

The Transactional Lawyer

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Zombie Documents

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One difficult challenge for transactional lawyers is dealing with zombie documents: written agreements for transactions long ago completed, which rise up and infect a new deal between the same parties with undesired terms. Consider, for example, the following scenario.

Bank makes a loan to Borrower, who signs a security agreement granting Bank a security interest in specified collateral to secure both the loan and all future obligations of Borrower to Bank. Borrower pays off the loan. Years later, perhaps for completely different reasons, Borrower again borrows funds from Bank. Does the collateral for the original loan secure the new debt? What if Bank's loan officer is unaware of the prior transaction and Borrower completely forgot about the future advances clause in the first security agreement, if indeed Borrower was ever aware of it? What if both Bank and Borrower intend the new loan to be unsecured or to have different collateral?

If the documents for the new loan expressly indicate the loan is unsecured, the answer should be fairly easy: the future advances clause in the earlier security agreement should not apply.¹ In the absence of such an express statement, however, courts understandably struggle with whether the original security agreement applies to the new transaction.

If documents for the new transaction include a new security agreement, and that agreement omits the collateral described in the earlier security agreement but

contains a merger clause indicating that the documents represent the complete agreement of the parties, it is quite possible that the court will treat that original security agreement as superseded: not a zombie document.

Such was the result last year in *Jipping v. First National Bank Alaska*,² a case decided by the Court of Appeals for the Ninth Circuit. The case involved a corporation that in 2009 obtained a loan from a bank and granted the bank a security interest in its deposit accounts to secure the debt. The security agreement contained a future advances clause covering all obligations of the corporation to the bank, "whether now existing or hereafter arising." The agreement also expressly provided that the security interest would "continue in effect even though all or any part of the Indebtedness is paid in full and even though for a period of time Grantor may not be indebted to Lender."³ The corporation paid off the original debt in 2011 and then, two years later, obtained a new loan from the bank. In so doing, the corporation executed a new security agreement that did not include deposit accounts as collateral. The agreement did, however, contain a merger clause; it provided that, "[t]his Agreement, together with any Related Documents, constitutes the entire understanding and agreement of the parties as to the matters set forth in this Agreement." The Ninth Circuit ruled that, because the 2009 security agreement was not a Related Document, the new loan was not secured by the borrower's deposit accounts. A contrary ruling, the court suggested, would render the merger clause meaningless.⁴

The decision disregards the language in the original security agreement expressly providing for the security interest to continue after the loan is paid off, but might nevertheless be correct. After all, the original security agreement and the new security agreement might well have differences other than their descriptions of the collateral. For example, they might differ in the definition of default or one might grant the debtor a right to cure. Giving efficacy to the original security agreement would therefore create the possibility of conflict. It might be better to let it rest in peace.

If there had been no new security agreement, merely a new loan agreement, then the argument that the original security agreement should continue to apply would have been much stronger.⁵ But even in that case, the answer might depend on whether the new loan agreement contains a merger clause and, if so, how that clause is phrased. If the merger clause expressly purports to

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“supersede” all prior agreements between the parties, the clause might well function as a zombie killer, preventing resurrection of the documents governing the earlier deal.

One thing that should not affect the analysis is the purpose of the loans. Before Article 9 was revised in 1999, there was a line of cases in which courts interpreted future advances clauses, despite their broad phrasing, to mean that only advances of the same character as the original advance would fall within the clause. Some courts even applied this “relatedness” requirement to debt incurred before the secured loan was made and the security agreement authenticated. The case of *In re Wollin*⁶ was typical; the debtors had purchased two automobiles with financing from a credit union. Both security agreements included a future advances clause providing that “[t]he security interest secures . . . any other amount you owe the credit union for any reason now or in the future.” Nevertheless, the court refused to treat a credit union’s security interest in the two automobiles as also securing either previously unsecured loans from the credit union or subsequent credit extended through a credit card issued by the credit union.

In a consumer case, such as *Wollin*, the relatedness requirement for antecedent debt and future advances might seem innocuous or even beneficial.⁷ Nevertheless, the relatedness requirement is unsupported by the text of the UCC itself.⁸ What is more, the relatedness requirement is inconsistent with its own underlying rationale. In an effort to ensure that the debtor has truly consented to having the future advance be secured, courts refuse to enforce the parties’ agreement as written – which is normally the best evidence of their intent. Moreover, in the process, they relegate the unquestioned intent of the secured party to an irrelevancy. Most significantly, there is no easy way to draft around the relatedness rule to ensure that all future advances will be covered, even if that is the true intent of both parties and even though that rule is ostensibly designed to give effect to their (or at least the debtor’s) intent.

Revised Article 9 left the text of the relevant UCC provisions largely intact. However, the comments were revised to expressly reject the relatedness requirement.⁹ While trying to change the law through a comment is potentially problematic, it appears to have been successful, both in commercial transactions,¹⁰ and in consumer transactions.¹¹

Advice for Transactional Lawyers

A transactional lawyer who is aware of all the prior dealings between the parties can adequately deal with the possibility of zombie documents by including in the documents for any new deal a clause expressly stating whether the prior documents remain effective or not. A

lawyer who is unaware of all prior dealings, however, is in a difficult situation. The decision on whether to reanimate the prior documents depends on what the documents say and which party the lawyer represents. Accordingly, the best course of action for the lawyer is to inquire about prior transactions between the parties and insist on seeing the documents memorializing them.

In the absence of reliably complete information, the lawyer should strongly consider insisting on a merger clause that supersedes prior agreements. The following should suffice to immunize the deal against infection by zombie documents.¹²

Merger Clause. This Agreement and [list other contemporaneous agreements] collectively contain the complete and exclusive understanding of the parties with respect to their subject matter, and collectively supersede all previous agreements between the parties. There are no promises or representations of the parties not included in one or more of these documents.

