

# THE TRANSACTIONAL LAWYER

Volume 9 – October 2019

## WHEN IS A BAILMENT REALLY A SALE

**Stephen L. Sepinuck**

Contracting parties often structure a transaction in one way, knowing that there is a risk that the law might re-characterize it as something else entirely. Recent issues of this newsletter have discussed at some length transactions structured as a sale of future receivables, and concluded that they are really loans structured as sales, perhaps so as to evade usury restrictions.<sup>1</sup> A credit sale of goods might be structured as a lease, perhaps in an effort to provide the seller/lessor with more favorable treatment if the buyer/lessee becomes the debtor in a bankruptcy proceeding. But the law might nevertheless treat the transaction as a sale.<sup>2</sup> Other types of transactions that the law might re-characterize are almost endless.<sup>3</sup>

The principal danger inherent in such a transaction is failing to either recognize the risk of future re-characterization or take appropriate action at the outset. For example, a lessor of goods that overlooks the possibility that the transaction might be a credit sale, and thus that the lessor's interest in the goods could be merely a security interest, might neglect to file a financing statement to perfect that interest.<sup>4</sup> That, in turn, can lead to a loss of priority or, worse, the avoidance of the security interest in the lessee's bankruptcy.<sup>5</sup>

A recent decision from the Bankruptcy Court for the Southern District of New York illustrates this sort of problem – the law treating a transaction as something other than what the parties intended – in connection with a bailment. But in this case, there was arguably little that the putative bailor could do to protect itself from re-characterization of the transaction as a sale.

In *In re Miami Metals I, Inc.*,<sup>6</sup> customers of Miami Metals delivered unrefined precious metals, primarily gold and silver, to Miami Metals for refining. Pursuant to the agreement between the parties, the raw metals were assigned lot numbers, weighed, and melted to obtain a homogenous sample for assay testing. Miami Metals then refined the material to produce silver and gold bars and casting grains. During the refining process, each customer's lot was commingled with the lots of other customers, after which it was no longer possible to identify the material provided by any particular customer.<sup>7</sup> After Miami Metals filed for bankruptcy protection, it claimed to be the owner of the metals that its customers had provided.

In canvassing the relevant law, the court noted that in a true bailment, the bailor retains ownership while the bailee has possession.<sup>8</sup> Such transactions include a bailment *locatio operis faciendi*, in which the bailee promises to perform work on the bailed item in exchange for consideration.<sup>9</sup> The court provided as examples the installation of a trailer hitch on a car and the waterproofing of fabric.<sup>10</sup> Then, citing U.S. Supreme Court cases from the nineteenth century, the court observed that in such a transaction the bailee must be obligated to return the specific article delivered to it; if the bailee is at liberty to return something else, the transaction is a sale.<sup>11</sup>

The agreement in *Miami Metals* declared that “[p]recious metals are fungible,” and that Miami Metals had a duty “to return precious metals to Customer of like kind representing the ounces of precious metals owed to Customer.”<sup>12</sup> Thus, the court observed, the metal returned to customers “is not the identical metal that [the customer] originally shipped to [Miami Metals], nor is it the same metal in altered form.” This fact, the court ruled, “precludes the existence of a bailment” between Miami Metals and its customers,<sup>13</sup> and requires instead that the transactions be treated as sales. It did not matter, the court added, that the agreement did not specify the quantity or the price because the former could be proved by the parties’ conduct and the latter supplied by either the agreement’s reference to the prevailing market price or under U.C.C. § 2-305.<sup>14</sup>

The court acknowledged that the result would be different if the customers had delivered fungible goods – such as natural gas or wheat – that were commingled with identical goods provided by others.<sup>15</sup> But the court described the goods in this case – which varied from gold scrap and polishing sweeps to jewelry – as “unique and heterogeneous materials of different quality and value,” and concluded that they were “non-fungible.”<sup>16</sup>

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The court's ruling had significant consequences to the customers. They were not the owners of gold and silver that they had delivered to Miami Metals. Instead, the gold and silver were part of the debtor's bankruptcy estate, and the customers had only unsecured claims for what they had delivered.<sup>17</sup>

The decision in *Miami Metals* is concerning for two reasons. First, the court offered no reason why it deemed the customers' property as non-fungible. More to the point, it offered no explanation why the fungibility of the inputs should take precedence over the fungibility of the output. Under the court's analysis, a silo operator that commingles and stores the wheat deposited by several farmers is, or at least can, be a bailee, and the farmers are or can be the owners of the wheat. But, a baker that receives flour from one customer and eggs from another, with an obligation to use them to bake cakes for each of them, is a buyer, and the customers are mere creditors.<sup>18</sup> Perhaps this makes sense, but the court's approach would suggest that if each of the baker's customers provided both flour and eggs, which the baker stored together before using them to make cakes, the result might constitute a bailment. It is difficult to discern what principle or policy this approach is designed to serve.

