

# THE TRANSACTIONAL LAWYER

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## PREVENTING NON-PARTIES FROM ENFORCING A SUBORDINATION AGREEMENT

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Recently, the Maryland Court of Special Appeals allowed a guarantor of a promissory note to enforce the rights of a senior creditor with respect to a subordination agreement to which the guarantor was not a party.<sup>1</sup> While a multitude of issues were raised by the court’s analysis and the parties’ arguments, the court’s holding begs the question: what is a transactional lawyer to do to prevent this from happening to a client?

### The Transaction and Lower Court Ruling

In 2013, Albert and Katherine Winfield (the “Winfields”) sold their shares of stock in a company that operated an electric contracting business.<sup>2</sup> The buyer (“GBJV”) paid part of the purchase price with the proceeds of a \$4,000,000 loan from Access Bank (“Bank”) and with \$1,000,000 in financing from the Winfields.<sup>3</sup> The financing from the Winfields was evidenced by two promissory notes (“Notes”)<sup>4</sup> and the Notes were guaranteed by the two principals of GBJV.

The Winfields and the Bank executed a subordination agreement (“Subordination Agreement”), pursuant to which the indebtedness owed by GBJV to the Winfields was subordinated in right of payment to the indebtedness owed to the Bank. Under the terms of the Subordination Agreement, the Winfields agreed not to accept any payment or enforce their rights under the Notes after a default until the Bank was paid in full.<sup>5</sup> As required by the Subordination Agreement, the Notes contained the following legend:

THIS NOTE IS SUBJECT TO THE TERMS AND CONDITIONS OF THAT CERTAIN SUBORDINATION AGREEMENT DATED AS OF OCTOBER 31, 2013 BY AND AMONG [BANK], BORROWER AND HOLDER. THE SUBORDINATION AGREEMENT CONTAINS PROVISIONS RESTRICTING, AMONG OTHER THINGS, CERTAIN PAYMENTS AND THE EXERCISE OF CERTAIN RIGHTS AND REMEDIES BY THE PARTIES HERETO.<sup>6</sup>

The Subordination Agreement, however, included a clause stating “[t]his Agreement is solely for the benefit of [the Winfields] and Bank and not for the benefit of Borrowers, Guarantors or any other party.”<sup>7</sup>

After GBJV defaulted, the Winfields sought to recover from GBJV and the guarantors. GBJV and the guarantors argued that the restrictions in the Subordination Agreement were incorporated into the Notes as conditions precedent to the Winfields’ right to payment and to take enforcement action. They further argued that, because those conditions precedent were not satisfied, the Winfields were not entitled to judgment as a matter of law. The trial court rejected that argument, concluding – based principally upon the no-third party beneficiary clause in the Subordination Agreement – that GBJV and the guarantors did not have standing to claim the benefit of the payment and remedy restrictions imposed by the Subordination Agreement. After the court entered judgment for the Winfields, GBJV and the guarantors appealed. Before the appeal was heard, however, the Winfields settled with GBJV and one of the guarantors. The appeal was prosecuted by the remaining guarantor.

### The Decision on Appeal

The Winfields argued that the legends did not add to the substance of the Notes; they were intended merely to prevent the notes from being negotiable, so that a later transferee of the Notes could not be a holder in due course.<sup>8</sup> The court acknowledged that might have been the purpose of the legends but also determined that this purpose supported the argument that the restrictions in the Subordination Agreement were incorporated into the notes. The court stated, “unless the Notes were, in fact, subject to the defenses grounded in the Subordination Agreement, the legend would not serve its intended purpose of providing notice of such defenses.”<sup>9</sup>

The court’s analysis is flawed. The legend by itself – that is, the mere statement in the Notes that the promise to pay is governed by another agreement – operated to prevent the Notes

### Contents

<i>PREVENTING NON-PARTIES FROM ENFORCING A SUBORDINATION AGREEMENT.....</i>	<b>1</b>
<i>WE ARE ALL TRANSACTIONAL LAWYERS.....</i>	<b>3</b>
<b>Recent Cases.....</b>	<b>7</b>

from being negotiable, regardless of whether the referenced agreement conditioned payment in any way. The comments to U.C.C. § 3-106 make this point expressly.<sup>10</sup> Because the legend's mere reference to the Subordination Agreement was sufficient to prevent the Notes from being negotiable, there was no reason to treat the legend as incorporating the actual terms of the Subordination Agreement into the Notes, particularly given that the language of the legend did not purport to do so.

