

# The Transactional Lawyer

A Publication of the Commercial Law Center



## A Deposit Account Is Not a Box of Money

**Jason J. Kilborn**

We all know that generalist courts frequently do not understand the arcane rules of the UCC. Worse yet, these courts often do not understand the operation of the underlying commercial structures, such as bank accounts. Worst of all, these courts sometimes insist they do know these things, and the application of the law is thus plain and obvious. A case in point is the recent Fifth Circuit ruling in *In re Tusa-Expo Holdings, Inc.*<sup>1</sup>

Knoll supplied furniture on secured credit to the operating company of Tusa, a large furniture retailer. Tusa also funded its operations with a revolving line of credit with a financier called Textron. Both Tusa and Textron had contractual security interests in Tusa’s accounts receivable arising from credit sales of furniture to customers. The obvious priority clash was dealt with contractually, with Textron subordinating its interest in Tusa’s accounts receivable to Knoll. Textron protected itself, however, by insisting that customer payments on these receivables be deposited directly into a “lockbox,” a deposit account controlled and swept by Textron. Tusa received the value for these payments only as Textron swept the lockbox account and disbursed funds to Tusa pursuant to its revolving loan agreement.

The odd twist in this case is created by bankruptcy preference avoidance law. Tusa’s bankruptcy trustee sued Knoll for return of over \$4.5 million that Tusa had paid to Knoll within 90 days of Tusa’s bankruptcy filing. Among Knoll’s responses, it asserted that a key element of an avoidable preference had not been established, *i.e.*, that Knoll was better off for having received these

payments pre-petition rather than waiting for a distribution in bankruptcy.<sup>2</sup> Since Knoll had a security interest in Tusa’s accounts receivable, and the money paid to Knoll was directly traceable to the customer-payment proceeds of these very accounts, Knoll argued that it had simply received a return of its collateral, to which it had a guaranteed right both in and outside of bankruptcy.

This clever argument depended on Knoll’s security interest surviving intact through several transformations. Much of the groundwork for establishing this continuous survival was done by Article 9 itself, which provides as a matter of law that a security interest automatically attaches to the identifiable proceeds of collateral.<sup>3</sup> It was more or less uncontroverted that Knoll could trace the proceeds of its collateral from: (1) the accounts receivable created upon credit sales of furniture to customers, to (2) the payments (probably instruments) made by Tusa’s customers, to (3) the Textron “lockbox” deposit account into which these payments were deposited, to (4) the sweep of funds from this lockbox by Textron, to (5) the revolving-loan disbursement of these funds by Textron to Tusa, and ultimately to (6) Tusa’s payments to Knoll.

Tusa’s trustee’s response homed in on the fourth and fifth stages. Article 9 contains an important rule protecting the liquidity of deposit accounts by stripping away security interests in deposit accounts from payments made out of those accounts. In other words, a deposit account is a one-way street for the continuation of a creditor’s security interest in proceeds deposited into that account. Payments of “funds” coming *out of* a deposit account are scrubbed of any security interest in those funds by operation of UCC § 9-332(b). When Textron swept the lockbox deposit account, it became a transferee of those funds who, as § 9-332(b) provides, “takes the funds free of a security interest in the deposit account.” Thus, the trustee argued, after Textron swept the lockbox, the funds disbursed to Tusa and eventually paid to Knoll were no longer encumbered with Knoll’s security interest and did not represent a return of Knoll’s collateral.

Here is where the Fifth Circuit went off the rails. It accepted Knoll’s factually and legally unsound response that § 9-332(b) “only concerns a security interest in the deposit account itself, not a security interest in the funds contained in it.” The Fifth Circuit held that since Knoll’s security interest had attached only to the proceeds of

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some accounts receivable, not to the entire deposit account,<sup>4</sup> § 9-332(b) did not allow Textron to take those funds free of Knoll's interest, as that section by its "plain language" affects only a security interest "in the deposit account."<sup>5</sup>

This contrived distinction between a security interest in a deposit account as a whole and a security interest in proceeds deposited into such an account, that is, "funds contained in it," misconceives both the factual nature of a bank deposit account and the legal treatment of the "funds contained in it." As any commercial lawyer knows, a bank deposit account, even one called a "lockbox," is not a metal drawer where the bank holds money placed on deposit. Rather, the concept is referred to as a "deposit account" because it is a subspecies of the general concept of an "account"; that is, "a right to payment of a monetary obligation."<sup>6</sup> The *in personam* right to collect payment from the recipient of goods or services provided on credit (or a variety of other collection rights) is an "account."<sup>7</sup> A bank account or "deposit account" is simply a specific, legally discrete kind of such an *in personam* "right to payment of a monetary obligation," which happens to be assertable only against a bank with whom funds have been deposited, the obligation being to return those funds to the depositor upon demand.<sup>8</sup>

Even if the bank held actual money in a box, the Fifth Circuit's distinction between a deposit and the account itself is unsound under Article 9. Since a bank account contains fungible "funds" that cannot be physically distinguished, it is useful to analogize this situation to the way Article 9 treats "goods" collateral (not deposited funds) commingled with other, fungible collateral. In such a case, § 9-336 provides that "a security interest attaches to the product or mass" into which the collateral is commingled.<sup>9</sup> That same provision is explicit in rejecting the Fifth Circuit's distinction between the part and the mass: Once collateral becomes commingled goods, "[a] security interest does not exist in commingled goods as such,"<sup>10</sup> and comment 3 observes, "the security interest in the specific original collateral alone is lost once the collateral becomes commingled goods." Reasoning by analogy here, once Tusa's customer payments were commingled with the indistinguishable "funds" in the Textron lockbox, they lost their independent security interest, and a replacement interest was created in "the mass"; *i.e.*, the entire deposit account.