Second, it would likely be very difficult to draft the transaction documents on behalf of the customers to achieve a different result. Although the court did examine the agreements and concluded, quite reasonably, that they indicated that the transaction was not a bailment, the court might have reached the same result even if the agreements unambiguously stated that the transaction was a bailment. After all, the court stated rather emphatically that "the test of a bailment is that the identical thing is to be returned in the same or some altered form; if another thing of equal value is to be returned, the transaction is a sale."<sup>19</sup>

A customer could contractually require that its goods not be commingled, but that appears to be incompatible with the nature of Miami Metals' business operations. Alternatively, a customer could retain a security interest in the goods it delivers and comply with U.C.C. § 9-324(b) in an effort to obtain priority over Miami Metals' inventory lender.<sup>20</sup> However, this might trigger a default under the security agreement with the inventory lender, and even if it did not, this approach would not be without risk once the goods provided by the customer were commingled.<sup>21</sup>

## CONCLUSION

There are a variety of scenarios in which a business delivers possession or control of property – goods, funds, or receivables – to another party for processing or distribution, and erroneously believes that the business remains the owner of the property. If the other party ends up in bankruptcy, the business

often ends up losing what it thought it owned. Several articles in this newsletter have explored such scenarios.<sup>22</sup> The situation in *Miami Metals* is therefore not unique. It is, however, another trap for businesses and the transactional lawyers who advise them. There might be no easy way to draft around the problem, but at a minimum the businesses need to be informed about the risk.

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## Notes:

1. John F. Hilson & Stephen L. Sepinuck, *A "Sale" of Future Receivables: Criminal Usury in Another Form*, [9 THE TRANSACTIONAL LAWYER 1](#) (Aug. 2019); John F. Hilson & Stephen L. Sepinuck, *A "Sale" of Future Receivables: Disguising a Secured Loan as a Purchase of Hope*, [9 THE TRANSACTIONAL LAWYER 14](#) (Apr. 2019).

2. See U.C.C. § 1-203; *In re Kittusamy, LLP*, [2017 WL 957152](#) (9th Cir. BAP 2017) (equipment leases under which the lessee had the option to purchase the equipment for \$1.00 at the end of the lease term were sales with a retained security interest); *Cozzetti v. Madrid*, [2017 WL 6395736](#) (Alaska 2017) (a 53-month lease of a mobile home pursuant to which the lessee would become the owner if he made all the payments was a sale and secured transaction); *Lyon Financial Services, Inc. v. Illinois Paper and Copier Co.*, [247 F. Supp. 3d 923](#) (N.D. Ill. 2017) (a six-year lease of copier equipment with an option to purchase at the end of the lease term for fair market value was a sale with a security interest, not a true lease, because the value of the equipment at the end of the lease term would be nominal, indicating that the lease term equaled or exceeded the economic life of the goods and that the option price would be nominal consideration); *In re Ajax Integrated LLC*, [554 B.R. 568](#) (Bankr. N.D.N.Y. 2016) (a four-year lease of equipment with an option to purchase at the end was a sale and secured transaction under the bright-line test of § 1-203(b) because the option price was less than the lessee's anticipated cost of returning the equipment in the condition required by the lease, and hence was nominal).

3. See *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); *In re Jeff Benfield Nursery, Inc.*, [565 B.R. 603](#) (Bankr. E.D.N.C. 2017) (grow contracts pursuant to which a wholesaler of nursery stock delivered trees to the debtor for planting and cultivation on the debtor's leased property were