The court's ruling also had the unfortunate effect of undercutting the law of waiver; that is, the right of a contracting party to waive its contractual rights. The Subordination Agreement was, as it expressly stated, for the benefit of the Bank. However, by the time the appeal was heard, the Bank had entered into a settlement that released GBJV and one of the guarantors.<sup>11</sup> The court did not discuss the terms of the settlement; however, if the Bank did not object to the Winfields' efforts to enforce the Notes – and nothing in the court's opinion suggests that the Bank did – then there is no basis for preventing the Winfields from seeking to enforce payment.<sup>12</sup>

But the Winfields' argument about negotiability was, itself, a bit off track. While the legend did prevent the Notes from being negotiable,<sup>13</sup> negotiability is not what mattered for two reasons. First, it is true that a transferee of notes can qualify as a holder in due course only if the notes are negotiable, and a holder in due course takes free of most claims to the instrument,<sup>14</sup> and most defenses of the obligor.<sup>15</sup> However, the rights of a senior creditor under a subordination agreement are neither of those things: they are neither a claim to the instrument itself nor a defense of the obligor. Second, and more to the point, the legend was needed to ensure that *any* subsequent transferee of the Notes would take subject to the Subordination Agreement. That purpose applies regardless of whether the Notes were negotiable and regardless of whether the transferee qualifies as a holder in due course. There is remarkably little law on whether a transferee of a right to payment – whether in the form of a negotiable instrument, nonnegotiable instrument, or something else – is subject to the terms of a subordination agreement of which the transferee was unaware at the time it acquired the right to payment.<sup>16</sup> However, there is no good reason to allow a transferee who knows of a subordination agreement not to be bound by that agreement. Accordingly, the legend was useful to ensure that any potential transferee of the Notes would take subject to the Subordination Agreement, but that purpose did not require that the terms of the Subordination Agreement be incorporated into the Notes.

The court need not have analyzed the legend and its purpose, as the court had an easier path to a proper outcome. That path would have been to hold that GBJV lacked standing to enforce the Subordination Agreement based upon the term in the Subordination Agreement that stated that the agreement was solely for the benefit of the Winfields and the Bank and not for the benefit of the borrowers, the guarantors, or any other party.<sup>17</sup>

Not only was this term one that specifically addressed the principal issue that the court was called upon to address,<sup>18</sup> but if the legend incorporated the Subordination Agreement, it presumably would have incorporated the whole agreement, including the no-third party beneficiary term. The Winfields raised this issue on appeal but were unsuccessful.<sup>19</sup> The court determined that the no-third-party beneficiary term did not relate to payments or to the exercise of remedies and was, therefore, not one of the “terms and conditions” in the Subordination Agreement to which the legend referred.<sup>20</sup> The court's conclusion on this point is perplexing. A different conclusion would have given effect to the language of the term and would have avoided making the guarantors beneficiaries of the remedies restrictions in the Subordination Agreement.

### Advice to Transactional Lawyers

Despite the flaws in the court's reasoning, transactional lawyers drafting subordination agreements and subordinated promissory notes need to be aware of this problem and draft around it. The key is to provide notice of the subordination agreement but disclaim the right of the note maker and any guarantor to enforce the terms of that agreement. The following language in a promissory note should suffice:

**The rights of the holder of this note to enforce its rights and to collect the indebtedness evidenced by this note are subject to the terms of a subordination agreement dated [---] by and among [-----]. Neither the maker of this note nor any guarantor of the obligation represented hereby has the right to enforce the terms of the subordination agreement.**

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### Notes:

1. Gourlay v. Buchner, [2021 WL 3832364](#) (Md. Ct. Spec. App. Aug. 27, 2021).
2. *Id.* at \*2.
3. *Id.*
4. *Id.*
5. *Id.*
6. *Id.*
7. *Id.* at \*6.

