

THE TRANSACTIONAL LAWYER

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THE BEST DEFENSE: BUY THE OFFENSE

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One classic adage of strategy, applicable to both warfare and some sports, is “the best defense is a good offense.”¹ There are certainly some litigators who follow this mantra by aggressively responding to a claim with baseless counterclaims, duplicative motions, and excessive discovery requests, thereby testing the limits of the rules of professional conduct.

Another approach – one that is often safer, more efficacious, and less expensive – is simply to deprive the other party of standing by acquiring the claim. This article illustrates how this was accomplished in two separate cases, one of which was decided less than two months ago. The article then offers some advice for transactional lawyers on how to lay a foundation for later use of this tactic.

*CONLEY V. PUBLIC SAFETY GROUP, INC.*²

In 1999, Tom and Karen Conley brought a variety of claims against their former employer, Public Safety Group, Inc. (“PSG”). PSG counterclaimed for breach of fiduciary duty relating to the Conleys’ alleged use, during their employment, of company funds to pay personal expenses. In 2004, before the case came to trial, the Conleys purchased a \$13,000 judgment that a creditor of PSG had obtained against the company. A month later, pursuant to a writ of execution, the Conleys used a credit bid of slightly more than \$5,200 to purchase at a sheriff’s sale PSG’s counterclaims against themselves and then sought to dismiss PSG’s counterclaims, arguing that they now owned them.

The trial court refused, believing that PSG’s secured creditor had a senior interest in the counterclaims and that this, for some unexplained reason, prevented the Conleys from acquiring the counterclaims at the sheriff’s sale. After trial, the court entered judgment for PSG on its counterclaims, awarding almost \$296,000 in compensatory and punitive damages.

The Iowa Court of Appeals reversed. After noting that federal courts had ruled, in unrelated proceedings, that the counterclaims were commercial tort claims to which the secured creditor’s security interest did not attach,³ the court of appeals concluded that the Conleys had become the owner of the counterclaims before trial and that the counterclaims should have been dismissed. It did not matter that the execution sale related to a judgment for only \$13,000 or that the high bid was less than half that amount; the sheriff’s sale was “of the entirety of PSG’s counterclaims.”⁴

In sum, the Conleys purchased a \$13,000 judgment – the court did not mention the purchase price, but it was unlikely to be for more than the face amount of the judgment – and used it to acquire ownership of and then dismiss claims against themselves that amount to almost \$300,000. Brilliant!

*FIGUEROA TOWER I, LP V. U.S. BANK*⁵

In 2006, three related entities (the “Figueroa Towers” limited partnerships) borrowed \$62 million secured by deeds of trust on real property in Los Angeles and specified personal property, including existing and after-acquired general intangibles. Eventually, U.S. Bank acquired the loans. After a default, the bank recorded a notice of trustee’s sale that listed the debt as \$82 million. This figure included a \$14 million prepayment penalty.

At the trustee’s sale in 2013, the bank acquired the real property collateral with a \$67 million credit bid. Eleven months later, the bank conducted a public sale of the personal property collateral, at which it was the only bidder. The bank purchased the personal property collateral, including general intangibles, with a \$10,000 bid. No doubt many of you reading this can see where this is headed.

In between the two sales, Figueroa Towers filed a complaint against U.S. Bank, alleging causes of action for breach of contract and wrongful foreclosure, among others, stemming from the bank’s efforts to collect the prepayment penalty. After a partial summary judgment was awarded to the bank, only the breach of contract claim survived. After the sale of the personal property, the bank then moved to dismiss that claim based on lack of standing.

The trial court agreed. It concluded that the bank had acquired the contract claim at the second sale, when the bank purchased Figueroa Towers’ general intangibles. The California Court of Appeal affirmed. Although the bank apparently waited years before raising the standing issue, the court concluded that

Contents

<i>THE BEST DEFENSE: BUY THE OFFENSE.....</i>	1
Recent Cases.....	6

lack of standing is a jurisdictional defect that is not waived by a defendant's failure to raise it by demurrer or in an answer, and can be raised at any time.⁶ The court then concluded that the breach of contract claim was a "general intangible" within the meaning of the deed of trust, because, even though that term was undefined in that document, the Article 9 definition could be used to provide the necessary meaning.⁷ The court also rejected Figueroa Towers' claim that to allow U.S. Bank to acquire and then dismiss the claim against itself would violate public policy.⁸

Figueroa Towers' final argument was that the sale of personal property collateral was not commercially reasonable. The court of appeals reviewed Article 9's rules on dispositions and correctly noted that a debtor's remedies for a secured party's commercially unreasonable sale do not include voiding the sale.⁹ Instead, as long as the buyer – in this case the bank – acted in good faith, the buyer takes the property free of other interests.¹⁰ In any event, the trial court had ruled that the sale of personal property collateral was commercially reasonable and there was no basis on appeal for overturning that conclusion.¹¹

So, in sum, the bank purchased the claim against itself and was entitled to dismiss the claim. It is unclear if this was the bank's plan or if, instead, it stumbled into this realization later, after having purchased the intangible collateral. But either way, it worked.¹²