disguised financing arrangements); *Holland v. Sullivan*, [2017 WL 3917142](#) (Tenn. Ct. App. 2017) (a transaction structured as a sale of an automobile for \$30,000 with an option to repurchase, with the putative seller retaining possession and the buyer receiving the certificate of title was really a loan and a secured transaction with the automobile as collateral); *Fagen, Inc. v. Exergy Development Group of Idaho, LLC*, [2016 WL 5660418](#) (D. Minn. 2016) (a transaction between a developer and its financier by which: (i) the developer immediately conveyed 99 of the 100 membership units in a subsidiary that owned the project; (ii) the developer forgave about \$11 million in debt, posted a \$16.8 million letter of credit, and retained a security interest in the remaining membership unit; (iii) the developer had the right to repurchase the 99 membership units if it obtained sufficient financing by a specified date to repay all loans to the financier; and (iv) if such financing was not obtained, the remaining membership unit automatically transferred to the financier, was a secured transaction with respect to the one remaining membership unit); *Calloway v. Commissioner of Internal Revenue*, [691 F.3d 1315](#) (11th Cir. 2012) (a transaction structured as three-year nonrecourse loan of stock during which the putative borrower had no right to repay early and the putative lender was entitled to dividends, the right to vote the shares, and the right to sell the shares was, for federal income tax purposes, a sale with an option to repurchase at the end); *Randle v. AmeriCash Loans, LLC*, [932 N.E.2d 1200](#) (Ill. Ct. App. 2010) (an EFT authorization form that borrower signed when taking out the loan and that authorized the lender to debit borrower's checking account upon a default constituted a security interest in her checking account). *See also* §§ 9-102(a)(20); 9-319 (effectively treating many consignment transactions as creating a security interest and deeming the consignee as having the rights of the consignor, including the right to encumber the goods).

4. *See, e.g., In re Ajax Integrated LLC*, [554 B.R. 568](#) (Bankr. N.D.N.Y. 2016).

5. *See id.*; 11 U.S.C. § 544(a)(1). Much the same fate befalls a consignor that fails to file a financing statement if the transaction constitutes a secured transaction governed by Article 9. *See, e.g., Rayfield Investment Co. v. Kreps*, [35 So. 3d 63](#) (Fla. Ct. App. 2010).

6. [2019 WL 3776043](#) (Bankr. S.D.N.Y. 2019).

7. *Id.* at \*9.

8. *Id.* at \*5 (citing *Cornelius v. Berinstein*, [50 N.Y.S.2d 186](#), 188 (Sup. Ct. 1944)).

9. *Id.* (citing *Adelman v. M & S Welding Shop, Inc.*, [105 So. 2d 802](#), 803 (Fla. Dist. Ct. App. 1958)).

10. *Id.* at \*5-6 (citing *Adelman and Aronette Mfg. Co. v. Capitol Piece Dye Works, Inc.*, [160 N.E.2d 842](#) (N.Y. 1959)).

11. *Id.* at \*6 (citing *Sturm v. Boker*, [150 U.S. 312](#), 329 (1893), and *Laflin & Rand Powder Co. v. Burkhardt*, [97 U.S. 110](#), 116 (1878)).

12. *Id.* at 6-7.

13. *Id.* at 7. This ruling was further supported by another term in the agreement providing that any material Miami Metals delivered to the customer remained property of Miami Metals, suggesting that the parties knew how to create a bailment when they wanted to do so. *Id.* at \*8.

14. *Id.* at \*9.

15. *Id.* at \*11 (citing *Pub. Serv. Elec. & Gas Co. v. Fed. Power Comm'n*, [371 F.2d 1](#), 4 (3d Cir. 1967), *In re Enron Corp.*, [2003 WL 23965469](#), at \*3 (Bankr. S.D.N.Y. 2003); *In re Fuel Oil Supply & Terminaling, Inc.*, [72 B.R. 752](#), 758 (S.D. Tex. 1987), *rev'd on other grounds*, 837 F.2d 224 (5th Cir. 1988); *Odell v. Leyda*, [20 N.E. 472](#) (Ohio 1889); *Inglebright v. Hammond*, [19 Ohio 337](#), 344 (1850)).

16. *Id.*

17. *Id.* at \*12.

18. *Cf.* U.C.C. § 9-336 cmts. 4-6 (describing the use of flour and eggs to make cakes as an example of a process that results in "commingled goods" within the meaning of Article 9.

19. [2019 WL 3776043](#), at \*6 (Bankr. S.D.N.Y. 2019).

20. This would require both filing an effective financing statement and making sure that the inventory lender received notification of the transaction before delivery of the goods to Miami Metals. *See* U.C.C. § 9-324(b)(1)–(3).