8. *Id.* at \*15.
9. *Id.* at \*10.
10. See U.C.C. § 3-106(a) & cmt. 1 (“It is not relevant whether any condition to payment is or is not stated in the writing to which reference is made. The rationale is that the holder of a negotiable instrument should not be required to examine another document to determine rights with respect to payment.”).
11. Gourlay v. Buchner, [2021 WL 3832364](#), at \*7.
12. The Bank’s failure to intervene or otherwise seek to prevent the Winfields from collecting against GBJV and the guarantors is puzzling. If the Bank were paid in full by means of the settlements that it entered into with GBJV and the one guarantor, then the subordination provisions would no longer be operative. If, on the other hand, the Bank was still owed money (presumably by the one remaining guarantor), then the Subordination Agreement would be an express bar to the action by the Winfields. (“The Subordination Agreement prohibited the Winfields from enforcing any rights under the Notes or taking any legal action against Borrowers *or the Winfield Guarantors* until all of the credit facilities to the Bank were fully paid and the Bank had no further obligations to make any additional loans to Borrowers.”) *Id.* at \*3 (emphasis added).
13. There is a much simpler way to prevent a party from becoming a holder in due course. The Bank could have required the notes to simply omit the so-called “magic words of negotiability.” That is, the Notes could have been made payable “to” the named creditors, rather than “to the order of” the named creditors. See U.C.C. § 3-104(a)(1) & cmt. 2. In this case, however, the Notes did use the phrase “to the order of.”
14. U.C.C. § 3-306.
15. U.C.C. § 3-305(b).
16. Stephen L. Sepinuck, *Due Diligence in the Purchase of Secured Loans*, [6 THE TRANSACTIONAL LAWYER 1](#), 2 & n.14 (Dec. 2016); see also JOHN F. HILSON & KATHERINE E. BELL, *ASSET-BASED LENDING: A PRACTICAL GUIDE TO SECURED FINANCING* § 9:2.6 (8th ed. 2015).
17. Gourlay v. Buchner, [2021 WL 3832364](#), at \*6.
18. This result could have been reached, in part, based upon the rule of construction that a specific term in an agreement controls over general terms. See *MBIA Ins. Corp. v. Patriarch Partners VIII, LLC*, [842 F. Supp. 2d 682](#) (S.D.N.Y. 2012).
19. Gourlay v. Buchner, [2021 WL 3832364](#), at \*16-18.
20. *Id.* at \*17.



## WE ARE ALL TRANSACTIONAL LAWYERS

**Stephen L. Sepinuck**

I have never tried a case. I have authored numerous appellate briefs and expect to write more in the coming years. But I have never picked a jury, made an opening or closing argument, or submitted admissible evidence. I am, of course, not proud of this. Inexperience, like ignorance, is never something to revel in. But it is also not shameful. As long as I do not represent myself as qualified to try a case, no one is endangered by my inexperience and lack of expertise.

But while a transactional lawyer can retire after a long and successful career without having ever entered a courtroom or argued before an arbitrator, the reverse is not true for litigators. Most disputes that make their way to court are resolved by settlement, and it is the litigators who usually draft the settlement agreement. Unfortunately, settlement agreements often end up spawning further litigation, particularly when the agreement requires one party to make one or more payments at a later date and that payment is not made when due. All too often, an error in the drafting of the settlement agreement leaves the creditor without what the creditor expected to have.

What follows is a brief description of four, relatively recent cases in which a settlement agreement did not work as intended, and the lesson that can be learned from each.

### Case One – Failure to Ensure Priority

In *In re Leaver*,<sup>1</sup> a dairy in possession of the debtor’s cattle when the debtor sought Chapter 12 bankruptcy protection, had a statutory boarding lien on the cattle to secure the debtor’s obligation to pay for the dairy’s services. The dairy and the debtor then entered into a court-approved stipulation that provided for the dairy to return the cattle to the debtor but for the dairy to retain its lien on the cattle. Following the return of the cattle, the dairy filed a proof of claim asserting that its claim was fully secured. The debtor objected to the amount of the claim, but not to the dairy’s status as a secured party. Nevertheless, the dairy encountered a problem.

Because the statutory lien was conditioned on possession, the court ruled that the dairy’s statutory lien – which had priority over the perfected security interest of the debtor’s prepetition lender,<sup>2</sup> was replaced by a consensual security interest.<sup>3</sup> Although the signed stipulation satisfied Article 9’s requirement of an authenticated security agreement, and the security interest had attached,<sup>4</sup> the court ruled that because no financing statement had been filed, the security interest was unperfected and subordinate to the lender’s security interest.<sup>5</sup>

Fortunately for the dairy, the stipulation also provided for the dairy to have an administrative expense claim for its services, and the court ruled that the dairy's loss of its statutory lien did not undermine that.<sup>6</sup> Therefore, provided there are sufficient assets to pay administrative expenses in full, the dairy will still be paid. But a more carefully drafted stipulation could have avoided the litigation.