However, a bank or other frequent lender might wish to take a slightly different approach – at least in commercial transactions¹³ – and modify its standard form to expressly provide for zombie documents.

Merger Clause.

(a) Nothing in this agreement affects or supersedes any previously executed agreement between the parties providing for a security interest in collateral, including any future advances clause therein.

(b) Except as provided in paragraph (a) above, this Agreement and [list other contemporaneous agreements] collectively contain the complete and exclusive understanding of the parties with respect to their subject matter, and collectively supersede all previous agreements between the parties. There are no promises or representations of the parties not included in one or more of these documents.

The most important advice is simply to be on guard for zombie documents.¹⁴ Such documents, like the zombies of film, pose the greatest danger to those who are unsuspecting.

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Notes:

1. See, e.g., *Union Bank Co. v. Heban*, [2012 WL 32102](#) (Ohio Ct. App. 2012) (although each of the several security agreements the debtor authenticated contained a cross-collateralization clause purporting to make the collateral secure all of the debtor's obligations to the bank, the clauses were insufficient to overcome the fact that the promissory note for one loan – entered into after one secured transaction and before several others – expressly stated that the loan was unsecured).
2. [735 F. App'x 436](#) (9th Cir. 2018).
3. *Jipping v. First Nat'l Bank Alaska*, [568 B.R. 321](#), 323 (D. Alaska 2017).
4. [735 F. App'x at 437](#).
5. Cf. *International Mfg. Group, Inc. v. McFarland*, [2016 WL 7163588](#) (Bankr. E.D. Cal. 2016), in which the court ruled that a business loan agreement that described the indebtedness secured as including a "Note," which was in turn defined to include "any other subsequent Notes evidencing future indebtedness," was sufficient to make the collateral secure future advances even though the agreement did not otherwise expressly refer to "future advances." The fact that the parties entered into a new business loan agreement for each subsequent loan did not indicate a contrary intent but merely that the lender was trying to cover all of its bases, and those agreements expressly "amend[ed] and restate[d]" the original agreement. It was not clear from the court's discussion of the facts whether the original loans were paid off before the new loan agreements were executed.
6. [249 B.R. 555](#) (Bankr. D. Or. 2000).
7. For another case discussing the relatedness requirement for future advances, see *In re James*, [221 B.R. 760](#) (Bankr. W.D. Wis. 1998).
8. See U.C.C. §§ 9-201, 9-204(c).
9. U.C.C. § 9-204(c) cmt. 5.
10. See *Pride Hyundai, Inc. v. Chrysler Financial Co., LLC*, [369 F.3d 603](#) (1st Cir. 2004), in which the court enforced a broad future advances clause in a commercial transaction without regard to whether the obligations were of the same kind as the original debt. In so doing, the court noted that refusing to treat a broadly drafted future advances clause to cover debts of a different type or class than the original advance would frustrate the intent of the parties, particularly in a commercial setting where the parties are presumed to have a certain level of sophistication regarding the transaction. The court did suggest, however, that the heightened standard of good faith in Revised Article 9 could operate as a control on

potential abuse by secured parties of a broad future advances clause. *Id.* at 616-18. See also *In re Dumlao*, [2011 WL 4501402](#) (9th Cir. BAP 2011) (language in consumer's car loan agreement with credit union providing that the vehicle secured "any other amounts or loans, including any credit card loan, you owe us for any reason now or in the future" was effective under § 9-204 to cover credit-card obligation, but case remanded to determine if clause violated the duty of good faith or was unconscionable given the adhesive nature of the agreement and the small font used). It is appropriate to consider the good faith duty in interpreting the parties' agreement. However, the duty of good faith cannot override terms to which the parties have agreed. See P.E.B. Commentary No. 10 (Feb. 10, 1994). To the extent either the *Pride Hyundai* or *Dumlao* court suggested otherwise, that suggestion is a misapplication of the duty of good faith.

11. See *In re Zaichney*, [2011 WL 6148727](#) (Bankr. D. Alaska 2011); *In re Renshaw*, [447 B.R. 453](#) (Bankr. W.D. Pa. 2011); *In re Hobart*, [452 B.R. 789](#) (Bankr. D. Id. 2011) (concluding that *Wollin* was no longer consistent with Oregon law); *In re Brannan*, [2011 WL 2076378](#) (Bankr. D. Mont. 2011); *Educators Credit Union v. Guyton*, [805 N.W.2d 736](#) (Wis. Ct. App. 2011); *In re Massey*, [2010 WL 99266](#) (Bankr. E.D. Okla. 2010). But cf. *In re Keeton*, [2008 WL 686938](#) (Bankr. M.D. Ala. 2008) (dragnet clause in security agreement in connection with car loan to joint debtors did not clearly encompass obligations later incurred by only one of them, and thus the collateral did not secure one debtor's individual credit card obligations); *In re Howard*, [312 B.R. 840](#) (Bankr. W.D. Ky. 2004).

12. For advice on the drafting of merger clauses, see Stephen L. Sepinuck, *Drafting a Merger Clause for an Integrated Transaction*, [4 THE TRANSACTIONAL LAWYER 2](#) (Dec. 2014); Jennifer Niesen, *Drafting a Bullet-Proof Merger Clause*, [2 THE TRANSACTIONAL LAWYER 1](#) (Apr. 2012).

13. This approach entails some risk in a consumer transaction because applicable law might impose a requirement that the lender conspicuously disclose whether the loan is secured and, if so, what the collateral is. See, e.g., [12 C.F.R. §§ 226.5b\(d\)\(3\), 226.6\(a\)\(4\), 226.18\(m\)](#).