21. Although multiple, perfected security interests in commingled goods often share equal priority in proportion to the value of the inputs that were commingled, *see* U.C.C. § 9-336(f)(2), this rule applies only among secured parties whose security interest attached to the product or mass resulting from commingling under § 9-336(c). In other words, it applies only to secured parties whose security interests were in less than all of the inputs. The rule does not govern the priority of a security interest that attaches to the product or mass under the terms of the security agreement, and thus the rule does not apply to a security interest covering all the debtor's existing and after acquired inventory (assuming the commingled goods are inventory in the hands of the debtor). Instead, the priority of a PMSI in one input and a security interest in the debtor's inventory is governed by the other provisions of Part 3 of Article 9. *See* § 9-336(e).

One might be tempted to think, therefore, that the PMSI would have priority under § 9-324(b), provided the secured party with the PMSI filed and provided notification of the transaction before the debtor received the goods. However, § 9-324(b) provides for priority in the PMSI goods themselves

and in some cash proceeds; neither it nor any of its comments says anything about priority in a product or mass that results from the commingling of the goods. The comments to § 9-336 similarly lack any indication that § 9-324(b) priority can extend to commingled goods. Thus, the text of Article 9 provides little guidance. Moreover, there are competing policy considerations. It would be undesirable to permit a debtor to destroy PMSI priority by commingling the goods, suggesting that PMSI priority should continue after commingling. However, applying § 9-324(b) to commingled goods can result in circular priority problems (if, for example, a creditor with a PMSI in one input complied with § 9-324(b) to have priority over the inventory lender while a creditor with a PMSI in a different input did not). Suffice it to say, the law on this point is not clear.

22. See Stephen L. Sepinuck, *Beware of Constructive Trusts When Establishing the Borrowing Base*, [5 The Transactional Lawyer 1](#) (Dec. 2015); Stephen L. Sepinuck, *Deconstructing the Constructive Trust*, [3 The Transactional Lawyer 2](#) (Aug. 2013).



## PAYMENT DISCOUNTS IN SETTLEMENT AGREEMENTS

*William B. Emmal*

Two commercial parties are engaged in a dispute, with Party A asserting a claim against Party B for \$2.8 million. After extensive negotiations, the parties agree on the financial terms of a settlement: Party B must either pay \$2.1 million within three months or \$2.8 million within six months. The lawyers drafting the settlement agreement have a choice. They can structure the deal as: (i) a settlement for \$2.1 million, with a surcharge if payment is late; or (ii) as a settlement for \$2.8 million, with a discount if payment is early. Economically, these two alternatives are the same. However, as two recent decisions from the California Court of Appeals indicate, legally the alternatives are quite different.<sup>1</sup> Structured as a discount, the arrangement is enforceable; structured as a surcharge, the arrangement likely is not.

In *Mitsuwa Corp. v. Wehba*, the court upheld the terms of a settlement agreement stipulating that the borrower owed \$15 million, but also providing that if payment of the first \$10.5 million was made on a timely basis, the remaining \$4.5 million would be forgiven.<sup>2</sup> In contrast, three days later a different panel of the court ruled in *Red & White Distribution, LLC v. Osteroid Enterprises, LLC*, that a settlement agreement stipulating that the borrower owed \$2.1 million, but also providing that if payment was not made on a timely basis then

the borrower had to pay \$2.8 million was a liquidated damages clause that created an unenforceable penalty of \$700,000.<sup>3</sup> The lesson from these rulings is clear: transactional lawyers should avoid drafting settlement agreements that include a surcharge for late payment, and instead incentivize timely payment through the use of a discount.

What is not clear, however, is what deference a court will pay to the stipulated settlement amount. After all, if the stipulated settlement amount is not a reasonable estimation of the value of the claim, but instead is an artifice, then structuring the settlement to have a sizeable discount for prompt payment arguably still results in an unreasonably high penalty for late payment.<sup>4</sup> In *Mitsuwa*, the court did not address the comparison between the \$15 million settlement amount and what the plaintiff was seeking in the lawsuit. Thus, there is no way to ascertain from the opinion alone whether the \$15 million amount was merely a fiction designed to evade the prohibition of contractual penalties.<sup>5</sup> However, a review of the pleadings indicates that, at the time the parties settled, the plaintiff had a judgment for approximately \$8 million, and was about to go to trial on its remaining claims for attorney's fees, more than \$27 million in compensatory damages, and punitive damages, and thus the stipulated amount was far below the amount claimed.<sup>6</sup>

### OTHER CONSIDERATIONS

There are at least two other things that the lawyer should consider before structuring a settlement to include a discount for early or timely payment. First, such a discount might result in cancellation of indebtedness income for the debtor and possibly a concomitant bad debt deduction for the creditor. Whether such tax consequences apply will likely depend on a variety of factors, including the nature of the claim and which party has a tax basis in it.<sup>7</sup>