What would that drafting have entailed? The court suggested that the stipulation could have provided for a retention of priority or automatic perfection.<sup>7</sup> Perhaps so, but automatic perfection might not have been enough. If the dairy's statutory lien truly was to be replaced by a consensual security interest, automatic perfection might not have been sufficient to ensure priority over the lender with a perfected security interest in the debtor's cattle. Under the first-to-file-or-perfect rule of § 9-322(a)(1), the secured party that filed or perfected first would have priority. Even if the dairy were permitted to treat its perfection as dating back to when it first acquired its statutory lien – a point that is subject to significant doubt<sup>8</sup> – that might still have been after the lender filed its financing statement. Accordingly, either the stipulation should have expressly provided for retention of priority or the dairy should have obtained the lender's agreement to subordinate its security interest to the dairy's interest in the cattle.

### Case Two – Another Failure to Ensure Priority

In *WIHC LLC v. NextGen Laboratories, Inc.*,<sup>9</sup> WIHC sued several of its employees and NextGen, alleging that the employees misappropriated and provided to NextGen confidential client information and trade secrets belonging to WIHC. At a settlement conference, the parties placed on the record the essential terms of a settlement agreement. Pursuant to that agreement, NextGen would pay \$500,000 up front, pay approximately \$4 million more through 18 monthly installments, and provide a security interest in its assets to secure the \$4 million debt. In addition, NextGen's principal owner would guarantee the debt.<sup>10</sup>

Shortly thereafter, and before WIHC attempted to perfect its security interest, NextGen's parent company took out loans using NextGen's assets as security, essentially priming the security interest that was to be granted to WIHC. WIHC then sought a court order requiring NextGen to provide unencumbered assets as security for the settlement amount or, alternatively, rescission of the settlement agreement based on bad faith and fraudulent inducement. The court rejected WIHC's request. In so doing, the court noted that the settlement agreement did not require that WIHC's security interest have first priority or that the collateral be otherwise unencumbered, and it concluded that if WIHC had wanted those terms, the terms should have been incorporated into the agreement.<sup>11</sup> Although, as the court acknowledged, there was some merit to

the plaintiff's argument that an implied condition precedent to the agreement was that the collateral be worth an amount equal to the settlement obligation, it was foreseeable that the defendant's assets would be subject to encumbrances as part of its ongoing business, the parties could have addressed this issue in the settlement agreement, and the guaranty from NextGen's owner mitigated the plaintiff's risk.<sup>12</sup>

The problem that WIHC encountered in this case – losing priority to an intervening creditor – is precisely the type of risk that transactional lawyers routinely guard against. And doing so would have been relatively easy. Even during the midst of settlement discussions, it should have been inexpensive and simple to run a search to see if there were any financing statements filed against NextGen. If so, that should have alerted WIHC's counsel to the need to address priority in the settlement agreement. And regardless of what such a search disclosed, WIHC should have wasted no time filing a financing statement of its own to ensure priority against any future secured party. The settlement agreement gave WIHC authority to file a financing statement,<sup>13</sup> and there was no good reason to put off doing so.<sup>14</sup>

If you think about it in these terms, Article 9 of the U.C.C. and its filing system are designed so that secured parties can protect themselves, at least in part, from the wrongful conduct of their debtors. Transactional lawyers who represent lenders routinely utilize Article 9's protections even though the proportion of borrowers who engage in wrongful conduct – that is who are scoundrels – is probably quite low. No one knows what proportion of defendants who agree to settle tort claims in return for millions of dollars to be paid over time are scoundrels. But there is no reason to think that such defendants are less likely to be scoundrels than are borrowers. So, WIHC's counsel should have either promptly filed a financing statement or advised WIHC to do so.

### Case Three – Failure to Preserve Rights

In *Urdan v. WR Capital Partners, LLC*,<sup>15</sup> two of the three founding owners of and investors in a Delaware corporation brought an action against a lender, its representatives, the corporation, and the corporation's new CEO, for breach of fiduciary duty, unjust enrichment, and other claims arising out of the lender's takeover of the corporation and ouster of the plaintiffs. During the litigation, the plaintiffs settled their claims against the corporation and the new CEO. Pursuant to that settlement, the plaintiffs sold their stock in the corporation back to the corporation. Although the settlement agreement expressly reserved the plaintiffs' claims against the non-settling defendants, the stock repurchase agreement provided that the plaintiffs transferred all of their "right, title, and interest" in the stock. The stock repurchase agreement also provided that any inconsistency between it and the stock repurchase agreement

was to be resolved in favor of the terms in the stock repurchase agreement.

The plaintiffs then continued to pursue the non-settling defendants for breach of fiduciary duty and unjust enrichment. But the trial court dismissed the case. It ruled that the breach of fiduciary duty claim followed the stock, and thus the plaintiffs no longer had standing to pursue it.<sup>16</sup> The court also ruled that the unjust enrichment claim was duplicative of the claim for breach of fiduciary duty, and dismissed it for the same reason.<sup>17</sup> On appeal, the Delaware Supreme Court affirmed.