TWO DIFFERENT PROCESSES

It is important to recognize that the process used in the two cases was different. In *Conley*, the transfer of the claim (technically, a counterclaim) was entirely involuntary on the part of the claim owner. The claim defendants simply found an existing judgment against the owner, acquired that judgment, and then employed judicial process to sell the claim to themselves. There is little that the claim owner could do to prevent this from happening, other than paying off the judgment, but the ability of claim defendants to use this tactic rests on the felicity that a judgment exists against the claim owner and that the judgment can be acquired for an amount much smaller than the claim is worth. There is little that a transactional lawyer can do at the inception of a transaction or during the contractual relationship of the parties to plan for or prearrange this situation. But perhaps litigators should regularly conduct searches for existing judgments against their client's opponent. You never know; you might get lucky.

In *Figueroa Tower*, there was, at least initially, a voluntary transfer of an interest in the claim when the borrowers granted security interests in their existing and after-acquired personal property to the bank. It was this voluntary transfer that later enabled the bank to acquire – through the Article 9 processes for enforcing a security interest and without further cooperation from the debtors – the debtors' claim against the bank. This

sequence of events is something that a transactional lawyer can plan for, at least in some circumstances. Accordingly, the remainder of this article focuses primarily on a secured party's acquisition of a claim against itself.

SETTING THE STAGE

The first thing the transactional lawyer representing the secured party must do is to make sure that the client acquires a security interest in the claim. This means that the claim must be included in the security agreement's description of the collateral. Almost all contract and statutory claims will be "general intangibles."¹³ Including them in the collateral description is quite simple: a reference to "existing and after-acquired general intangibles" would suffice.¹⁴

A tort claim, in contrast, will either be a "commercial tort claim"¹⁵ or, if not, a security interest in it will be outside the scope of Article 9.¹⁶ Encumbering tort claims is difficult for three reasons. First, a description of a commercial tort claim simply by collateral type – *i.e.* "all commercial tort claims" – is inadequate; a more specific description is needed.¹⁷ Second, and more important, a security interest cannot attach to a commercial tort claim pursuant to an after-acquired property clause.¹⁸ Of course, a debtor is unlikely to expressly grant to the secured party a security interest in any type of claim that the debtor already has against the secured party. In other words, the only way a secured party is likely to have a security interest in a claim against itself is if the security interest attaches to the claim under an after-acquired property clause. Because such a clause will not encumber an after-acquired commercial tort claim, it is exceedingly unlikely that a secured party will ever acquire a security interest in a commercial tort claim against itself. Finally, if the tort claim were not a commercial tort claim, and hence Article 9 did not apply to a security interest in it, any attempted assignment of the claim would have to get past the common law's historical distaste for champerty.¹⁹

One conclusion to be drawn from all of this is that the tactic of acquiring a claim against oneself for the purpose of dismissing it is far simpler with respect to claims based on contract or statutory rights, rather than with respect to claims arising in tort.²⁰

ACQUIRING OWNERSHIP OF THE CLAIM

So, let's assume that the secured party has a security interest in the primary collateral – real property, inventory, equipment, or accounts, for example – but that the security agreement also encumbers after-acquired general intangibles, which would cover contractual or statutory claims that the debtor has acquired or will in the future acquire against the secured party. The debtor has defaulted. If the secured party wishes to take advantage of the tactic used in *Figueroa Tower*, the secured party needs to follow these steps when foreclosing its interest in the collateral.

1. If the secured party does not intend to buy the primary collateral at the foreclosure sale, then the sale should be limited to the primary collateral. In other words, the sale should exclude either all general intangibles or, if some general intangibles are part of the primary collateral, exclude all claims against the secured party.²¹

2. If the secured party does intend to buy the primary collateral at the foreclosure sale, in which case the sale will likely need to be a public auction,²² and the secured party is confident that it will be high bidder, the secured party should include the claims against itself in the property to be sold.²³

3. If the secured party is bidding at a disposition of the primary collateral, the secured party should endeavor not to credit bid the entire secured obligation. That is because the disposition of the primary collateral could itself violate the debtor's contractual or statutory rights, and thereby give rise to a claim against the secured party. Such a claim would itself be an after-acquired general intangible to which the security interest would attach, provided some portion of the secured obligation remained after the disposition.

4. After the disposition of the primary collateral, the secured party should conduct a second disposition of the remaining collateral: *i.e.*, any claims of the debtor against the secured party, including any claims that might have arisen from the sale of the primary collateral. This disposition will need to be held by public sale²⁴ and the secured party should endeavor to be the successful bidder.

By advising the secured party to follow this approach, a transactional lawyer maximizes the secured party's likelihood of acquiring any claims against itself, and thereby depriving the debtor of standing to pursue those claims.