14. Zombification is not limited to security agreements with a future advances clause. A continuing guaranty or a master agreement intended to govern future transactions between the parties, among others, can become a zombie document.



“Including without Limitation”

Stephen L. Sepinuck

A recent decision of the Texas Court of Appeals, *Woodhaven Dr. 1401 Land Trust v. Citibank*,¹ is a useful vehicle for exploring the problems that might arise when transactional lawyers should use the phrase “including without limitation.”

The case involved a lien priority dispute between a mortgagee and a homeowners association. The property was subject to the association’s declaration of covenants, conditions and restrictions, which subordinated the association’s lien for assessments to:

[b]ona-fide first mortgage or deed of trust liens for purchase money and/or home improvement purposes placed upon a Lot, including without limitation, Institutional Mortgages and Eligible Mortgages, in which event the Association’s lien shall automatically become subordinate and inferior to such lien.

The declaration defined “Institutional Mortgage” as:

any bona-fide mortgage, lien or security interest held by a bank, ... or other recognized lending institutions.

Homeowners, who had apparently already paid off their purchase-money mortgage loan, obtained a home equity loan from Countrywide Home Loans, Inc. Countrywide assigned the mortgage to Bank of America, which later assigned it to Citibank, as Trustee of NRZ Pass-through Trust VI. During a later foreclosure, the association and Citibank disputed priority.

The appellate court ruled for Citibank. The court concluded that: (i) an “Institutional Mortgage” did not have to be for purchase-money or home improvement purposes to qualify for priority; and (ii) the mortgage was an institutional mortgage. Both of these conclusions are highly dubious interpretations of the declaration.

With respect to whether the mortgage was an “Institutional Mortgage,” the court reasoned somewhat simplistically that Citibank is a bank; therefore the mortgage is an Institutional Mortgage. But recall that Citibank was not acting in its individual capacity; it was acting as trustee with respect to a pass-through trust. The pass-through trust, which held the beneficial interest in the mortgage loan, was not a bank or other lending institution. Moreover, the mortgage loan was originated by Countrywide, which was also not a bank. The court did not address the difficult issue of which entity – the

originator, beneficial owner, or agent – was the one to which the agreement referred, and instead stopped its analysis at the rather superficial observation that Citibank is a bank.

With respect to whether the mortgage loan had to be for purchase-money or home improvement purposes, the court seems to have misread the clause. To see why, and to formulate advice for transactional lawyers, let us examine a series of three, more simple, contract terms, each containing an “including” clause.

Consider first a security agreement that describes the collateral as:

All of Borrower’s fruits, including tomatoes.

In one sense, the phrase “including tomatoes” is unnecessary. Tomatoes are fruits, at least according to the botanical definition,² so the phrase does not really add to the general statement “all of Borrower’s fruits.” Nevertheless, one can readily imagine a party or court imbuing the word “fruits” not with its botanical meaning but with its more colloquial meaning – the sweet, edible portion of plants customarily made into jams, pies, and tarts – and thus excluding tomatoes. Therefore, a cautious drafter of the security agreement might insert “including tomatoes” in the collateral description to leave no doubt that Borrower’s tomatoes are among the collateral and are encumbered by the security interest.³

Now consider the effect of adding the words “without limitation,” so that the clause reads:

All of Borrower’s fruits, including, without limitation, tomatoes.

The addition of “without limitation” does not – or, at least, should not – change things.⁴ The reason is that “includes” and “including” are, by themselves, not limiting. At least two federal statutes and more than a half dozen federal regulations make this point expressly.⁵ But even in contexts outside the scope of those statutes and regulations, courts have made this point numerous times, both in interpreting agreements,⁶ and in interpreting statutes.⁷

In fact, several courts have stated that an “including” clause is one of “enlargement,” rather than limitation, suggesting that the clause expands the meaning of the general language preceding it.⁸ That suggestion is belied somewhat by the fact that in none of their decisions did the court actually interpret the “including” clause to cover something that the preceding, general language did not. Nevertheless, the courts that refer to “including” as a term of enlargement clearly reject the idea that an “including” clause narrows the scope of preceding language.

On the other hand, some courts have suggested that “includes” and “including” can introduce a limiting clause.⁹ These pronouncements are no doubt what have prompted many transactional lawyers to incorporate the phrase “without limitation” or its equivalent. But despite this suggestion, these courts almost invariably concluded that the “including” clause at issue was not limiting.¹⁰ Indeed, it is extremely difficult to find any court that has actually interpreted an “including” clause as limiting the scope of the general language that preceded it. Even those that purported to treat an “including” clause as limiting have really not done so.

For example, in *Tyson v. Viacom Inc.*,¹¹ an employee of Viacom brought suit under the Florida Whistle Blowers Act after he was fired for sending a letter to a federal court suggesting that Viacom had violated the court’s injunction. The statute in question protects individuals who provide information to an appropriate governmental agency about an alleged “violation of a law, rule, or regulation” by the employer. Another section of the statute states that the term

“law, rule, or regulation” includes any statute or ordinance or any rule or regulation adopted pursuant to any federal, state, or local statute or ordinance applicable to the employer and pertaining to the business.

The court wrote that “[i]n context, the word ‘includes’ is unambiguously one of limitation, not enlargement,”¹² and held that the injunction was not a “law, rule, or regulation.” However, the “including” clause in the statute did not follow a more general statement, and thus the court did not really conclude that the clause limited anything else.

