

# THE TRANSACTIONAL LAWYER

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## COURT RULES THAT EXPLICITNESS RULE IS FUNDAMENTAL POLICY

*Stephen L. Sepinuck*

A 2018 article in this newsletter identified numerous rules of “explicitness” – legal rules that require a heightened degree of explicitness for a particular term to be effective – and classified some of them as benign, some as silly, and some as ill-considered traps for unsuspecting drafters of agreements.<sup>1</sup> A recent court decision compels the creation of a whole new category: rules that reflect a fundamental state policy.

In a case before the U.S. District Court of the Eastern District of Pennsylvania,<sup>2</sup> an employee of Manpower Inc., a temporary staffing company, was injured while working at a Pennsylvania distribution facility operated by Manpower’s client, Northtec. The employee sued Northtec for negligence in failing to provide a safe work environment and adequate training, warnings, and oversight with respect to the machine she was tasked with operating. Northtec sought indemnification from Manpower pursuant to the parties’ staffing services agreement. Manpower moved for summary judgment, arguing that it was immune under the Pennsylvania Workers’ Compensation Act from third-party indemnity claims for its employees’ work-related injuries. Northtec countered that the staffing services agreement was governed by New York law.

The court began its analysis by accepting the parties’ agreement that the indemnification provision was sufficient to waive Manpower’s immunity under the New York workers’ compensation law.<sup>3</sup> The court then noted, however, that the indemnification provision was not sufficient under Pennsylvania law.<sup>4</sup> That was because, even though Pennsylvania permits

employers to waive – through an indemnification clause – the statutory immunity granted to them under the state’s workers’ compensation law, to do so the indemnification clause must “expressly say that employer agreed to forego its statutory protection and to assume unlimited liability for damages arising from harm suffered by its own employees.”<sup>5</sup> Although the indemnification provision in the parties’ agreement provided for indemnification of all claims for bodily injury to “any person,” it expressly mentioned employees of the indemnitee (in this case, Northtec), rather than expressly mentioning the employees of the indemnitor (Manpower).<sup>6</sup>

The court then moved to the staggering portion of its opinion: the choice-of-law analysis. The court concluded that, despite the choice-of-law clause in the staffing agreement, New York law did not govern the validity of the indemnification clause. In so doing, the court applied § 187 of the Restatement (Second) of Conflict of Laws, which provides that a contractual choice of law will not be enforced if:

application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which . . . would be the state of the applicable law in the absence of an effective choice of law by the parties.<sup>7</sup>

The court readily concluded that, because the injury occurred in Pennsylvania, Pennsylvania had a materially greater interest in the issue than did New York and that Pennsylvania law would apply in the absence of an effective choice-of-law clause. Those conclusions make sense. But the court also concluded that applying New York law would violate a fundamental policy of Pennsylvania.<sup>8</sup> This conclusion is highly questionable.

The court relied on a Pennsylvania Supreme Court decision refusing to enforce language in an employment contract choosing West Virginia law to apply to claims for work-related injuries occurring in Pennsylvania.<sup>9</sup> But that case involved an agreement between an employer and one of its own employees, and thus ran afoul of the policy, expressed in the statutory scheme, that the Pennsylvania Workers’ Compensation Act “shall apply to all injuries occurring within this Commonwealth.”<sup>10</sup> In this case, because both New York and Pennsylvania law permit an employer to waive the protections of the state’s workers’ compensation law, the only “fundamental policy” truly at issue was the rule regarding how explicit such a waiver must be. The court did cite two other federal district court decisions in support,<sup>11</sup> but the fact remains that neither of them explained why a judicially created explicitness rule really embodies a fundamental policy of the state.

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Regardless of the merits of the decision, however, the advice for transactional lawyers is clear. Be on the lookout for explicitness rules and do not assume that an otherwise valid choice-of-law clause will allow you to evade such rules.

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#### Notes:

1. See Stephen L. Sepinuck, *Gotcha!: Caught in the Explicitness Trap*, [8 THE TRANSACTIONAL LAWYER 1](#) (June 2018).

2. Bookard v. The Estee Lauder Companies, Inc., [2020 WL 1164789](#) (E.D. Pa. 2020).

3. *Id.* at \*1. It is not clear why Manpower made this concession. The indemnification agreement provided in pertinent part that: “each party shall indemnify . . . the other party . . . from and against . . . any and all claims . . . for . . . bodily injury to, or death of, any person, including without limitation the employees . . . of the party being indemnified . . . but . . . only to the extent such [c]laims are caused by or result from the negligence, gross negligence, recklessness or willful misconduct of the indemnifying party” (emphasis added). The alleged negligence was by Northtec (the indemnitee), not by Manpower (the indemnifying party). So, by its terms, the indemnification would not appear to apply to the claim at issue regardless of which state’s law governed.