LIMITATIONS ON THE EFFICACY OF THE TACTIC

Admittedly, all this seems somewhat shady. And, of course, other courts might not follow *Figuroa Tower* and rule instead that the tactic does violate public policy. This risk is probably higher with respect to statutory claims – particularly claims relating to nonwaivable statutory rights²⁵ – than it is with respect to contractual claims. Finally, the tactic in no way protects the secured party from the claims that others, such as junior lienors or secondary obligors, have standing to assert.²⁶ That said, there seems to be little downside risk to this tactic.²⁷ So even if it is not something you use regularly, it might be a useful arrow to keep in your quiver. After all, the best defense is a good offense.

Notes

1. See Wikipedia at https://en.wikipedia.org/wiki/The_best_defense_is_a_good_offense.

2. [2009 WL 1492269](#) (Iowa Ct. App. 2009).

3. *Shirley Medical Clinic, P.C. v. United States*, [446 F. Supp. 2d 1028](#) (S.D. Iowa 2006), *aff'd*, [243 F. App'x 191](#) (8th Cir. 2007). The district court ruled that generic reference in the security agreement to “proceeds from any lawsuit due or pending” was insufficient, under § 9-108(e)(2), to create a valid security interest in the counterclaims.

4. [2009 WL 1492269 at *4](#).

5. [2019 WL 1467953](#) (Cal. Ct. App. 2019).

6. *Id. at *11*. *But cf. id. at *13* (stating that U.S. Bank asserted plaintiffs' lack of standing as an affirmative defense at least as early as 2013).

7. *Id. at *12-13*. Article 9's definitions apply only within Article 9 itself – that is, they give meaning to the defined terms each place they are used in Article 9, not to when they are used in a private contract, such as a security agreement. See U.C.C. § 9-102(a) (beginning “[i]n this Article”). Parties are free to express their agreements in whatever language they wish and to imbue terms, even terms used and defined in the UCC, with whatever meaning they desire. Thus, it is arguably inappropriate to assume that a term in a written security agreement carries with it the meaning ascribed to it by the UCC. See, e.g., *In re Eaddy*, [2016 WL 745277](#) at *5-6 (Bankr. S.D. Ind. 2016) (suggesting that the term “accessions” in a security agreement need not have the meaning ascribed to it in § 9-335 because that definition is relevant only “to determine the priority of competing lienholders”). On the other hand, Article 9 has been in force for well over a generation. Few of the commercial lawyers still practicing did so under prior law. As a result, it has created a sort of usage of trade for secured transactions. Consequently, the UCC's definitions are highly probative in interpreting private security agreements and courts routinely apply those statutory definitions without even considering whether the parties meant something different. See, e.g., *Porter Cap. Corp. v. Horne*, [2016 WL 4197328](#) (N.J. Super. Ct. 2016) (looking to the Article 9 definitions of collateral types to determine the meaning of terms undefined in a security agreement); *In re Wiersma*, [324 B.R. 92](#) (9th Cir. BAP 2005) (security interest attached to debtor's contract claim because it was a “general intangible” and thus fell within the description of the collateral), *rev'd in part*, [483 F.3d 933](#) (9th Cir. 2007). See also § 9-108(b)(3) (expressly validating a description of collateral – whether in a financing statement or a security agreement – by use of a term defined in Article 9). In addition, many security agreements expressly adopt the Code definitions.

The court in *Figuroa Tower* also dispensed with an argument that the general intangibles had to relate to the real property, noting that the language of the deed of trust was not so limited and, in any event, *Figuroa Towers'* action for breach of the note and deed of trust “is inherently related to the Property.” [2019 WL 1467953 at *13](#).

8. [2019 WL 1467953 at *14](#). *But cf. DB NPI Century City, LLC v. Legendary Investors Group No. 1, LLC*, [2019 WL 2082039 at *14](#) (Cal. Ct. App. 2019) (suggesting – in connection with the court’s incorrect conclusion that a security agreement’s after-acquired property clause cannot encumber rights under an agreement settling a commercial tort claim – that this would lead to the absurd result that the lender could then have a security interest in the proceeds of the debtor’s claim against the lender).

9. *Id.* (citing U.C.C. § 9-615).

10. *Id.* (citing U.C.C. § 9-617). Unfortunately, the court’s discussion of this point is a bit confused. The court’s syllogism appears to be:

- (i) remedies for a commercially unreasonable sale do not include voiding the sale;
- (ii) if the buyer acts in good faith, the buyer takes the property free of other interests;
- (iii) therefore, if the secured party is the buyer and acts in good faith, the secured party acquires full ownership of the property sold.

However, the court phrased the conclusion as requiring the secured party to both “act[] in good faith and conduct[] a commercially reasonable sale.” *Id.* at *15. The court offered no reason why conducting the sale in a commercially reasonable manner should matter, given the analysis and discussion it had just provided.

11. *Id.* at *15.