Second, if, after making payment, the debtor files for bankruptcy protection and the payment is avoided as a preference, the creditor will want the entire debt revived, not merely the amount of the discounted payment. Accordingly, the settlement agreement should expressly provide that if the payment is avoided, the entire settlement amount becomes immediately due.<sup>8</sup>

### CONCLUSION

Attorneys representing clients who are entering into a settlement agreement with payments extended over time should incentivize prompt payment properly by providing for a discounted amount if payments are made on a timely basis. However, even where a payment discount is used as an incentive for timely payment, parties can maximize the possibility of a valid payment incentive by assessing whether the original amount of the settlement agreement is a reasonable estimation of anticipated or actual loss.<sup>9</sup> The prudent lawyer may do this



by way of recitals or declarations reiterating the reasonableness of the settlement amount. After all, a statement by the parties, while not conclusive, does help a court assess the true intent of the parties and possibly uphold an otherwise invalid liquidated damages provision.<sup>10</sup> In contrast, parties would be wise to not provide for an increased settlement amount, or a lump sum payment of interest,<sup>11</sup> if the payment is untimely because doing so creates the possibility that the amount in excess of the stipulated settlement amount will be held to be an unenforceable penalty.

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#### Notes:

1. See *Mitsuwa Corp. v. Wehba*, [2019 WL 3561928](#) (Cal. Ct. App. 2019); *Red & White Distribution, LLC v. Osteroid Enterprises, LLC.*, [2019 WL 3759458](#) (Cal. Ct. App. 2019).
2. *Mitsuwa*, [2019 WL 3561928](#) at \*3.
3. *Red & White Distribution, LLC*, [2019 WL 3759458](#) at \*5.
4. [RESTATEMENT \(SECOND\) OF CONTRACTS § 356](#) (1981).
5. Indeed, the debtor claimed in its pleadings that “[t]he \$15,000,000 is merely a fiction designed to escape Civil Code § 1671,” which codifies the rules regarding liquidated damages clauses, and that “no evidence was presented . . . that this amount was actually owed.” Appellant C. Frederick Wehba II’s Opening Brief, [2018 WL 1750773](#), at \*22.
6. Respondent/Cross-Appellant Mitsuwa Corporation’s Initial Brief, [2018 WL 3611474](#), at \*11-12, 55.
7. For example, if the settlement relates to a defaulted loan, the borrower - who received the funds at the time of the loan and will now be excused from repaying a portion of the debt - will likely have cancellation of indebtedness income, at least with respect to forgiven principal (forgiven interest creates taxable income only if payment of the interest would not have been a deductible expense). In such a case, the creditor will have a bad debt deduction with respect to the forgiven principal. In contrast, if the settlement relates to a tort, the debtor might not have received anything from the creditor at the time the tort occurred. In such a case, the discount will not result in cancellation of indebtedness income or a bad debt deduction. See [IRS Publications 550](#) and [4681](#).
8. See Stephen L. Sepinuck, *Revival Clauses in Guarantees: Protecting the Creditor from Preference and Fraudulent Transfer Risk*, [2 THE TRANSACTIONAL LAWYER 1](#) (June 2012).
9. [RESTATEMENT \(SECOND\) OF CONTRACTS § 356](#).

10. *Walter Implement, Inc. v. Focht*, [730 P.2d 1340](#), 1343 (Wash. 1987) (citing *Underwood v. Sterner*, 387 P.2d 366 (Wash. 1963)).

11. *Ridgley v. Topa Thrift & Loan Ass’n*, [953 P.2d 484](#) (Cal. 1998) (holding that a contractual term requiring payment of six months of interest in the event of default was not a reasonable estimation of actual or anticipated loss, and thus was an unenforceable penalty).



## Filing Problems in Nevada

*Paul Hodnefield*

On July 18, 2019, the Office of the Nevada Secretary of State (“OSS”) replaced its old UCC and business services computer systems with a new integrated system designed to facilitate online electronic transactions. Unfortunately, the new system, known as “SilverFlume,” is experiencing unanticipated difficulties. As a result, turnaround times are increasing and the OSS reports it has substantial backlogs of business filings and business license renewals. UCC search and copy retrieval requests have been significantly impacted as well.

Currently, the OSS is running approximately two months behind in processing routine UCC certified search and copy requests. The turnaround for business filings is not much better, although filings submitted online through the SilverFlume portal are being processed within one day.