4. *Id.* at \*4–5.

5. Bester v. Essex Crane Rental Corp., [619 A.2d 304](#), 308 (Pa. Super. Ct. 1993). See also [77 Pa. Cons. Stat. § 481\(b\)](#) (providing that the employer is not liable to indemnify a third party unless such liability is “expressly provided for in a written contract entered into by the party alleged to be liable prior to the date of the occurrence which gave rise to the action”). But cf. Hackman v. Moyer Packing, [621 A.2d 166](#) (Pa. Super. Ct. 1993) (ruling that an employer’s contractual promise to indemnify a third party “against any and all claim or claims brought by the agents, workmen, servants or employees of [the employer] for any alleged negligence or condition, caused or created, [in] whole or in part, by [the third party]” was sufficiently explicit to waive the employer’s statutory immunity). These decisions are apparently rooted in older rulings that “a contract of indemnity against personal injuries, should not be construed to indemnify against the negligence of the indemnitee, unless it is so expressed in unequivocal terms.” Pittsburgh Steel Co. v. Patterson-Emerson-Comstock, Inc., [171 A.2d 185](#), 188 (Pa. 1961), cited in Bester, [619 A.2d at 307](#).

6. [2020 WL 1164789](#), at \*9.

7. *Id.* at \*5 (quoting Restatement (Second) of Conflict of Laws § 187).

8. *Id.* at \*6–7.

9. *Id.* (discussing McIlvaine Trucking, Inc. v. Workers’ Comp. Appeal Bd. (States), [810 A.2d 1280](#), 1286 (Pa. 2002)).

10. See [77 Pa. Cons. Stat. § 1](#).

11. [2020 WL 1164789](#), at \*6 (discussing Finney v. CSX Transp., Inc., [2009 WL 3719382](#) (E.D. Pa. Nov. 5, 2009), and Jones v. Swept L.P., [2020 WL 241009](#) (W.D. Pa. 2020)).



## Transactional Lawyers Can Have RICO Liability for Abetting Fraudulent Transfers

*Stephen L. Sepinuck*

In 2012, Steven Weller caused an automobile accident in which Christina Kruse was horrifically injured. He admitted fault and, following a 2015 bench trial, was held liable for slightly more than \$2.5 million. Shortly after the accident and before the trial, however, Weller engaged in series of financial transactions designed to shield his assets from Kruse. Specifically, he transferred his real property to a revocable trust of which he was the sole trustee and primary beneficiary, and he made cash “gifts” totaling \$104,000 to family and friends.<sup>1</sup>

When it became apparent that these transactions were avoidable fraudulent transfers, Weller sought the assistance of David Repp, who held himself out as an “asset protection attorney.” With Repp’s assistance, Weller, as trustee of the trust, transferred the real property to a newly formed limited liability company with “special creditor-thwarting provisions.”<sup>2</sup> He also refinanced the bank loans against the real property, and in the process obtained personal loans secured by the property.

In 2016, Kruse brought a fraudulent transfer action challenging the validity of these transactions and in 2018 the court ruled in her favor.<sup>3</sup> The court avoided, among other things, Weller’s 2012 cash gifts, the obligations incurred in connection with the refinancing, and the transfer of the real property to the LLC.<sup>4</sup>

Despite this ruling, Kruse’s efforts to collect were further frustrated by the bank’s efforts to foreclose mortgages on the real property that predated these events. So, as part of her effort to obtain payment, Kruse brought an action against Repp and

the bank that assisted Weller. She asserted claims, among other things: (i) for aiding and abetting Weller's fraudulent transfers and (ii) under the federal Racketeering Influenced and Corrupt Organizations Act<sup>5</sup> (RICO) for participating in a racketeering enterprise with the purpose of defrauding Kruse.<sup>6</sup>

On a motion to dismiss, the court began its analysis by noting that the facts alleged "do not tell a story of bankers acting like bankers or attorneys acting like attorneys; they allege plausible claims that the Defendants departed from the 'traditional rendition of [professional] services' and 'crosse[d] the line' to active participation in a fraudulent scheme."<sup>7</sup> The court then discussed each of the claims.

