

PREPAYMENT FEES
IN COMMERCIAL PROMISSORY NOTES:
APPLICABILITY TO PAYMENTS MADE
BECAUSE OF ACCELERATION

GEORGE A. NATION, III*

This Article focuses on whether a lender may collect a prepayment fee in a case in which the lender has forced the borrower to pay the loan early by accelerating the loan. Under the common law of most states, a borrower does not have the right to prepay a commercial loan unless the documents provide that right. This rule developed in recognition of the lender's interest in receiving the agreed upon interest for the full term of the loan. Therefore the lender has the right to charge a fee, a prepayment fee, for allowing the borrower the privilege of early payment. Virtually all courts agree that if a borrower chooses to pay the loan early, the prepayment fee must be paid. Some courts, however, have refused to enforce prepayment fees in situations in which the prepayment is not considered to be under the control of the borrower. Courts are split regarding whether prepayment fees should be paid when a loan is paid early because it has been accelerated.

A lender does not have the unfettered discretion to accelerate; rather, a lender may accelerate only if a specific event of default has occurred. Thus, when a lender accelerates, it is doing something it is authorized to do in the agreement with the borrower. The negotiation and agreement by the lender and the borrower on a definition of "event of default" and the workings of acceleration (for example, optional, automatic, immediate, or with grace periods) are a reflection of the allocation of risk between the parties. This allocation of risk should be respected by the courts. Thus, reasonable prepayment provisions should be enforced in accordance with their terms even if early payment has resulted from acceleration and even if the event giving rise to acceleration is beyond the control of the borrower.

* Professor of Law and Business, Lehigh University.