The UCC filing process, if not made online, is taking only a few days at this point. However, the acknowledgment copies and images of UCC records filed for a period of time beginning in mid-July do not display the file number or file date. This is problematic for several reasons, not the least of which is that, without the file number, the filer cannot later file an amendment or termination statement. For this reason, filers should double check any acknowledgment they received during July and early August to determine whether the file number and date are provided. The OSS is aware of the issue and is in the process of correcting the images but has given no timeframe for completion.

Due to the current conditions at the OSS, anyone who anticipates searching in Nevada or filing outside the SilverFlume portal should expect to deal with the extended turnaround time. The only alternative is to order expedited service. The OSS is offering two levels of expedited service for an added fee: (i) a 2-hour turnaround for \$500; and (ii) a 1-hour turnaround for \$1000. Thus, anyone who needs an order

processed faster than the current 2-month turnaround will need to pay at least an additional \$500, and possibly more, depending on the number of copies involved.

Hopefully, the OSS will resolve the situation before too much longer. In the meantime, those who need to obtain a certified UCC search, file business records, or renew business licenses should plan on either a long turnaround time or substantial expedite expenses for at least the next few weeks.

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## Legislative Alert

This summer, the State of Washington amended its version of the UCC to exclude from Article 9's scope "the creation or transfer of an interest in or lien on a live dog or cat."<sup>1</sup> Although the legislation was apparently intended to deal with dogs and cats as pets – that is, as consumer goods – the amendment is not so narrowly tailored and covers a security interest granted by anyone, including breeders and pet stores.

The legislation does more than reduce the scope of the state's Article 9, however. It also invalidates some security interests in a live dog or cat. Specifically, it adds the following new section to the state's Consumer Loan Act:

A contract entered into on or after July 28, 2019 for the payment to repay a loan for the purchase of a live dog or cat, where a security interest is granted in the dog or cat, is void and unenforceable.<sup>2</sup>

This language appears to do more than merely invalidate the security interest in the dog or cat: it purports to render void the entire contract of which the security interest was a part. Thus, when it applies, the new section might invalidate an entire loan agreement, including both the debtor's promise to repay the debt and the security interest in any collateral other than the live dog or cat.

Fortunately, while the new limitation on Article 9's scope applies to all security interests in live dogs and cats, the new section of the Consumer Loan Act seems to be limited to purchase-money transactions and to transactions within the scope of that Act.<sup>3</sup> So, the risk to those lending to business entities is probably minimal.

### Notes:

1. Wash. Rev. Code § 62A.9A-109(d)(15). For the full text of the legislation, see [2019 Wash. Legis. Serv. ch. 340](#).
2. [Wash. Rev. Code § 31.04.030](#) (the hyperlinks to this section and to the sections cited below are to the Washington State Legislature's site, rather than to Westlaw, because at the time of publication Westlaw had not yet identified the section numbers assigned to the new provisions). The legislation also added similar sections to the state's laws governing consumer leases and retail installment contracts. Those new provisions are, respectively:

A contract entered into on or after the effective date of this section to transfer ownership of a live dog or cat in which ownership is contingent upon the making of payments over a period of time subsequent to the transfer of possession of the live dog or cat, or provides for or offers the option of transferring ownership of the dog or cat at the end of a lease term, is void and unenforceable.

### [Wash. Rev. Code § 63.10.070](#).

A retail installment contract entered into on or after the effective date of this section that includes a live dog or cat as a security interest for the contract is void and unenforceable.

### [Wash. Rev. Code § 63.14.127](#).

3. The new provisions of the acts governing consumer leases and the retail installment contracts similarly do not apply to commercial loans.



## Recent Cases

### SECURED TRANSACTIONS

#### *Scope Issues*

*Funding Metrics, LLC v. NRO Boston, LLC*,  
[2019 N.Y. Misc. LEXIS 4878](#) (Sup. Ct. 2019)

A transaction structured as a sale of \$286,000 of future receivables for \$200,000, to be repaid in daily increments of \$2,600 for 22 weeks was a loan bearing interest at an annualized rate of 102%, as was a similar transaction between the parties. The documents shifted all risk of nonpayment of the receivables to the seller, which remained absolutely liable for the Purchased Amount.

*In re Steele,*

[2019 WL 3756368](#) (Bankr. E.D.N.C. 2019)

A transaction structured as a sale of 12% of future receivables was a sale, not a loan because the terms of the agreement were clear.