12. Other cases – although not involving a claim acquired by the defendant – similarly suggest that foreclosure on a claimant’s rights does or at least can result in a transfer of the claim. For example, in *DG Cogen Partners, LLC v. Lane Powell PC*, [917 F. Supp. 2d 1123](#) (D. Or. 2013), the court ruled that a debtor had no cause of action against its attorneys for malpractice in connection with the execution of an unreasonably unfavorable settlement of tort and contract claims because the debtor’s secured party had acquired all of the debtor’s general intangibles at a foreclosure sale and thus the debtor was not a proper plaintiff. The court did not discuss whether the security agreement adequately described the tort claims under § 9-108(e) or whether § 9-204(b)(2) prevented the security interest from attaching to the tort claims. *F.R.S. Development Co. v. American Community Bank and Trust*, [58 N.E.3d 26](#) (Ill. Ct. App. 2016), involved a real estate developer’s right to recapture from the city some of the cost of roadway and intersection improvements that benefitted property outside the development. The court ruled that those recapture rights were personal property – a general intangible – and therefore a bank did not acquire those rights when it foreclosed on the real property. Instead, the bank had released its security interest in those rights

when the bank released its security interest in general intangibles. In *Nelson v. Vernco Construction, Inc.*, [406 S.W.3d 374](#) (Tex. Ct. App. 2013), the court ruled that because a bank’s forbearance agreement with the debtor recited that the bank “now owns” the debtor’s contract and tort claims in a pending lawsuit and further recited that “pursuant to applicable law, [the bank] is the owner of all claims (including commercial tort claims) identified in the Litigation,” the bank had accepted the claims in partial satisfaction of the secured obligation, and was the owner of the claims. Accordingly, the debtor had no standing to prosecute the claims and a judgment in favor of the debtor had to be vacated.

13. *See* U.C.C. § 9-102(a)(42). While contractual rights can also fall under other Article 9 classifications of collateral – accounts, chattel paper, instruments, and letter-of-credit rights, for example, *see* U.C.C. § 9-102(a)(2), (11), (47), (51) – the debtor is unlikely to have any of those rights against the secured party.

14. *See* U.C.C. §§ 9-108(b)(3), 9-204(b).

15. *See* U.C.C. § 9-102(a)(13).

16. *See* U.C.C. § 9-109(d)(12).

17. *See* U.C.C. § 9-108(e)(1). *See also* *In re Connolly Geaney Ablitt & Willard P.C.*, [585 B.R. 644](#) (Bankr. D. Mass. 2018); *In re Modern Plastics Corp.*, [534 B.R. 723](#) (Bankr. W.D. Mich. 2015); *California Charley’s Corp. v. City of Allen Park*, [2013 WL 1442242](#) (Mich. Ct. App. 2013); *In re Residential Capital, LLC*, [497 B.R. 403](#) (Bankr. S.D.N.Y. 2013); *In re Doctors Hospital of Hyde Park, Inc.*, [474 B.R. 576](#) (Bankr. N.D. Ill. 2012); *Beane v. Beane*, [2011 WL 223167](#) (D.N.H. 2011); *Conley v. Public Safety Group, Inc.*, [2009 WL 1492269](#) (Iowa Ct. App. 2009); *In re Sarah Michaels, Inc.*, [358 B.R. 366](#) (Bankr. N.D. Ill. 2007).

18. *See* U.C.C. § 9-204(b)(2). *See also* *In re Modern Plastics Corp.*, [534 B.R. 723](#); *Waltrip v. Kimberlon*, [79 Cal. Rptr. 3d 460](#) (Cal. Ct. App. 2008).

19. Champerty is the practice of acquiring for profit an interest in a cause of action. The historical justification for prohibiting champerty was that it encouraged fraudulent lawsuits. But regardless of whether that assessment ever was accurate, “the modern doctrines of abuse of process, malicious prosecution, and wrongful initiation of litigation,” along with the ethical and legal obligations of lawyers to insure that litigation be conducted in good faith, “deal more directly with the problems that may have originally motivated the common law doctrine of champerty.” *See* American Bar Association, [Commission on Ethics 20/20, Informational Report to the House of Delegates](#) at 9 (December 27, 2011). As a result, many U.S. jurisdictions have abandoned or limited their restrictions on champerty. *See, e.g., Del Webb Communities, Inc. v. Partington*, [652 F.3d 1145](#), 1156 (9th Cir. 2011) (“The consistent trend across the country

is toward limiting, not expanding, champerty's reach.”). Nevertheless, the doctrine survives in some places. *See, e.g.*, *Revolutionary Concepts, Inc. v. Clements Walker PLLC*, [744 S.E.2d 130](#) (N.C. Ct. App. 2013) (legal malpractice claims are not assignable in North Carolina because assignment promotes champerty); *Gurski v. Rosenblum and Filan, LLC*, [885 A.2d 163](#) (Conn. 2005) (invalidating the assignment of a legal malpractice claim to the adverse person in the litigation who benefitted from the malpractice).

That said, it is worth noting that the principal concern underlying the prohibition on champerty is that the practice has the effect of promoting litigation, particularly litigation of dubious merit. An assignment to the defendant is designed to *curtail* litigation, not to *facilitate* it, so it is not at all clear that the policies underlying the limits on champerty apply. Nevertheless, a lawyer seeking to employ the tactic for the benefit of a client should carefully review the law of the applicable jurisdiction to determine whether an assignment of the claim is permissible.