Similarly, in *Frame v. Nehls*,¹³ grandparents of a minor child intervened in a paternity action and sought visitation rights pursuant to a state statute that grants grandparents standing when “a child custody dispute with respect to that child is pending before the court.” Another portion of the statute specified some types of proceedings included within the meaning of “child custody dispute.” The court concluded that this language had to be interpreted as a limitation on the term,¹⁴ and that the paternity action was not a child custody dispute. Again, however, there was no general language preceding the “including” clause, so the court in fact did not interpret the clause as limiting other language.¹⁵

The upshot of all this is that the words “without limitation” and their equivalent are almost assuredly unnecessary.¹⁶ For this reason, at least one contract drafting expert recommends that they not be used.¹⁷ But that advice is probably quixotic. Transactional lawyers are notoriously reluctant to alter their forms and

customary language, even when they might cause mischief.¹⁸ The words “without limitation” are harmless, so there is little reason to drop them from “including” clauses.¹⁹

Let us now consider the final example in our series, which adds a modifier (in red below) to the introductory language:

All of Borrower’s red fruits, including, without limitation, tomatoes.

While all tomatoes might be fruits, not all tomatoes are red. Putting aside the fact that unripe tomatoes are invariably green, even those that are ripe can be white, yellow, orange, pink, green, burgundy, purple, brown, or near black. Some are even striped. Are such non-red tomatoes within the collateral description above? Probably not.

The issue is essentially whether the “including” clause describes “red fruits” or merely “fruits.” If it describes “red fruits,” then all tomatoes regardless of color are included. This might seem a bit nonsensical, but contracts and statutes sometimes define terms to include things that would not otherwise seem to be covered.²⁰ If, as is more likely, the clause merely describes “fruits,” then non-red tomatoes would not be included.

Justice Scalia explored this issue in his dissent in *Massachusetts v. EPA*,²¹ the case holding that the EPA has statutory authority to regulate greenhouse gas emissions from new motor vehicles if the EPA determines that such emissions contribute to climate change. He wrote that a statute covering “any American automobile, including any truck or minivan” would most naturally be read to cover only *American* trucks and minivans.²² Similarly, a federal statute referring to “a proceeding in a foreign or international tribunal, including criminal investigations conducted before formal accusation” would not encompass criminal investigations underway in a domestic tribunal.²³ Thus, he suggested, an “including” clause that follows general language subject to a modifier is often still subject to that modifier.

Justice Scalia acknowledged, however, that an “including” clause need not always be interpreted in this manner, and that it could provide an example of something intended to fit within *all* the general language that precedes it, even if that language contains a modifier. For example, as the D.C. Circuit recently noted, if an ordinance prohibited “all disruptive activity in the park, including the playing of loud music,” the playing of loud music would be an example of “disruptive activity,” not merely of an “activity,” and would be prohibited without the need to establish that the loud music is disruptive.²⁴

The conclusion to draw from this is that an “including” clause that follows general language subject to a modifier can be ambiguous. In some cases, the “including” clause describes something that satisfies all the preceding language, even the modifier; in other cases the “including” clause merely gives an example of something that fits within the unmodified language. To decide which interpretation prevails, one must consider the purpose of the clause.

The court in *Woodhaven Dr. 1401 Land Trust v. Citibank* failed to recognize this subtlety. The clause at issue had the structure of modified general language followed by an “including” clause. Slightly simplified, it was:

First mortgage liens for purchase money purposes, including without limitation, Institutional Mortgages.

The court blithely assumed that an Institutional Mortgage need not be for purchase-money purposes, regardless of whether that made any sense in the context of the document.²⁵

For transactional lawyers, there is an important lesson here. Be careful when placing an “including” clause after general language that contains a modifier. Instead, consider moving the “including” clause to a separate sentence and making it clear precisely what portion of the first sentence it describes. Contrast, for example, the two examples that follow:

All of Borrower’s red fruits. For this purpose, “fruits” includes tomatoes.

All of Borrower’s red fruits. For this purpose, “red fruits” includes all tomatoes.

The first example includes tomatoes that are red; the second purports to include tomatoes of all colors.

Of course, the second example remains problematic. By purporting to define “red fruits” to include yellow and green tomatoes, the example appears to be engaged in Orwellian doublespeak. It would be preferable by far to rewrite the clause entirely, perhaps to something such as the following:

All of Borrower’s red fruits and all of Borrower’s tomatoes.

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Notes:

1. [2018 WL 6629586](#) (Tex. Ct. App. 2018).
2. A fruit is the seed-bearing structure in flowering plants (angiosperms) formed from the ovary after flowering. *But cf. Nix v. Hedden*, 149 U.S. 304 (1893) (concluding, based on dictionary definitions and common understanding, that tomatoes are a vegetable, not a fruit, for the purposes of a tariff on vegetables).
3. Of course, if tomatoes were not a fruit, the entire clause would become problematic. Consider, for example, the following clause: “all of Borrower’s fruits, including broccoli.” Broccoli is not a fruit under either the botanical or colloquial definition. So, this clause is now ambiguous. Perhaps because the resulting problem is so obvious, it is difficult to find any case involving an example of an “including” clause that so clearly does not fit within the introductory language.
4. See BLACK’S LAW DICTIONARY 831 (9th ed. 1990) (indicating that “including,” “including without limitation,” and “including but not limited to” all introduce a partial list and mean the same thing).
5. See 11 U.S.C. § 102(3); 28 U.S.C. § 3003(a)(1); 7 C.F.R. §§ 1703.302, 1710.2, 1717.302, 1717.352, 1780.3; 10 C.F.R. § 609.2. See also 720 ILCS ¶ 5/2–10 (discussed in *People v. Perry*, [864 N.E.2d 196](#), 207-08 (Ill. 2007); Md. Code Art. 1, § 30).
6. See, e.g., *Safeco Ins. Co. of Ill. v. Hicks*, [2018 WL 1832971](#) at *7 (N.D. Iowa. 2018). See also *Public Storage v. Sprint Corp.*, [2015 WL 1057923](#) at *2 (C.D. Cal. 2015) (the agreement itself contained a rule of construction that “includes” and “including” are not limiting); *Bekor v. Bear Stearns and Co.*, [2004 WL 2389751](#) at *4 (S.D.N.Y. 2004) (the agreement used the phrase “including without limitation”).
7. See, e.g., *Federal Land Bank v. Bismarck Lumber Co.*, [314 U.S. 95](#), 100 (1941); *DIRECTTV, Inc. v. Crespín*, [224 F. App’x 741](#), 748 (10th Cir. 2007); *McFadden v. State*, [15 So. 3d 755](#), 757-58 (Fla. Ct. App. 2009), *rev’d*, [50 So. 3d 1131](#) (Fla. 2010); *In re Transcon Lines*, [178 B.R. 228](#), 232 (Bankr. C.D. Cal. 1995); *In re Abernathy*, [150 B.R. 688](#), 693-94 (Bankr. N.D. Ill. 1993); *Simmons v. Department of Revenue*, [2008 WL 1862370](#) at *2 (Or. Tax Ct. 2008); *Boardwalk Regency Corp. v. New Jersey Casino Control Comm’n*, [800 A.2d 157](#), 168 (N.J. Super. Ct. 2002).
8. See, e.g., *American Surety Co. v. Marotta*, [287 U.S. 513](#), 517 (1933); *City of New York v. Exxon Corp.*, [697 F. Supp. 677](#), 684-85 (S.D.N.Y. 1998); *In re Chambers*, [140 B.R. 233](#), 236 (N.D. Ill. 1992); *McLaughlin v. State*, [698 So. 2d 296](#), 298 (Fla. Ct. App. 1997), *rev’d*, [721](#)