First, the court ruled that there is no third-party liability under the Uniform Fraudulent Transfer Act for aiding and abetting a fraudulent transfer.<sup>8</sup> In so doing, the court followed the majority of other courts dealing with the issue in concluding that an action to avoid a fraudulent transfer is fundamentally equitable in nature and a plaintiff suing in equity cannot recover monetary damages, which are traditionally a remedy at law.<sup>9</sup>

However, the court then ruled that Kruse had stated a claim under RICO.<sup>10</sup> That portion of the court's opinion is quite lengthy and fact-specific. The key point for the purpose of this article is that Kruse had alleged several different enterprises and a pattern of racketeering involving both Repp and the bank. Specifically, Repp and his firm had assisted in the creation of the LLC for the fraudulent purpose of obstructing Kruse's collection efforts.<sup>11</sup> Moreover, in the court's view, the complaint did not allege that Repp and his firm "merely represented a client later found guilty of fraudulent conduct," but that "they shared his intent when advancing this goal by designing, implementing, and defending the [fraudulent] transactions."<sup>12</sup>

## Conclusion

Transactional lawyers have several reasons not to assist a client's fraudulent conduct. First, providing such assistance is immoral. Second, ABA Model Rule of Professional Conduct 1.2(d) states that "[a] lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is fraudulent."<sup>13</sup> Thus, a transactional lawyer risks disciplinary sanctions for assisting a client in fraudulent activity.

The court's decision in this case – even though merely denying a motion to dismiss – adds another powerful reason: to avoid personal liability. So, all self-styled "asset protection attorneys" should beware. Your path to financial security might be a toll road.

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## Notes:

1. Kruse v. Repp, [2020 WL 1317479](#), at \*2 (S.D. Iowa 2020).
2. *Id.* at \*3. Specifically, the operating agreement: (i) allowed Weller to retain voting rights in the LLC even if there was an execution upon or assignment of his membership interest; (ii) provided that a levy on Weller's distribution rights would trigger a buy-out provision to allow the LLC and Weller's son to buy Weller's interest at an amount set by the Wellers themselves; (iii) permitted Weller to deplete all profits and assets of the LLC through salaries at an amount determined by the Wellers; and (iv) allowed the Wellers to obtain personal loans secured by mortgages on the assets of the LLC. *Id.*
3. *Id.* at \*5.
4. *Id.* at \*6.
5. [18 U.S.C. §§ 1961–1968](#).
6. [2020 WL 1317479](#), at \*6.
7. *Id.* at \*8.
8. *Id.* at \*12–16.
9. *Id.* at \*13 (citing *Lewellen v. Universal Underwriters Ins. Co.*, [574 S.W.3d 251](#), 270 (Mo. Ct. App. 2019); *Cadle Co. v. Woods & Erickson, LLP*, [345 P.3d 1049](#), 1052–53 (Nev. 2015); *GATX Corp. v. Addington*, [879 F. Supp. 2d 633](#), 648 (E.D. Ky. 2012); *Forum Ins. Co. v. Devere Ltd.*, [151 F. Supp. 2d 1145](#), 1148–49 (C.D. Cal. 2001), *aff'd sub nom.* *Forum Ins. Co. v. Comparet*, [62 F. App'x 151](#) (9th Cir. 2003)).
10. *Id.* at \*16–28.
11. *Id.* at \*20.
12. *Id.* at \*21.
13. [Model Rule 8.4\(c\)](#) adds that it is professional misconduct to engage in conduct involving fraud.



## Recent Cases

### SECURED TRANSACTIONS

#### Scope Issues

*Huntington Technology Finance, Inc. v. Neff*,  
[2020 WL 1430092](#) (D. Conn. 2020)

A 77-month lease of an electronic advertising sign was not a sale and secured transaction under § 1-203(b) even though the lessee had no right to terminate and had the option to purchase the sign for \$1 at the end of an optional 9-month renewal term because nothing required the lessee to exercise the option to renew.

### Attachment Issues

*Equity Bank v. Southside Baptist Church of Lead Hill*,  
[2020 WL 1283431](#) (Ark. Ct. App. 2020)

Although the cross-collateralization clause in a security agreement referred to “all obligations, debts and liabilities” of the debtor to the secured party, “whether now existing or hereafter arising,” it was insufficiently specific to cover an existing mortgage loan. Antecedent debts must be referred to with specificity under Arkansas law.

*Behrend v. New Windsor Group, LLC*,  
[2020 WL 559565](#) (N.Y. App. Div. 2020)

Regardless of whether the plaintiff’s agreement with the debtor provided for an outright assignment of, or a security interest in, the debtor’s interest in a LLC, the plaintiff acquired no interest because the LLC operating agreement required the consent of all other members to any transfer and there was no evidence that such consent was obtained. Moreover, the plaintiff could have no interest in the assets of the LLC because the debtor, as a member of the LLC, had no interest in, and could not transfer any interest in, the LLC’s property.