*In re Green Parts International, Inc.,*

[2019 WL 3713691](#) (Bankr. N.D. Ga. 2019)

A three-year equipment lease that called for total payments of \$82,868.50 – which equaled the \$65,000 price plus 9.163% interest – and included an option to purchase at the end of the lease term for fair market value was not shown to be a sale. Although, prior to executing the lease, the lessee received a letter indicating that the option price would be \$3,250, that letter was inadmissible under the parol evidence rule and, without that letter, the lessee had not shown that the option price was nominal or that the lease term was for the entire useful life of the goods.

### **Attachment Issues**

*Cheniere Energy, Inc. v. Parallax Enterprises LLC,*

[2019 WL 3801955](#) (Tex. Ct. App. 2019)

[2019 WL 3788210](#) (Tex. Ct. App. 2019) (dissent)

A promissory note describing the collateral to include “[a]ll other tangible and intangible property and assets of” the debtor did not adequately describe “general intangibles,” and therefore did not include the debtor’s only asset: its interest in a wholly owned limited liability company. “Intangible property” is a super-generic term that encompasses things other than general intangibles, and hence is not an adequate description.

*Scott v. PNC Bank,*

[2019 WL 3937594](#) (3d Cir. 2019)

The district court erred in ruling that an assignment of a life insurance policy “as collateral security for any and all liabilities . . . to the Assignee, both those now existing and those that may hereafter arise in the ordinary course of business between . . . the undersigned and the Assignee” survived the repayment of the original loan, persisted for another thirteen years, during which the assignee was acquired by another entity, and then applied to the acquiring entity’s new and unrelated loan. Discovery was necessary to ascertain whether the new loan was “in the ordinary course of business” established by the original parties.

*In re Woodbridge Group of Companies, LLC,*

[2019 WL 4305444](#) (D. Del. 2019)

A promissory note that prohibited assignment without consent and stated that any attempted assignment without the required consent was void could not be assigned. A buyer of promissory notes does not have a “security interest” and therefore § 9-408 does not apply and does not override a restriction on assignment of the notes.

### **Perfection Issues**

*In re 180 Equipment, LLC,*

[2019 WL 4296751](#) (7th Cir. 2019)

A financing statement describing the collateral as “[a]ll Collateral described in First Amended and Restated Security Agreement dated March 9, 2015 between Debtor and Secured Party” was sufficient to perfect even though the security agreement was not also filed because the collateral was “objectively determinable” under § 9-108(b)(6).

### **Liability Issues**

*Parkhill LLC v. Economic and Community Dev. Institute, Inc.,*

[2019 WL 4016275](#) (Ohio Ct. App. 2019)

A secured party to which the debtor’s landlord had contractually agreed to subordinate its interest in the debtor’s equipment was liable under the subordination agreement for per diem rent only for 10 days. The agreement provided for per diem rent beginning 20 days after the secured party received notification of the debtor’s default under the lease but also provided that the secured party’s rights under the agreement – including its right of entry to take the collateral – expired 30 days after receipt of the notification. It made no sense for the secured party to be liable for rent after its right to enter expired.

## **BANKRUPTCY ISSUES**

### **Avoidance Powers**

*In re Hackler,*

[2019 WL 4309510](#) (3d Cir. 2019)

A strict foreclosure of a New Jersey tax lien on real property two months before the taxpayers’ bankruptcy, pursuant to which the lien holder received property worth far more than the amount of the debtor, was an avoidable preference. The transfer enabled the lien holder to receive more than it would have had the transfer not been made and the taxpayers’ assets liquidated under Chapter 7.

*Textron Financial, Inc. v. Bash,*

[2019 WL 3290257](#) (N.D. Ohio 2019)

Even if a secured party with a security interest in all of the debtor’s assets to secure a \$17.5 million revolving line of credit lacked good faith when it received intentionally fraudulent transfers totalling \$316 million, the secured party’s liability would be limited to the \$17.5 million credit limit, which the debtor never exceeded. It would be inequitable and lead to multiple recoveries to impose liability for the transfers followed by a further extension of credit.

*In re Generation Resources Holding Company, LLC*,  
[2019 WL 3941079](#) (Bankr. D. Kan. 2019)

Entities that received from the initial transferee of an avoidable fraudulent transfer the proceeds of the property transferred, rather than the fraudulently transferred property itself, could have liability under § 550(a). That provision imposes liability on an immediate or mediate transferee of “the value of [the property transferred].”