[So. 2d 1170](#) (Fla. 1998); *Miami Country Day Sch. v. Bakst*, [641 So. 2d 467](#), 469 (Fla. Ct. App. 1994); *Yon v. Fleming*, [595 So. 2d 573](#), 577 (Fla. Ct. App. 1992); *Albertson's Inc. v. Hanson*, [600 P.2d 982](#), 990 (Utah 1979); *Schwab v. Ariyoshi*, [564 P.2d 135](#), 141 (Haw. 1977); *Jackson v. Concord Co.*, [253 A.2d 793](#), 800 (N.J. 1969); *People v. Western Air Lines, Inc.*, [268 P.2d 723](#), 733 (Cal. 1954). *Cf.* BLACK'S LAW DICTIONARY (rev. 4th ed. 1968) (suggesting that the term “including” can also mean “and” or “in addition to”; this meaning is not listed in more modern editions).

9. *See, e.g., Auer v. Commonwealth*, [621 S.E.2d 140](#), 144-45 (Va. Ct. App. 2005); *Liverpool v. Baltimore Diamond Exch., Inc.*, [799 A.2d 1264](#), 1274-75 (Md. Ct. App. 2002).

10. *See* cases cited *supra* note 9.

11. [760 So. 2d 276](#) (Fla. Ct. App. 2000).

12. *Id.* at 277.

13. [550 N.W.2d 739](#) (Mich. 1996).

14. *Id.* at 742.

15. For another, somewhat similar example, see *TLC Home Health Care, L.L.C. v. Iowa Dep't of Human Servs.*, [638 N.W.2d 708](#), 713 (Iowa 2002), in which the court interpreted a federal regulation defining the term “home health services.” The regulation begins by stating that the term “means the services described in paragraph (b)” and paragraph (b) then indicates that the term “includes” some specified services. As with the prior examples, there simply was no general language for the “including” clause to limit.

16. Indeed, at least one decision suggests that the words might be less than fully effective because the “including” clause still limits the preceding general language to things of the same type, similar to how the interpretive principle *ejusdem generis* operates. *See In re Clark*, [910 A.2d 1198](#), 1200 (N.H. 2006) (“When the legislature uses the phrase ‘including, but not limited to’ in a statute, the application of that statute is limited to the types of items therein particularized”).

17. *See* Adams on Contract Drafting Blog, www.adamsdrafting.com/including-without-limitation/

18. *See* MITU GULATI & ROBERT E. SCOTT, THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN (Chicago Univ. Press 2012).

19. Alternatively, some transactional lawyers incorporate into the agreements they draft a rule of construction stating that “the terms ‘includes’ and ‘including’ are not limiting.” Doing so can economize on words and should

allay any concern that would result if the document used “including” in some places and “including, without limitation” in others.

20. The Uniform Commercial Code defines “purchaser” to include a donee and “inventory” to include things not held for sale. *See* U.C.C. §§ 1-201(b)(29), (30), 9-102(a)(48)(D). It also provides that an individual debtor’s name is the name indicated on the individual’s unexpired driver’s license (if issued by the state in which the individual is located), even if the license has a typographical error or the individual’s name was legally changed after the license was issued. *See* U.C.C. § 9-503(a)(4).

21. [549 U.S. 497](#) (2007).

22. *Id.* at 557 (Scalia, J., dissenting).

23. *Id.*

24. *See also* *Epsilon Electronics, Inc. v. Department of Treasury*, [857 F.3d 913](#), 922 (D.C. Cir. 2017). Of course, the “including” clause in this example contains the word “loud,” which apparently substitutes for the adjective “disruptive” in the general language that precedes the “including” clause. Moreover, playing loud music *outside* the park would presumably not violate the ordinance. Thus, even in this example, the “including” clause is still limited by some of the general language preceding it.

25. In fact, such an interpretation probably does not make sense. While there might be good reason for a homeowners association to subordinate its lien to mortgages securing loans made for specified purposes – such as a home-equity loan, the proceeds of which are used to increase the value of the property – there is no obvious reason why an association would subordinate its lien to a mortgage that happens to secure a loan from a bank.