The supreme court clearly understood that this result was not consistent with the plaintiffs' intent or expectations, and that the court's decision essentially made the carve-out in the settlement agreement mere surplusage.<sup>18</sup> Nevertheless, in the court's view, the agreements simply did not "fit together," and it refused to "torture or twist words or imply terms to make square pegs fit into round holes."<sup>19</sup> Because the terms of the stock repurchase agreement trumped the terms of the settlement agreement, the plaintiffs had parted with all of their rights as stockholders.

The plaintiffs also argued that their claims against the remaining defendants were personal claims, not derivative claims, and therefore had not been transferred in connection with the sale of the stock.<sup>20</sup> In so doing, the plaintiffs relied on an earlier Delaware Supreme Court decision that treated a dilution claim as personal.<sup>21</sup> But in its decision in *Urdan*, the court overruled that portion of the earlier case, and clarified that "dilution claims, whether direct, derivative, or a combination of the two, are not claims personal to the stockholder."<sup>22</sup>

It is difficult not to be sympathetic to the *Urdan* plaintiffs and their legal counsel. They undoubtedly foresaw the issue – that a sale of the stock in connection with the partial settlement might result in a loss of standing to pursue the remaining defendants – and attempted to draft the documents to avoid the problem. Moreover, in some sense the law shifted underneath them when the Delaware Supreme Court "clarified" that dilution claims are not personal claims and instead follow the stock. Still, the result might have been different if the stock repurchase agreement did not expressly trump the terms of the settlement agreement. And even if removing that term from the stock repurchase agreement would not have changed the result – in other words, even if it would not have been possible to sell the stock while retaining the claims against the other defendants<sup>23</sup> – then alternative structures could have been pursued<sup>24</sup> or, if desirable, the partial settlement scuttled. When a deal term a client desires will be unenforceable, and there is no way to draft around that result, one of the jobs of a transactional lawyer is to tell that to the client.

#### Case Four – Discount vs. Unenforceable Penalty

In *In re WM Distribution, Inc.*,<sup>25</sup> WM Distribution and another entity agreed to settle a \$5 million claim brought against them. Under the terms of the settlement agreement and the accompanying promissory note, they agreed to pay over a period of approximately six years the sum of \$1.3 million, which both documents defined as "the Indebtedness."<sup>26</sup> The note provided for interest, a late charge of 5% on any installment not made within seven days of the due date, and an additional \$600,000 upon default under some specified circumstances.<sup>27</sup> After WM Distribution defaulted and filed for bankruptcy protection, the creditor filed a claim for an amount that included the additional \$600,000.

The debtor argued that the term providing for the additional \$600,000 was a penalty clause, and therefore unenforceable. The bankruptcy court agreed. Although the creditor alleged that she had been poised to recover \$1.8 million plus punitive damages on her claim if the litigation had not been settled, and that the \$600,000 was a discount for timely performance,<sup>28</sup> neither the note nor the settlement agreement contained any term admitting liability or fixing the amount of damages. Instead, they called for payment of only \$1.3 million. Accordingly, the court ruled that the term calling for the additional \$600,000 was a liquidated damages clause that was not a reasonable estimate of actual damage, and hence was invalid as a penalty.<sup>29</sup>

As the court itself suggested,<sup>30</sup> had the settlement agreement and note been drafted slightly differently, the result would likely have been different. Specifically, if the parties had agreed to settle for \$1.9 million, with a \$600,000 discount if full payment was made by a specified time, the terms likely would have been enforceable. In short, a discount for timely payment and a penalty for late payment might be economically equivalent, but the law treats them quite differently.<sup>31</sup>

#### Conclusion

In a decision from earlier this year, one judge lamented the frequency with which courts were called upon to interpret and analyze prenuptial agreements drafted by lawyers with little or no experience in such matters. One unfortunate consequence of this was, he wrote, that such agreements frequently end up in court, costing the parties monumental sums of legal and expert fees. The judge added:

In today's complex legal world, lawyers, much like physicians in the medical field, must increasingly focus their practices on specific sectors of the law. . . . [Unfortunately, a]s one famously witty matrimonial attorney once said, "if you ask a neurosurgeon to perform your knee-replacement surgery, you may wind up with a limp."<sup>32</sup>

Inexperience is, of course, not limited to any specific area of law. Nor is it limited to type of practice (*e.g.*, litigating disputes; structuring and documenting transactions). Yet litigators do draft settlement agreements and it would be naive and unrealistic to expect them regularly to transfer that responsibility to someone else.