*Landress v. Sparkman*,  
[2020 WL 561893](#) (E.D.N.C.), *appeal filed*, (4th Cir. 2020)

A guarantor granted a security interest in his interest in a Delaware limited partnership, as well as in dividends and distributions therefrom, even though the partnership agreement provided that any purported transfer would be void unless approved by the Board, and no such approval was given. The issue was governed by New York law because the security agreement selected New York as the governing law. Although, under the internal affairs doctrine, Delaware law governs matters relating the partnership’s governance and its relationship to the partners, the pledge of the guarantor’s economic interest and distributions did not involve such matters. New York’s § 9-406 overrode the restriction on transfer of the guarantor’s economic interest in the partnership because the partnership is an account debtor with respect to a payment intangible and the restriction on transfer was in an agreement between the debtor and the account debtor (the partnership agreement expressly stated that it was made by and between the partners and the partnership). For similar reasons, § 9-408 overrode the transfer restriction with respect to general intangibles.

*In re First River Energy, LLC*,  
[2020 WL 1016175](#) (Bankr. W.D. Tex. 2020)

A term in the agreements under which several oil producers sold oil to the debtor, which provided that the seller “warrants good title to all crude oil delivered hereunder and warrants that such crude oil shall be free from all . . . liens,” or used similar language, did not constitute a waiver of the seller’s right to claim a security interest or statutory lien on the oil sold to secure payment of the purchase price. The term was a warranty –

presumably that no third party claimed a lien – not a waiver of the seller’s security interest or lien.

*Diamondhead Country Club and Property Owners Ass’n, Inc. v. The Peoples Bank*, [2020 WL 948324](#) (Miss. 2020)

A real property developer’s exemption from Property Owner Association assessments was a general intangible covered by language in the deed of trust for some lots, which granted the lender a security interest in “all personal property located on or connected with the Property, including . . . general intangibles.” Another deed of trust covering other lots did not contain such language and thus did not include the developer’s exemption with respect to those lots. Accordingly, the bank that foreclosed on the real property and acquired it at the foreclosure sale was exempt from assessments only with respect to some lots.

### Perfection Issues

*In re Keast Enterprises, Inc.*,  
[2020 WL 534717](#) (Bankr. S.D. Iowa 2020)

A financing statement filed by the holder of an Iowa agricultural lien that identified the debtor as “Russel Keast,” when the debtor was actually Keast Enterprises, Inc., was ineffective to perfect. The fact that a search under the name “Keast Enterprises” now revealed the filed financing statement, which had been amended to include that name for the debtor, did not make the financing statement effective when filed. The amendment does not relate back to the filing date, and thus the financing statement was not effective to perfect within the 31-day period required under the agricultural lien statute.

### Enforcement Issues

*Piazza v. Santander Consumer USA, Inc.*,  
[2020 WL 1190825](#) (D. Mass. 2020)

Because, under Massachusetts law, the deficiency on a car loan is calculated based on the car’s fair market value, rather than the foreclosure sale price, and a notification of disposition must, in indicating the debtor’s potential liability for a deficiency, so state, the debtors stated a cause of action against a secured party for including in its notifications the following statement: “The money that we get from the sale (after paying our costs) will reduce the amount you owe. If the net proceeds at the sale, after expenses, does not equal your unpaid balance, and if the total unpaid balance exceeds \$2,000, you may owe us the difference, subject to applicable law (including Mass. Gen. Laws. ch. 255B § 20B).” Even though such a notification need not expressly refer to “fair market value,” and even though the notifications referenced the applicable state law, it is not clear at the pleading stage that the debtors would have understood the notification’s reference to § 20B meant that a deficiency would be calculated by using the fair market value of the vehicle.



*Kirkendoll v. Entertainment Acquisitions, LLC*,  
[2020 WL 1471674](#) (E.D. La. 2020)

A 7-year, \$2.5 million promissory note that required principal payments in monthly installments of \$35,200 but defined “default” as failure to pay amounts due on the Maturity Date, a term defined to mean the seventh anniversary of the note (or an earlier “liquidity event”), did not permit the holder to sue for missed installments prior to the Maturity Date or to foreclose on the collateral securing the note.

### **Liability Issues**

*Whitney Bank v. SMI Companies Global, Inc.*,  
[949 F.3d 196](#) (5th Cir. 2020)

A bank with a security interest in the debtor’s accounts, which after the loan matured sent instructions to the debtor’s customers to pay the bank directly, was not guilty of tortious interference with business relations even though some of the customers did not owe obligations at that time and the instructions had a negative impact on the debtor’s business. There was no evidence that the bank was motivated by ill will toward the debtor. Although the security agreement did not authorize the bank to demand money from customers who owed nothing, the bank’s attempts to collect were at most negligent, and Louisiana does not recognize a cause of action for negligent interference with contract or business relations.