SEARCHABLE CONTENT

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Spotlight



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The purpose of this column is to identify some of the most disconcerting judicial decisions interpreting the Uniform Commercial Code or related commercial laws. The purpose of the column is not to be mean. It is not to get judges recalled, law clerks fired, or litigators disciplined for incompetence. Instead, it is to shine a spotlight on analytical errors, and thereby provide practitioners and judges with reason to disregard the decisions.

This column normally appears in *The Commercial Law Newsletter*, a publication of the ABA Business Law Section. Because an article in the [October issue](#) of this newsletter referenced an upcoming *Spotlight* column, and publication of the Commercial Law Newsletter has been unexpectedly delayed, the relevant portion of *Spotlight* is being published here.

In re Woodbridge Group of Companies, LLC
 590 B.R. 99 (Bankr. D. Del. 2018)

Contractual restrictions on assignment present a clash of two fundamental principles of American law: freedom of contract and freedom to alienate property. The former suggests that contracting parties should be able to construct their relationship as they see fit, with either or both parties being bound by an agreement not to assign their rights. The latter suggests that contractual rights, like any other property, should be freely transferable so as to facilitate commerce.

Article 9 of the U.C.C. comes down rather firmly on the side of free alienability of property through its rules that override many contractual restrictions on assignment. Unfortunately, the sections containing these rules are very detailed and somewhat opaque, and that probably caused the court in this case to badly misinterpret them.

The facts of the case are relatively simple. Prior to bankruptcy, the debtor issued three promissory notes expressly providing that the lender's rights were not assignable, and that any such attempted assignment would be null and void. After the bankruptcy petition, and despite this clause, the holders of the notes purported to

sell them to a buyer, which then filed a proof of claim. The debtor objected to the claim.

The court first concluded that Delaware law generally allows contracting parties to restrict assignment, provided the language used deals not merely with the right to assign, but also with the power to assign. 590 B.R. at 103-04. The language in the notes satisfied this requirement because it included language expressly indicating that an attempted assignment was "void." The court then ruled that the fact that the debtor had breached the notes by failing to pay did not affect the prohibition on assignment. Neither of these conclusions is objectionable.

The court then addressed the anti-assignment rules in U.C.C. Article 9, and concluded that they did not override the restriction on assignment. It therefore sustained the debtor's objection to the assignee's claim. Unfortunately, in so ruling, the court applied the wrong section and misread the section that it did apply.

Before further discussing the court's reasoning, it is useful to understand how Article 9 does deal with this type of situation.

First, § 9-109(a)(3) provides that Article 9 applies to a sale of a promissory note. So, regardless of whether the promissory notes are sold or used as collateral for a loan – that is, regardless of whether a note holder assigns the notes outright or as security for an indebtedness – Article 9 applies to that transaction. In sales of promissory notes, the interest of the buyer is nonetheless called a "security interest," for convenience; because most, although not all of, Article 9's rules apply to such sales. U.C.C. § 1-201(b)(35).

Second, Article 9 contains several sections dealing with contractual restrictions on assignment, each applicable to different collateral or to different types of transactions in such property. The two most important, and the two at issue in this case, are § 9-406 and § 9-408. The scopes of these sections do not overlap – that is, to no transaction will both sections apply – but they are a bit convoluted. The following chart depicts them (a more detailed version of this chart, also covering legal restrictions on assignment, appears in PRACTICE UNDER ARTICLE 9 OF THE UCC (ABA 2d ed. 2013)).

	Accounts & Chattel Paper	Payment Int. & Promissory Notes	General Intangibles	Health-Care Insurance Receivables
Contractual Restriction on Sale	§ 9-406(d)	§ 9-408(a), (d)	unaffected by Article 9	§ 9-408(a), (d)
Contractual Restriction on Encumbrance	§ 9-406(d)	§ 9-406(d)	§ 9-408(a), (d)	§ 9-408(a), (d)

Determining which section applies can matter because the rules have differing effects. When § 9-406 applies, it both overrides a contractual restriction on assignment and permits the assignee to enforce the obligation against the counter-party. In contrast, when § 9-408 applies, it overrides the contractual restriction on assignment, but does not permit enforcement by the assignee. In other words, it does not require the counterparty “to recognize the security interest [or to] pay or render performance to the secured party.” U.C.C. § 9-408(a), (d)(3).

Unfortunately, the court erred at every step in its analysis of how Article 9 applies to the assignment of promissory notes.

The court first balked at the idea that the sale of a promissory note necessarily creates a security interest. The court looked to § 9-109 comment 4, which states that “[a]lthough this Article occasionally distinguishes between outright sales of receivables and sales [*sic*, ‘transfers’] that secure an obligation, neither this Article nor the definition of ‘security interest’ . . . delineates how a particular transaction is to be classified. That issue is left to the courts.” The court then wrote that “[i]f, as [the assignee] assumes, the drafters of the UCC intended for there to be a bright line rule, classifying all sales of promissory notes as security interests, the courts would have nothing to decide.” *Id.* at 108.

That is not correct. All sales of promissory notes are indeed termed “security interests,” as noted above. This, however, does not leave the courts with “nothing to decide,” because in order to determine whether some rules within Article 9 apply, a court must distinguish between a security interest that is an outright sale and a security interest that secures an obligation. Most notably for purposes of this case, and as the chart above indicates, for promissory notes the characterization of a transaction as a sale or as a secured borrowing affects whether § 9-406 or § 9-408 applies. The distinction is also relevant to whether the assignor has a right to a surplus or obligation for a deficiency, *see* U.C.C. § 9-608(b), and, somewhat indirectly, to whether the assignee must proceed in a commercially reasonable manner when exercising collection rights, *see* U.C.C. § 9-607(c).