So what is to be done? Let me suggest two things. First, all lawyers – litigators and transactional specialists alike – must be cognizant of their limitations. There is no shame in seeking assistance from those with more experience in the task at hand. Indeed, the rules of professional responsibility might on occasion require it.<sup>33</sup>

Second, law schools must give greater attention to the teaching of transactional skills. How many students complete the course on Contracts without ever seeing an agreement, let alone writing one? How many students obtain a law degree without any exposure to the differences between a representation and a warranty? This must change. I know of law schools that chose not to create – and one that created but later abandoned – *required* courses in transactional skills in part due to the lack of expertise in transaction skills among the full-time faculty. Their decisions were influenced by ABA Accreditation Standard 403, which mandates that full-time faculty teach substantially all of the first third of each student’s course work. In essence, the ABA Accreditation standard ossifies law schools’ focus on litigation. This is regrettable.

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#### Notes:

1. [627 B.R. 517](#) (Bankr. W.D. Wis. 2021).
2. *See id.* at 523, (citing U.C.C. § 9-333).
3. *Id.* at 523-26. Although the court stated four times that the stipulation provided for the debtor to “retain” its lien rights, *id.* at 520, 521, 522, 523, the court never quoted the stipulation or fully explained why it was choosing to treat the stipulation as replacing the statutory lien with a consensual security interest.
4. *Id.* at 524-26.
5. *Id.* at 528.
6. *Id.*
7. *Id.* at 527.
8. Although a secured party that perfects its security interest in one way (such as by possession or through temporary automatic perfection) and then perfects in another way (such as through filing a financing statement) can tack the latter onto the former provided there is no period when there is neither filing or perfection, *see* U.C.C. § 9-322(a)(1), & cmt. 5, ex. 3, nothing in Article 9 allows a security interest to be tacked onto a prior statutory lien. Note, although Article 9 does apply to “agricultural liens,” U.C.C. § 9-109(a)(2), which are a type of statutory lien, a statutory lien that depends on possession, as the dairy’s lien in this case apparently did, is not an “agricultural lien.” *See* U.C.C. § 9-102(a)(5).
9. [2020 WL 5032055](#) (D. Haw. 2020).
10. *Id.* at \*2.
11. *Id.* at \*4.
12. *Id.* at \*5-7.
13. *See* U.C.C. § 9-509(b) (“By authenticating or becoming bound as debtor by a security agreement, a debtor . . . authorizes the filing of an initial financing statement.”).
14. In addition, the settlement agreement could have included a warranty that the collateral was unencumbered, a covenant to keep the collateral free from liens, and a right to accelerate the debt if NextGen breached either of these promises. Such terms by themselves would not prevent WIHC’s security interest from being subordinated if the security interest were unperfected, but they might have deterred NextGen’s conduct.
15. [244 A.3d 668](#) (Del. 2020).
16. *Id.* at 673.
17. *Id.*
18. *Id.* at 676.
19. *Id.*
20. *Id.* at 676-77.
21. *Id.* at 677-78 (discussing *Shultz v. Ginsburg*, 965 A.2d 661 (Del. 2009)).
22. *Id.* at 678.
23. It is unclear from the court’s decision what the result would have been if the stock purchase agreement had not purported to sell all of the plaintiffs’ “right, title, and interest” in the stock and if, instead, both agreements had expressly reserved to the plaintiffs their rights against the non-settling defendants. If, as the court ruled, the claims follow the stock, it might not be possible to separate them from the stock no matter how clearly the transaction documents purport to do so.
24. Perhaps the result would be different if the settlement agreement provided for a sale of the stock but the sale did not close (*i.e.*, the purchase price and stock were placed in escrow) until after the litigation with the remaining defendants was resolved.
25. [591 B.R. 52](#) (Bankr. D.N.M. 2018).