20. One thing a secured party can – and frequently does – do to insulate itself from tort liability to the debtor is to require the debtor to release any such claim as a condition to entering into a forbearance agreement. For example, after the debtor defaults, the secured party might agree to forbear from foreclosing on the collateral in exchange for an increase in the interest rate and a release of all tort, contract, and statutory claims that the debtor currently has against the secured party. This approach is effective to release accrued claims but is generally ineffective to release future tort and statutory claims. *See, e.g.*, *Viridis Corp. v. TCA Global Credit Master Funds, LP*, [721 F. App'x 865](#) (11th Cir. 2018) (also indicating that a general release was ineffective to cover claims based on fraudulent misrepresentations because it did not expressly indicate that it was incontestable on the ground of fraud).

21. Because all aspects of a disposition must be commercially reasonable, *see* U.C.C. § 9-610(b), the secured party should consider whether selling the collateral in different lots might violate that standard. For example, if the security agreement encumbered all of a business debtor's personal property and the goal was to sell the business as a going concern, it might not be commercially reasonable to exclude all general intangibles from the sale. However, it is unlikely that a disposition would be deemed to be commercially unreasonable if the only thing excluded was the debtor's claims against the secured party.

22. Although most dispositions under Article 9 are conducted as a private sale, the secured party is permitted to buy at a private sale only if the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations. U.C.C. § 9-610(c)(2). In general, to be permitted to buy at a disposition, the secured party must conduct the disposition as a “public sale,” *see* § 9-610(c)(1), which means that the sale must be an auction in which “the

public has a meaningful opportunity for competitive bidding.” U.C.C. § 9-610 cmt. 7.

23. *Cf. Macquarie Bank Ltd. v. Knickel*, [723 F. Supp. 2d 1161](#) (D.N.D. 2010) (denying a bank's motion for summary judgment on a claim against it for tortiously disclosing confidential and proprietary information about the debtor; although the bank had a security interest in all of the debtor's confidential data, and thus could have transferred the data as part of a disposition, the sheriff's sale did not include general intangibles and thus the bank did not foreclose on them).

24. The secured party must, of course, conduct the sale in a commercially reasonable manner. *See* U.C.C. § 9-610(b). If it fails to do so, then the debtor will have a claim against the secured party for any damages caused thereby. Because such a claim would arise from the sale itself, the claim would not be part of the collateral transferred and would remain property of the debtor.

25. *See* U.C.C. §§ 9-602, 9-624 (delineating the Article 9 rights that are nonwaivable or waivable only after default).

26. *See* U.C.C. §§ 9-611(c), 9-615(a), 9-623(a), 9-625(c) (each dealing, at least in part, with rights of someone other than the debtor or the secured party).

27. The approach used in the *Conley* case – buying a judgment against the claimant and then executing against the claim – could be an avoidable fraudulent transfer if the claimant is insolvent and the amount paid at the execution sale is not reasonably equivalent to the value of the claim. *See* Uniform Voidable Transactions Act § 4(a)(2). As a result, a defendant who uses this tactic might end up paying for the judgment and not be able to retain ownership of the claim. Even in such a case, the defendant would, presumably, be entitled to set off the judgment debt against any liability the defendant ultimately has on the claim. *But cf.* 11 U.S.C. § 553(a)(2) (disallowing setoff against a bankruptcy debtor if the claim against the debtor was transferred within 90 days before the petition and while the debtor was insolvent). A transaction in which a secured party acquires the claim through a disposition of collateral is, in contrast, not subject to avoidance as a fraudulent transfer. *See id.* § 8(e)(2).



Recent Cases

SECURED TRANSACTIONS

Scope Issues

Power Up Lending Group, Ltd. v. Cardinal Energy Group, Inc.,
[2019 WL 1473090](#) (E.D.N.Y. 2019)

A transaction in which a business sold for \$128,000 18% of its future accounts receivable, to be collected by way of daily, automatic withdrawals from the business's bank account until a total of \$172,800 was collected, was a true sale and hence not subject to state usury law.

In re McQuaig,
[2019 WL 1470891](#) (Bankr. S.D. Ga. 2019)

A lease of a portable barn for a renewable one-month term was a true lease even though the lessee would automatically become the owner if the lessee renewed the lease and paid the rent for a total of 48 consecutive months. Although the agreement was titled a "48 Month Purchase Agreement & Disclosure Statement," it was clear that the term was for only one month and that the lessee had no obligation beyond that period.

In re Hawaii Island Air, Inc.,
[2019 WL 2041705](#) (Bankr. D. Haw. 2019)

Factual issues prohibited a determination at the summary judgment stage of whether a transaction by which an airline sold spare parts to the lessor of its aircraft, but retained possession of the spare parts, was a true sale or a secured loan. Several facts suggest that the transaction was a loan: (i) the transaction occurred only because the airline needed an immediate cash infusion; (ii) the lessor had no need for the spare parts, would not have bought them if the airline had not needed cash, had no interest in them other than liquidating them as rapidly as possible, and apparently was not in the business of dealing in such items; (iii) neither party seemed concerned about whether the parts were worth the purchase price; and (iv) the lessor apparently did not expect or demand payment contemporaneously with the sale. However, some facts suggest that the transaction was a true sale: (i) the airline also had no use for the parts and apparently never intended to regain full control of them; and (ii) the lessor had no contractual guarantee of repayment.