The court then proceeded to deal with whether § 9-406 or § 9-408 applied, and concluded that if, as the assignee argued, § 9-408 applied, that would “render § 9-406 superfluous.” *Id.* at 108. That too was incorrect. As noted above, the two sections have different, non-overlapping scopes. Section 9-406 applies to, among other things, a transaction in which a security interest is granted in a promissory note to secure an indebtedness. Section 9-408 applies to a sale of a promissory note, as is provided by both § 9-406(e) and § 9-408(b). The court cited to § 9-406(e) but seems to have interpreted it as an exception to Article 9’s invalidation of contractual restrictions on assignment, rather than simply as a statement of § 9-406(d)’s scope.

Finally, wrapping up its muddled analysis, the court wrote, “[i]n short, § 9-406 endorses the enforceability of anti-assignment provisions in the sale, or assignability, of promissory notes, whereas § 9-408 is applicable only to grants of security interests.” *Id.* at 109.

Everything in this statement is wrong. The latter portion of this statement seems to be saying that, as applied to promissory notes, § 9-408 applies to security interests *that secure an obligation*, not to security interests that are sales, when in fact the opposite is true. The first part of the statement is even worse. Section 9-406 does not apply to the sale of a promissory note (other than a disposition conducted pursuant to § 9-610 or an acceptance under § 9-620) and, more important, it does not “endorse the enforceability of anti-assignment provisions . . . of promissory notes.” On the contrary, when it applies, § 9-406 overrides contractual restrictions on assignment *more fully* than does § 9-408. In short, either § 9-406 does not apply to a transaction, or it obliterates a restriction on assignment. It never “endorses” a restriction on assignment.

The court’s errors were several and serious. And because of these errors, the court did not reach a further interesting issue, this time of bankruptcy law: when a promissory note has been effectively sold, but state law provides that the buyer cannot enforce the note (*see* discussion of § 9-408(a) and (d)(3) above), which party has the allowable claim in bankruptcy: the buyer or the seller?

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Recent Cases

SECURED TRANSACTIONS

Scope Issues

In re TSAWD Holdings, Inc.,

[2018 WL 6839743](#) (Bankr. D. Del. 2018)

Because the debtor's principal lender with a perfected security interest in the debtor's inventory had actual knowledge that the debtor was selling the consignor's goods on consignment, the consignor's interest was not – vis-à-vis the lender – subject to Article 9 and thus was not rendered subordinate by the consignor's failure to file a continuation statement and maintain perfection.

In re TSAWD Holdings, Inc.,

[2018 WL 6885922](#) (Bankr. D. Del. 2018)

Because the debtor's principal lender with a perfected security interest in the debtor's inventory did not have actual knowledge that the debtor was selling the consignor's goods on consignment until the consignor filed a financing statement, the consignor's interest in goods sold before that time was subject to Article 9 and subordinate to the lender's security interest.

Priority Issues

Legacy Bank v. Fab Tech Drilling Equipment, Inc.,

[2018 WL 6928971](#) (Tex. Ct. App. 2018)

The holder of a prior perfected security interest in the debtor's accounts did not waive its interest in the collateral by not taking action to foreclose, despite the debtor's default for several years, before a judgment lien creditor sought to garnish the accounts, or by continuing to lend to the debtor after the garnishment action was filed. The security agreement expressly provided that the secured party would not be deemed to have waived any rights in the absence of a writing signed by the secured party and that no delay in exercising rights would operate as a waiver, and under § 9-201 the terms of the security agreement are binding on creditors of the debtor.

SE Property Holdings, LLC v. Unified Recovery Group, LLC, [2018 WL 6267183](#) (E.D. La. 2018)

A lender with a security interest in the debtor's accounts, and which perfected that security interest years before the IRS filed a notice of tax lien, had priority over the IRS only to the extent that the security interest in the disputed account was choate before the tax lien notice was filed. The fact that the debtor had assigned the account to a related party before it granted the security interest did not matter because the related party never perfected its interest, and thus the debtor was deemed to remain the owner of the account. The fact that the security agreement encumbered all accounts "subject only to Permitted Liens," did not subordinate the security interest to permitted liens (including the tax lien); it meant only that the security interest *might* be subordinated to permitted liens if such liens otherwise have priority. However, even though the debtor had, before the tax lien notice was filed, fully performed the services giving rise to the account at issue, the debtor's obligations also included providing the account debtor with the documentation needed to substantiate the work performed. Until the account debtor gave its approval of that documentation, the account was inchoate.

Enforcement Issues

Wells Fargo Bank v. Worldwide Shrimp Co.,

[2018 WL 6696607](#) (N.D. Ill. 2018)

Because the debtor failed to provide the secured party with required financial information, the debtor was in default and the secured party was authorized to exercise the remedies available after default. Doing so could not be a breach of the duty of good faith because the agreement expressly authorized it. The secured party did not waive the breach; at most the secured party offered by email to discuss a possible waiver. The email message could not be a modification because state law requires a modification of a credit agreement to be signed by both parties and the debtor did not sign the message. Finally, the message could not be a basis for estoppel because it was not reasonable for the debtor to rely on it, given that the message merely offered to discuss the matter.

Eskelsen v. Theta Investment Co.,

[2019 WL 115215](#) (Utah Ct. App. 2018)

Secured parties who accepted the debtors' membership interest in a manager-managed LLC in full satisfaction of the debt did not thereby become the manager. Nor did they properly remove the manager because they did not file a certificate of amendment. Consequently, one of the debtors remained the manager. Although the manager might have lacked actual authority to bind the LLC to a sale of all its assets, the manager had apparent authority to do so because the other parties to the transaction had no notice of the restrictions in the operating agreement on

the manager's authority. The operating agreement was not filed as a public record; the articles of organization were filed, but they lacked the restriction on the manager's authority.