26. [Id. at 55, 56.](#)
27. [Id. at 56-57.](#)
28. [Id. at 60.](#)
29. [Id. at 63-67.](#)
30. [Id. at 63.](#)
31. See *Graylee v. Castro*, [265 Cal. Rptr. 3d 885](#) (Cal. Ct. App. 2020) (the term in an agreement settling a landlord’s unlawful detainer action and providing for the tenants to vacate the property by a specified date and time and, if they did not, to pay \$28,970, was an unenforceable penalty because there was no acknowledgment of the debt); Mark Loeterman and Susan Segal, *Errors to Avoid When Drafting Stipulated Judgments in Calif.*, [Law360](#) (Aug. 21, 2020); William B. Emmal, *Payment Discounts in Settlement Agreements*, [9 THE TRANSACTIONAL LAWYER 4](#) (Oct. 2019); Stephen L. Sepinuck, *Liquidated Damages, Alternative Performance, and Ensuring the Enforceability of Contingent Charges and Fees*, [5 THE TRANSACTIONAL LAWYER 3](#) (Oct. 2015).
32. *Anonymous v. Anonymous*, [70 Misc. 3d 1216\(A\)](#) at \*2 (N.Y. Sup. Ct. 2021).
33. [ABA Model Rule of Professional Conduct 1.1](#) requires a lawyer to provide competent representation to a client, and defines competence to include both knowledge and skill. [Comment 2](#) to the rule states that “[c]ompetent representation can also be provided through the association of a lawyer of established competence in the field in question.”



## Recent Cases

### SECURED TRANSACTIONS

#### *Scope Issues*

*Prospect ECHN, Inc. v. Winthrop Resources Corp.*,  
[2021 WL 5086274](#) (D. Minn. 2021)

Equipment leases that provided for automatic annual renewal after expiration of the initial terms of 4-5 years, unless terminated, were true leases. Although the leases were not terminable during the initial terms, they were terminable during the renewal periods, and therefore the bright-line test of § 1-203(b) was not satisfied. Even if the leases were not terminable, the lessee did not prove that either the initial terms or the renewed terms exceeded the useful life of the equipment.

#### *Attachment Issues*

*In re Timberline Four Seasons Utilities, Inc.*,  
[2021 WL 4952613](#) (Bankr. N.D.W. Va. 2021)

A financier that purchased future accounts receivable from the debtor – a regulated utility – without the required approval from the Public Service District did acquire a security interest in the receivables. West Virginia law treats such a non-approved contract as void only “to the extent that the interests of the public . . . are adversely affected,” and there was no claim that the public suffered any detriment as a result of this contract. Moreover, the contract is binding between the parties until a court of competent authority orders otherwise. Although the debtor’s officers might have fraudulently represented that the debtor had authority to enter into the contract, that merely rendered the contract voidable by the financier, not void or voidable by the debtor.

#### *Perfection Issues*

*In re Barbato*,  
[2021 WL 5173354](#) (Bankr. W.D.N.Y. 2021)

A bank’s security interest in two annuity contracts – structured as a conditional assignment – was perfected under New York common law when the issuer of each annuity received and acknowledged notification of the bank’s interest. The bank’s security interest in one of the annuities was also perfected by possession of the annuity contract.

#### *Priority Issues*

*MGG Investment Group LP v. Mull Enterprises, Ltd.*,  
[2021 WL 5264189](#) (Ky. Ct. App. 2021)

A lender with a security interest in the “equine collateral” of a debtor that owned and raised race horses, including the debtor’s horses, fractional interests therein, and breeding rights, had no cause of action against the buyers of horses and breeding rights because the buyers took free of the lender’s security interest under the Food Security Act as buyers in ordinary course of business of farm products. The Act defines “farm products” to include horses and products of horses in the possession of a person engaged in farming operations. Although the Act does not define “farming operations,” Article 9 defines that term to include raising livestock. Because the debtor was involved in raising race horses, it was engaged in farming operations. Even the breeding rights were farm products. Because the debtor was in the business of selling horses, the buyers were all buyers in ordinary course of business. The lender could have protected itself by providing notice to the purchaser but it failed to do so. The lender was also barred from pursuing one of the buyers by a Kentucky statute that prohibits a secured party from suing a buyer of an equine interest until the secured party pursues the debtor to the point where a judgment is rendered on the merits.

*HHH Farms, LLC v. Fannin Bank*,  
[2021 WL 5263701](#) (Tex. Ct. App. 2021)

A bank that received on deposit the cash proceeds of the debtor's crops in which another lender had a security interest, and then accepted payment by checks drawn on that deposit account to pay off the bank's loan to the debtor, converted the other lender's property. Even if the buyers of the debtor's crops took free of the lender's security interest under the Food Security Act, that did not prevent the lender's security interest from attaching to the proceeds. The bank was not a transferee of money under § 9-332(a) because the transfer was by check, not by money. The bank was not protected by § 9-332(b) as a transferee of funds from a deposit account because that rule applies only to a security interest in a deposit account, and the lender did not claim a security interest in a deposit account; it claimed a security interest in the crop proceeds deposited into the deposit account.