Attachment Issues

Mantle v. North Star Energy & Construction LLC,
[2019 WL 2183117](#) (Wy. 2019)

Because of the heightened requirements for describing a commercial tort claim in a security agreement, a security interest covering after-acquired "general intangibles" is insufficient to encumber the debtor's rights under an agreement settling a commercial tort claim.

DB NPI Century City, LLC v. Legendary Investors Group No. 1, LLC, [2019 WL 2082039](#) (Cal. Ct. App. 2019)

Even though a lender's security agreement covered after-acquired general intangibles, the security interest did not attach to the debtor's rights under an agreement settling a commercial tort claim that arose after the security agreement was authenticated. Because a security interest cannot attach under an after-acquired property clause to a commercial tort claim, it cannot attach to the rights under a settlement agreement relating to such a claim.

1st Source Bank v. Minnie Moore Resources, Inc.,
[2019 WL 2161679](#) (N.D. Ind. 2019)

A security agreement sufficiently described the equipment that the debtor purchased with financing from a bank even though the agreement did not identify the items by their model year and even though there was an error in the serial number of one item. The model of each item was listed and the debtor did not claim to own more than one of that model.

In re Mason,
[2019 WL 1472947](#) (Bankr. E.D.N.C. 2019)

The debtor's purported grant of a security interest in his ownership interest in a Delaware limited liability partnership was, pursuant to the "internal affairs doctrine," governed by Delaware law even though the security agreement chose New York law to govern and the debtor was a resident of North Carolina. Because the partnership agreement stated that any attempt by a partner to grant a security interest in the partner's interest without the consent of the other partners was void, and Delaware law enforces such a restriction, no security interest attached. It did not matter that the debtor represented to the secured party that the debtor had authority to grant the security interest.

In re Aerogroup International, Inc.,
[2019 WL 2120735](#) (Bankr. D. Del. 2019)

A secured party with a senior security interest in the debtor's intellectual property was not entitled to any portion of the proceeds of a settlement agreement that the debtor entered into with a buyer after the buyer breached an asset purchase agreement even though the agreement included a transfer of rights in trademarks. Another creditor had priority in the debtor's claims against the buyer and nothing in the settlement agreement allocated a portion of it to the alleged diminution in value of the intellectual property. As a result, even if some portion of the settlement were for loss to the value of the intellectual property, that portion was not *identifiable* proceeds of the intellectual property.

Perfection Issues

Fishback Nursery, Inc. v. PNC Bank,
[920 F.3d 932](#) (5th Cir. 2019)

Because under § 9-302 the law of the jurisdiction where farm products are located governs the perfection and priority of an agricultural lien on the farm products, the law of Michigan, Tennessee, and Oregon governed, respectively, the priority of the agricultural liens on the farm products shipped to those states, even though the debtor's contracts with the agricultural lienholders purported to select only Oregon law. The priority issue among the lienholders was not a contractual dispute to which the contractual choice-of-law did. The result would be the same if the court applied federal choice-of-law rules to determine which state's law controlled. The lien notice filed in Oregon was ineffective because such a notice expires 45 days after final payment is due and, while the effectiveness of notice can be extended, the lienholder's extension was filed after the notice became ineffective. The financing statement the lienholder filed in Oregon did not substitute for a proper lien notice because it was not supported by the required affidavit, was not in the prescribed form, and lacked some of the information required for an effective lien notice.

In re Trinity Investment Group, LLC,
[2019 WL 2004760](#) (Bankr. N.D. Ind. 2019)

A seller that sold several Subway restaurants located in Ohio to the debtor and retained a security interest in the equipment and accounts did not perfect the security interest by filing a financing statement in Ohio because the debtor is an Indiana limited liability company and its chief executive office is in Indiana, and thus is located in Indiana.

Enforcement Issues

McDonald v. Wells Fargo Bank,
[2019 WL 1656761](#) (W.D. Pa. 2019)

A notification of disposition sent by the secured party complied with §§ 9-613 and 9-614. Although the notification did not state that the debtor was entitled to "an accounting," it did state that "[i]f you want us to explain to you in writing how we have figured the amount that you owe us, you may call us at . . . and request a written explanation." The Code, which emphasizes substance over form, permits a secured party to use language its customers can understand. Although the notification did not indicate the charge for an accounting, the notification included a summary of the overdue charges, and that is sufficient. Moreover, there was no evidence that the secured party charged for an accounting and, if it did not, there is no need for the notification to expressly state that there is no charge. A jury question remained about whether a second notification sent after the collateral was not sold as planned rendered the disposition commercially unreasonable. The initial notification stated a minimum price and the subsequent notification failed to indicate

the minimum did not apply to the second attempted sale. The secured party's post-sale notification of deficiency complied in both form and substance with § 9-616 because it stated the aggregate amount of obligations secured, the gross proceeds from the disposition, the aggregate amount "of expenses, including expenses of retaking, holding, preparing for disposition, processing and disposing of the collateral and attorney fees secured by the collateral which are known to the secured party and relate to the current disposition," the lack of credits for insurance and other rebates, and, in bold, the total amount of the deficiency.