Liability Issues

LVG-Ogden marketing, LLC v. Bingham,
[2018 WL 6435711](#) (W.D. Wash. 2018)

Assets serving as collateral for a loan from a spendthrift trust to the sole beneficiary, which after default the trust received in satisfaction of the debt, were not thereby imbued with spendthrift protection; instead the assets were essentially self-settled trust property. The assets were therefore subject to the claims of the beneficiary's judgment creditor.

BANKRUPTCY

Pergament v. Brooklyn Law School,
[2019 WL 111044](#) (E.D.N.Y. 2019)

A university was an initial transferee of funds paid by the debtor to cover the tuition obligation of his children if payment was made after the university no longer had an obligation to issue a refund if the child withdrew from classes. As to payments made before then – either before the child registered or after registration but during the period when the university would be obligated to refund the payment to the child if he or she withdrew from classes – the child was the initial transferee and the university was a subsequent transferee. Because the university unquestionably received those funds in good faith, the transfers were excepted from avoidance under § 550(b).

GUARANTIES & RELATED MATTERS

Comerica Bank v. Pars Ice Cream Co.,
[2018 WL 6625171](#) (Mich. Ct. App. 2018)

An individual's guaranty of "of all existing and future indebtedness" to a Bank of a specified LLC included the LLC's subsequent liability to the bank on the LLC's guaranty of a corporation's liability on its guaranty of another LLC's debt. It did not matter that the individual's guaranty designated the specified LLC as "Borrower." That designation was used merely to identify the entity, not to limit the capacity in which it incurred liability.

LENDING & CONTRACTING

Peach REO, LLC v. Blalock Investments, LLC,
[2019 WL 102142](#) (S.C. Ct. App. 2019)

The trial court erred in dismissing a borrower's claim against its lender for the lender's failure to respond to the borrower's numerous requests for permission to sell or lease collateral. Although the loan agreement gave the lender discretion whether to approve of such transactions, the covenant of good faith and fair dealing obligated the lender to exercise that discretion in good faith, and the complaint sufficiently alleged a lack of good faith.

Ticer v. Reed Migraine Centers of Texas, PLLC,
[2018 WL 6322167](#) (Tex. Ct. App. 2018)

A settlement agreement that provided that a lawyer "hereby releases" specified parties but also that the pending lawsuit would be dismissed "following the receipt" of the payments called for in the agreement, was ambiguous as to whether the release was effective even though payment had not been made.

Atlantic Trustee Services, L.L.C. v. Cortez,
[2018 WL 6795069](#) (Va. Cir. Ct. 2018)

A mortgagee that contractually subordinated its \$415,000 senior lien to its \$250,000 junior lien did not thereby unintentionally elevate the \$220,000 intermediate lien of a different mortgagee. Instead, the intermediate mortgagee was unaffected by the subordination agreement. As a result, the lien priority was as follows: the junior lien was first, followed by the senior lien to the extent of \$165,000 (\$415,000 – \$250,000), then the intermediate lien, and finally the \$250,000 remainder of the senior lien. Because a foreclosure does not discharge a senior lien and foreclosure proceeds go only to the holder of the foreclosing lien and junior liens, the proceeds of the intermediate mortgagee's foreclosure would be used first to pay the intermediate lien and then to pay the subordinated portion of the senior lien. Consequently, the \$250,000 junior lien and \$165,000 of the senior lien continue to encumber the property.

In re La Paloma Generating Co.,
[2018 WL 6822271](#) (Bank. D. Del. 2018)

An intercreditor agreement that prohibited the junior lienors from retaining any payment received in connection with the exercise of any right or remedy before the senior lienor was paid in full remained binding even though the senior lienor's financing statement lapsed and its security interest became unperfected, because the intercreditor agreement expressly so provided. Bankruptcy distributions on account of the junior lienor's claims were in connection with a remedy because the intercreditor agreement explicitly included filing a proof of claim as an "exercise of remedies."

Woodhaven Dr. 1401 Land Trust v. Citibank,
[2018 WL 6629586](#) (Tex. Ct. App. 2018)

A homeowners association's lien, which was subordinate to a "first mortgage or deed of trust for purchase money or home improvement purposes, including without limitation [any mortgage held by a bank]" was subordinate to a bank's first mortgage regardless of whether the indebtedness it secured was for purchase-money or home improvement purposes.

Innovation Ventures, LLC v. Custom Nutrition Labs.,
[2018 WL 6695875](#) (6th Cir. 2018)

An asset purchase agreement that provided "the formula for energy drinks manufactured by [seller] and certain related trademark and copyright matters are limited by the settlement agreement between [seller] and [third party] and the related consent judgments contained in Schedule 4.2(h)," and which then in Schedule 4.2(h) listed a settlement agreement between the seller and a third party, were sufficient to bind the purchaser to the restrictions in the settlement agreement on how energy drinks could be manufactured.

In re Goione,
[2019 WL 137133](#) (Bankr. D.N.J. 2019)

A bank that obtained a judgment of foreclosure on a mortgage loan was entitled to post-judgment interest at the legal rate, not at the contract rate, because, pursuant to New Jersey law, the mortgage debt merged into the judgment and thereafter the contract documents do not serve as a basis of the borrower's obligations unless they clearly evidence the intent to remain effective post-judgment. These documents did not.

F&M Mafco, Inc. v. Ocean Marine Contractor's, LLC,
[2019 WL 142297](#) (E.D. La. 2019)

A purchase agreement that included a clause selecting Louisiana law to govern the agreement and a clause providing that any proceeding brought to enforce an arbitration must be brought in Louisiana did not deprive Ohio courts of jurisdiction over an action for breach. The agreement contained no arbitration clause, and thus the forum-section clause for actions to enforce an arbitration award did not apply.



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