### ***Enforcement Issues***

*PBB Investments II, LLC v. Borden LP*,  
[2021 WL 5407957](#) (N.Y. Sup. Ct. 2021)

A secured party that had previously received full payment on its nonrecourse loan but nevertheless obtained a preliminary injunction requiring the debtor and related entities to deposit into a collateralized brokerage account assets with a value of at least \$26 million, an amount sufficient to cover the debtor's alleged liability under a term entitling the secured party to 30% of any increase in value of the collateralized securities, was not entitled to have the injunction modified after an appellate court ruled that the debtor had breached the credit agreement by not honoring the secured party's right to buy the securities. Although the ruling allegedly increased the debtor's exposure to \$55 million, the secured party had not demonstrated that the additional amount was part of the secured obligation. The credit agreement indicated that, after default, the secured party could accelerate the loan and demand that the collateral be sold to pay off the loan and the profit sharing percentage, but did not indicate that the collateral could be used to pay the difference between the fair market value of the securities and the price offered by the secured party.

*Connex Credit Union v. Thibodeau*,  
[2021 WL 5538661](#) (Conn. Ct. App. 2021)

Even though a credit union's notification of a planned disposition of collateral in a consumer transaction did not state that the debtor was entitled to an accounting, the notification was sufficient because it provided an accounting: it stated the principal balance, the interest accrued as of that date and the interest accruing daily thereafter, the late fees, and the cost of towing.

*In re Hambright*,  
[2021 WL 5441074](#) (Bankr. N.D. Ala. 2021)

Under Alabama law, a vehicle in the debtor's possession is not a pawned good merely because the certificate of title for the vehicle is pawned and in the possession of the pawn shop. Consequently, ownership is not forfeited to the pawnshop if payment is not made before the redemption period expires. Instead, the pawn shop is relegated to its foreclosure rights under Article 9.

### **BANKRUPTCY**

*In re Shurley*,  
[2021 WL 5508518](#) (Bankr. W.D. Tex. 2021)

Debts owed to a bank by borrowers who misrepresented in form loan documents that there were no other liens on the collateral were not nondischargeable under § 523(a)(2). The bank did not reasonably rely on the misrepresentation because it knew that the borrowers were in financial trouble but did not conduct an updated search for financing statements, which would have revealed a statement recently filed by another lender. The debtors did not have intent to deceive because they were unsophisticated, the representation in the form was not explained to them, and they thought the other lender had a lien only on receivables whereas the collateral for the bank's loan was inventory and equipment.

### **GUARANTIES & RELATED MATTERS**

*Ernest Bock, LLC v. Steelman*,  
[2021 WL 4771306](#) (N.J. Super. Ct. 2021)

The trial court improperly granted summary judgment against guarantors before key witnesses were deposed, thereby denying the guarantors fair opportunity to litigate their contentions that the lender: (i) breached the implied covenant of good faith and fair dealing by engaging in transactions for its own benefit, which impeded the flow of revenues that might otherwise have been used to pay down the loan balances; and (ii) tortiously interfered with the guarantors' reasonable expectations of economic advantage. Although the guaranty agreement included language waiving any defense based on impairment of collateral or failure to exhaust remedies against the borrower, it did not include express language waiving a defense based on breach of the covenant of good faith and fair dealing, and absent express language, a guarantor does not waive the implied covenant of good faith and fair dealing.

## LENDING, CONTRACTING &amp; COMMERCIAL LITIGATION

*Itria Ventures, LLC v. O'Keefe*,  
[2021 WL 4477088](#) (N.D.N.Y. 2021)

The sole owner of a corporation that constructed and installed pools, hot tubs, and spas, and who started a similar business after the corporation ceased operations, could not have successor liability for the obligations of the corporation because successor liability extends only to business entities, not to individuals.

*Wells Fargo Bank v. Deerbrook Mall, LLC*,  
[2021 WL 5054644](#) (S.D. Tex. 2021)

A mortgagor that asked for a payoff statement and then – without reservation, objection, or qualification – paid the amount indicated a few days before a scheduled foreclosure, could not two months later assert a claim that some of the fees included in the payoff statement were not properly owing. In the absence of fraud or mistake, the voluntary payment doctrine bars recovery of amounts voluntarily paid with full knowledge of the facts.

*Onemata Corp. v. Rahman*,  
[2021 WL 5175544](#) (S.D. Fla. 2021)

A claim of fraudulent inducement cannot be waived in the written agreement itself absent an express term that makes the contract incontestable due to fraud. Consequently, including in the agreement a merger clause, which purports to make unenforceable oral terms not incorporated into the writing, does bar evidence that oral representations fraudulently induced a party to enter into the agreement.

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