Meruelo v. East West Bank,
[2019 WL 1567561](#) (Cal. Ct. App. 2019)

A bank that, prior to conducting a public disposition of a secured promissory note, sent notification to the debtor at five different addresses, including the address provided for in the loan agreement, and to two lawyers for the debtor, satisfied its obligation to send reasonable notification. The bank had no duty to send notification to the address indicated on a change-of-address form that the debtor had previously submitted to the bank because the form concerned only billing, not all notifications, and there was no evidence that it was sent by any of the methods specified in the loan agreement for a change of address for all purposes (*i.e.*, registered or certified mail, personal delivery, facsimile, overnight mail, or overnight courier). The bank also had no duty to send the notification to the debtor's son, even though he was the bank's main contact with respect to the loan and a potential bidder at the sale. The notification, which included all the information required by § 9-613, was not rendered ineffective by the fact that the letter's heading – "Notice of Continuing Default and Foreclosure" – referred first to continuing default rather than to foreclosure.

Liability Issues

Windsor Securities, LLC v. Arent Fox LLP,
[2019 WL 1510895](#) (S.D.N.Y. 2019)

Summary judgment could not be awarded for either side in a secured party's malpractice claim against its legal counsel for allegedly giving incorrect advice with respect to the application of California law to an acceptance of financed insurance policies in satisfaction of the secured obligation. There was conflicting evidence as to what advice was given and conflicting expert testimony as to whether counsel had satisfied the applicable standard of care.

Eurosemillas, S.A. v. PLC Diagnostics Inc.,
[2019 WL 2088479](#) (N.D. Cal. 2019)

Two secured parties with an intercreditor agreement between them did not breach an intercreditor agreement with a third lender because neither the debtor nor one of the secured parties signed the draft that was circulated and that secured party instead expressly indicated what terms needed to be changed to obtain its assent. Although subsequent email messages indicated that the parties thought they had a three-way intercreditor agreement, there is no evidence of such an agreement or indication of what its terms are. While the parties might have agreed that the three security interests would be of equal priority, they left unresolved all the other terms of the agreement, such as “the treatment of payments, distributions, impairment, specific performance, foreclosure, and so on,” with the result that the alleged agreement is too indefinite to be enforceable. Even though one of the secured parties and the lender signed the draft agreement, no one was bound by the agreement because the signature of all parties is a condition to the efficacy of the agreement.

GUARANTIES & RELATED MATTERS

Wyrick v. Business Bank of Texas,
[2019 WL 1941839](#) (Tex. Ct. App. 2019)

Guarantors had no fraudulent inducement or negligent misrepresentation defense based on the lender’s failure to obtain a security interest in the intended collateral because the guarantors waived suretyship defenses and the guaranty agreement expressly authorized the lender to enforce the guaranty without pursuing the collateral, and thus there could be no justifiable reliance on any statement by the lender that it would obtain a security interest. The guarantors’ mutual mistake defense based on the nonexistence of the collateral failed for a similar reason: the guarantors assume the risk of the mistake.

LENDING, CONTRACTING & COMMERCIAL LITIGATION

Himelsein Mandel Fund Mgmt., LLC v. Fortress Inv. Group LLC, [2019 WL 1395963](#) (Cal. Ct. App. 2019)

The trial court erred in enforcing a security agreement’s choice of New York law to govern the parties’ rights and a waiver of a jury trial because the waiver violated fundamental policy of California law and California had a materially greater interest in the matter even though the debtor was organized under New York law, the secured party’s principal office is in New York, and the parties negotiated the agreement in New York.

In re Emerald Grande, LLC,
[2019 WL 1421429](#) (Bankr. N.D.W. Va. 2019)

Loan documents that made the debtor responsible for the legal expenses incurred by the lender “in connection with the enforcement of this Agreement,” including: (i) expenses incurred “for bankruptcy proceedings (including efforts to modify or vacate any automatic stay or injunction);” (ii) “costs and expenses of preserving and protecting [the collateral];” and (iii) any “expenses paid or incurred to . . . enforce [its] security interests and liens . . . or to defend any claims made or threatened against [it] arising out of the transactions contemplated hereby,” did not encompass fees incurred in opposition to an administrative expense claim, monitoring the bankruptcy case, seeking the conversion or dismissal of the debtor’s case, or for other clerical work incidental to its participation in the debtor’s bankruptcy case.