#### LENDING, CONTRACTING & COMMERCIAL LITIGATION

*Secured Financings, LLC v. Bristol Holdings, LLC*,  
[2019 WL 3758943](#) (Cal. Ct. App. 2019)

Although a lender that has contractually agreed to subordinate its lien might normally have a cause of action against an entity related to the debtor for buying the senior loan and then releasing the guarantor in return for nominal payment, thereby materially prejudicing the rights of the junior lender that also had a right to buy the senior loan, the junior lender in this case had no such claim because it had waived its rights pursuant to the clause in the subordination agreement providing that the senior lender could “release or compromise any obligation or provisions of the notes and deed of trust . . . and all documents given in connection therewith.”

*Mitsuwa Corp. v. Wehba*,  
[2019 WL 3561928](#) (Cal. Ct. App. 2019)

An agreement that settled a dispute for \$15 million and called for two payments totaling \$10.5 million, with the remaining \$4.5 million forgiven if both payments were timely made, did not create an unenforceable penalty for late payment. The agreement expressly called for payment of \$15 million, with discount for timely performance, not liquidated damages or a penalty for late payment. Had the agreement not expressly created liability for \$15 million, the result might have been different.

*Red & White Distribution, LLC v. Osteroid Enterprises, LLC*,  
[2019 WL 3759458](#) (Cal. Ct. App. 2019)

An agreement that settled a dispute between a lender and a borrower and provided for payment by the borrower of \$2.1 million through installments over a one-year period, but also included a stipulation for entry of a \$2.8 million judgment in the event of default, created an unenforceable penalty. Nothing in the settlement agreement indicated that the borrower owed \$2.8 million; rather it stated that the borrower was liable for \$2.1 million. Had the parties intended to settle for \$2.8 million, but apply a discount for timely payments, they could have done so expressly.

*Tavarua Restaurants, Inc. v. McDonald’s USA, LLC*,  
[2019 WL 3858826](#) (S.D. Cal. 2019)

A franchisor, which had a contractual option to purchase the franchisee’s franchises “on the same terms and conditions” that the franchisee offered to any third party, could exercise that option without also purchasing the franchisee’s office and storage facility, even though those properties were part of the franchisee’s negotiated transaction with a prospective buyer.

*MNM Investments, LLC v. McCloud*,  
[2019 WL 3801672](#) (D. Kan. 2019)

Bills of sale by which two entities purported to “sell, transfer, and quit claim” virtually all of their assets, including “general intangibles,” were sufficient to transfer trademarks.

*The Ricardo S. and Ilda FG. Fernandez Revocable Living Trust v. Ripps*, [2019 WL 3934375](#) (Ariz. Ct. App. 2019)

A creditor with three deeds of trust on a piece of property and which, upon payment of the amounts due under two of them, signed releases stating that “the indebtedness and/or obligations secured by the Deed of Trust . . . has been fully paid, satisfied and discharged,” thereby discharged the liens. However, the releases were not determinative of whether the debt had been fully paid.

*Sprint Nextel Corp. v. Wireless Buybacks Holdings, LLC*,  
[2019 WL 4197239](#) (4th Cir. 2019)

A clause in a wireless service provider’s agreements with its customers providing that subsidized “customer devices . . . are not for resale and are intended for reasonable and non-continuous use” on the provider’s networks was merely a background statement of intent, not an enforceable promise not to resell subsidized phones. Accordingly, a company that bought subsidized phones from customers of the provider was not liable for tortious interference with contract.

*Affiniti Colorado, LLC v. Kissinger & Feldman, PC*,  
[2019 WL 4309532](#) (Colo. Ct. App. 2019)

Under Colorado law, although the attorney-client privilege survives the death of an individual client, the privilege does not survive a corporate client’s dissolution if no one remains to act on the corporation’s behalf. As a result, a law firm being sued for negligent misrepresentation based on a corporate client’s failure to obtain necessary governmental approval to grant the plaintiff a security interest had to disclose its communications with the now-dissolved client.



*In re Mayacamas Holdings LLC,*

[2019 WL 4233624](#) (Bankr. N.D. Cal. 2019)

The court would respect the parties' contractual choice to have a deed of trust governed by California law, which is where the property is located, but have the promissory note governed by Oregon law. As a result, the increase in the contractual interest rate from 6% to 18% after default, along with a monthly late charge of 4% and a \$75,000 exit fee were enforceable. The lender's security interest in the real property did not extend to the insurance proceeds received after damage caused by fire because the lender neither was named as an insured nor provided the insurer with written notification that it should be added as a loss payee to the policy.

■ ■ ■

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