### **BANKRUPTCY ISSUES**

#### **Claims & Expenses**

*In re Financial Oversight and Mgmt. Board for Puerto Rico*,  
[948 F.3d 457](#) (1st Cir. 2020)

The holders of bonds issued by the Employees Retirement System of the Government of the Commonwealth of Puerto Rico, who had a security interest in the System’s rights to “Revenues,” which were defined to include “Employers’ Contributions received by the System,” had no prepetition property right in postpetition contributions, merely an expectancy. Consequently, postpetition contributions were not proceeds of a prepetition security interest, and thus § 552 prevented the security interest from attaching to postpetition contributions.

*In re Southern Inyo Healthcare District*,  
[2020 WL 634295](#) (E.D. Cal. 2020)

A bank that refinanced an equipment loan to a healthcare district might not have a valid claim because a state statute limits the length of such loans to the useful life of the equipment, as determined by the board of directors, and it had not been established that the board made such a determination, either when entering into the initial transaction or when refinancing.

### **Avoidance Powers**

*In re Gas-Mart USA, Inc.*,  
[2020 WL 1291108](#) (8th Cir. BAP 2020)

Although a senior secured party released its lien on equipment in return for less than full payment, to facilitate the debtor’s sale of the equipment, that did not necessarily mean there was no equity for the junior lienor. Because there was equity, the junior lienor gave new value when, in return for the payment, it too released its lien.

### **LENDING, CONTRACTING & COMMERCIAL LITIGATION**

*Whitney Bank v. SMI Companies Global, Inc.*,  
[949 F.3d 196](#) (5th Cir. 2020)

Even though the purpose of a commercial loan was stated in recitals at the beginning of the loan agreement, the lender’s refusal to fund the borrower’s project to completion after the loan matured, or to extend maturity date, did not constitute a breach of the agreement. Interpreting the recital to require the lender to fund the project through completion would render the loan’s stated maturity date meaningless. Even if there was an oral promise to continue financing, that promise was unenforceable under the Louisiana Credit Agreement Statute, which requires agreements to extend credit, to forbear from exercising remedies under an existing credit agreement, or to extend a due date, to be in writing.

*ResCap Liquidating Trust v. LendingTree, Inc.*,  
[2020 WL 1317719](#) (D. Minn. 2020)

Although successor liability typically arises in connection with the purchase of the assets of – rather than the equity in – a business, it can arise in a purchase of equity if the purchaser expressly assumes the business’s liabilities.



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## COMMERCIAL LAW AMICUS INITIATIVE UPDATE

### *Latest Activities – Request for Support*

The Commercial Law Amicus Initiative (“CLAI”) is as a tax-exempt charitable organization under § 501(c)(3) of the Internal Revenue Code with the following mission:

1. To assist the courts in faithfully interpreting and applying the Uniform Commercial Code, other commercial statutes, and related common law, in order to achieve the laws’ underlying policies and to facilitate consistent decision-making by the courts;
2. To advance education at law schools by providing law students with training and practical experience in pro bono advocacy relating to the proper application and interpretation of commercial law; and
3. To offer research and recommendations on matters of commercial law to non-profit organizations such as the American Law Institute and the Uniform Law Commission, in connection with such organizations’ preparation of uniform or model legislation or restatements of the law.

Formed less than a year ago, CLAI already has filed an *amicus curia* brief in each of two cases, one before the Idaho Supreme Court dealing with Article 2 of the Uniform Commercial Code and one before Nebraska Supreme Court dealing with Article 9 of the Uniform Commercial Code. CLAI’s next project will be to seek permission to file – and to file – an *amicus curiae* brief with the United States Court of Appeals for the Fourth Circuit in the *Landress v. Sparkman* case, which is described on page 4 of this newsletter. That brief will show that the District Court erred in its analysis of which state’s law governed attachment of a security interest in a limited partner’s partnership interest and distribution rights.

Although all of CLAI’s work is performed by volunteers, CLAI needs funds to create and maintain a web site, pay court fees and printing costs associated with the filing of *amicus curiae* briefs, and pay travel expenses incurred to attend or participate in oral argument. Accordingly, **CLAI now gratefully accepts contributions from individuals and organizations who wish to support CLAI’s mission.\*** To make a contribution, please send a check, payable to Commercial Law Amicus Initiative, to Professor Stephen L. Sepinuck at Gonzaga University School of Law, P.O. Box 3528, Spokane, WA 99220.

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