Estate of Malkin v. Wells Fargo Bank,
[2019 WL 1429660](#) (S.D. Fla. 2019)

The estate of an individual was entitled to the benefits paid under a stranger-initiated life insurance (“STOLI”) policy rather than the entity that acquired the policy from the original financier. The entity was not protected under § 8-502 as a bona fide purchaser of a financial asset because the policy was void ab initio and because § 8-502 does not override Delaware’s insurable interest statute, which prohibits investors from retaining the death benefits under a life insurance policy procured through a STOLI scheme.

Figueroa Tower I, LP v. U.S. Bank,
[2019 WL 1467953](#) (Cal. Ct. App. 2019)

A debtor had no standing to prosecute a breach of contract claim against a lender for conduct relating to efforts to collect a \$14 million prepayment penalty allegedly before that amount was due because several months thereafter the lender foreclosed on and purchased for \$10,000 the personal property collateral listed in the deed of trust – which included general intangibles, and hence claims for breach of contract – and thus the debtor was no longer the owner of the contract claim. The general intangibles were not limited to things associated with the real property.

Sotheby’s, Inc. v. Mao,
[2019 WL 1938506](#) (N.Y. App. Div. 2019)

Even though an oral waiver of contractual rights can be effective despite a term in the written agreement purporting to prohibit oral modifications and waivers, such a waiver cannot operate to extend the limitations period because state law requires a waiver of the statute of limitations to be in a signed writing. Consequently, a creditor’s alleged waiver of default, even if otherwise effective, did not extend the limitations period for bringing an action on the debt.

In re Rent-Rite Superkegs West, Ltd.,

[2019 WL 2184708](#) (Bankr. D. Colo. 2019)

A promissory note between a Colorado borrower and a Wisconsin bank, which selected Wisconsin as the governing law and provided for interest at more than 120% per year – a rate that would be usurious under Colorado law but not under Wisconsin law – was enforceable because the federal Depository Institutions Deregulation and Monetary Control Act of 1980 (“DIDMCA”) expressly allows a state-chartered bank to charge interest at “the rate allowed by the laws of the State . . . where the bank is located.” It did not matter that the bank later assigned the note to a non-bank. Even if DIDMCA did not apply, a federal court not sitting in diversity would apply federal choice-of-law principles, and under those rules, Wisconsin law would govern because the note expressly designated Wisconsin as the place of payment. Even if Colorado choice-of-law rules applied, Wisconsin law would govern because, under U.C.C. § 1-301, the parties are free to select any state’s law to govern if the transaction bears a reasonable relation to that state, and the transaction did bear a reasonable relation to Wisconsin. Finally, even if U.C.C. § 1-301 were inapplicable, Wisconsin law would still apply pursuant to § 187 of the Restatement (Second) of Conflict of Laws because Colorado did not have a materially greater interest than Wisconsin in the issue, enforcing the note would not violate a fundamental policy of Colorado, and Wisconsin law would govern in the absence of the contractual choice because the place of performance was in Wisconsin.

BMO Harris Bank v. Richland Express, Inc.,

[2018 WL 8299883](#) (E.D. Ark. 2019)

Loan agreements selecting Texas and Utah law and providing for a default rate of interest that would be usurious under Arkansas law violate a fundamental policy of Arkansas, and hence Arkansas law applies despite the contractual choice. However the default interest rate that the agreements provide for – 18% per year, or “otherwise at the highest rate [the debtor] can legally obligate itself to pay” – could be reduced to 17%, the maximum amount permitted under Arkansas law, even though the penalty for usury in the state is that the agreement is void as to both principal and interest.

■ ■ ■

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**Center for Law,
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ANNOUNCING A NEW AMICUS INITIATIVE

Nominations for Directors Invited

The Commercial Law Amicus Initiative (“CLAI”) seeks nominations for qualified people to serve on its Board of Directors. CLAI is a newly formed corporation (currently applying for § 501(c)(3) status) with the following stated purposes:

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.

CLAI’s primary activity will be preparing and filing *amicus curiae* briefs in commercial law cases around the country. Pursuant to a policy adopted by CLAI’s Board of Directors, CLAI will not become involved in a case without the approval of two-thirds of the Directors voting on the matter. CLAI’s Board of Directors currently consists of Professors Stephen Sepinuck (Gonzaga), Kristen Adams (Stetson), and Jennifer Martin (St. Thomas). The current board seeks nominations for additional Directors, to expand the Board’s expertise and help instill confidence in the Board’s decisions.

Each Director must, at the time of appointment, satisfy two or more of the following conditions:

- (i) be a tenured professor or emeritus professor at an ABA accredited law school;
- (ii) be a member of the American Law Institute;
- (iii) be a fellow of the American College of Commercial Finance Lawyers;
- (iv) be a current or former Uniform Law Commissioner; or
- (v) have completed at least one term as chair of a committee of either the American Bar Association or Association of American Law Schools.

New Directors will serve for a three-year term. They will not be expected to prepare, edit or sign *amicus curiae* briefs, merely to help decide what cases and issues CLAI should take on.

Anyone may make a nomination or self-nomination by sending a brief message to any of the three current Directors:

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