION

¶30 For the foregoing reasons, we affirm the superior court's judgment in favor of Sunrise.

[10]We also note BDS has raised additional arguments in its reply brief regarding the superior court's reliance on "inaccurate facts" in its ruling. BDS did not raise these arguments in its opening brief, but in any event, the record supports the findings made by the superior court.