But again, this easy fix is unavailable, since a deposit account is not a box of commingled physical money. It is not like a vat holding commingled oil or a barrel holding commingled ball bearings. To put it more directly, a deposit account does not "contain" a physical

concept called "funds." Rather, it is an aggregate of many intangible promises by the bank to give back funds transferred temporarily to that bank. It is a series of indistinguishable "rights to payment of a monetary obligation" to return deposits made at various times in varying amounts. There is no basis in fact or law to draw a distinction between a deposit account and any one of the many promises to return funds that make up that deposit account. Indeed, the definition of "cash proceeds" does not include any notion of funds on deposit in a deposit account; rather, cash proceeds are "deposit accounts" as an undivided and indivisible whole, the result of what must be multiple deposits of various funds.<sup>11</sup> The interest that § 9-315(a)(2) creates in the proceeds of, say, accounts receivable, eventually deposited in a bank account, attaches to the deposit account—either an undivided portion of the account corresponding to the amount of the deposited proceeds (analogous to the undivided interest of a partial co-owner in the whole of a parcel of property), or at least in the portion of the deposit account representing the promise to repay that very deposit. In either event, the security interest is in the deposit account itself, not in any unidentifiable and indistinguishable "funds" that are supposedly "contained in" that deposit account.

One final observation about the key notion of "proceeds" further undermines the Fifth Circuit's analysis. Knoll enjoyed its security interest in the Textron lockbox deposit account only because Article 9 created that right in the proceeds of Tusa's accounts receivable. The concept of "proceeds" applicable to Knoll's case adheres to the law of physics that matter is neither created nor destroyed, it simply changes form. The definition of "proceeds" applicable to Knoll's case is "whatever is acquired upon the . . . exchange, or other disposition of collateral."<sup>12</sup> Knoll's collateral, the account receivable, was exchanged for the customer's payment, and that payment was exchanged for the bank's promise to repay a similar amount of funds upon demand in the future. That is, the "funds contained in the deposit account," as the Fifth Circuit described it, is a non-existent concept. Deposited checks and other funds are not collected in a deposit account, they are exchanged for the promise that the deposit account represents. Once money, instruments, or anything else is deposited in a deposit account, the specific things deposited either go out of existence altogether (*e.g.*, a finally paid check or ACH order) or at the very least are commingled with indistinguishable things (other dollar bills) and physically routed out of the transaction between the depositor and the bank.

This explains the distinction, seized on by the Fifth Circuit, between § 9-332(a) and (b). The former strips

“money” of *any* security interest, while the latter strips “funds from a deposit account” only of a security interest *in the deposit account*. While the drafting might have been tighter here, the distinction the Fifth Circuit draws is not intended. As discussed already, there is no other security interest in “funds” other than the interest in the deposit account from which they are paid. The undefined concept of “funds” is an unfortunate way of describing the credits that ultimately will emerge from the account in a multitude of forms as the bank fulfills its promise to return deposited value (*e.g.*, cash, check, electronic transfer). The distinction between the language of § 9-332(a) and (b) is the result of the fundamental, ontological difference between the defined, tangible thing called “money” and the undefined, intangible concepts of “funds” and “deposit accounts.”

How can a lawyer be expected to make all of this clear in page-limited briefing before a generalist court that stubbornly refuses to acknowledge its ignorance of the facts and law of modern commerce? I wish I had a better answer. But the Fifth Circuit’s ruling in *Tusa-Expo* illustrates the danger of failing to disabuse such a court of its fundamental misunderstandings about how the world of commercial law and practice actually works.

If we can’t rely on the courts, how might a transactional lawyer avoid the problem entirely? Knoll won here on an improper application of the law, but presuming proper application of the law, Knoll might have avoided this problem by structuring the transaction differently. Three approaches come to mind. First, Knoll could have taken and perfected a security interest in the deposit account as original collateral. This would ensure that any payment received from the deposit account was a payment of collateral, and would thus not be preferential. The trouble with this approach is that if Textron still swept the deposit account periodically, before payment to Knoll, Textron’s subsequent advance by re-crediting the deposit account might itself be preferential.

A second and better approach would have been for the agreement between Knoll and Textron to prohibit Textron from sweeping the deposit account (at least prior to default) and for Knoll to receive payment directly from the deposit account, rather than receiving it circuitously after Textron’s sweep and re-advance to Tusa. This too would ensure that the payment Knoll received was from its own collateral.

A third approach would be for Textron to pay Knoll directly after it swept the deposit account. Under this approach, because Textron would have taken the swept funds free under § 9-332(b), the payment would arguably

not be a transfer of the debtor’s property, and thus could not be an avoidable preference under § 547(b).

As is often the case, the best solution requires not merely documenting the deal differently, but understanding the implications of alternative commercial actions.

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#### Notes:

1. [811 F.3d 786](#) (5th Cir. 2016).
2. *See* 11 U.S.C. § 547(b)(5).
3. U.C.C. § 9-315(a)(2).
4. Though query whether all of the funds in the lockbox were proceeds encumbered by Knoll’s interest, which seems to be the only reason that Knoll could be sure that the funds it received from Tusa were surely identifiable proceeds of its collateral, the original accounts receivable. The Fifth Circuit did not address this further wrinkle.
5. [811 F.3d at 795-97](#).
6. U.C.C. § 9-102(a)(2).
7. *Id.*
8. It is unfortunate that the definition of “deposit account” in U.C.C. § 9-102(a)(29) does not clearly make this connection to the basic notion of an “account,” or offer much of a useful definition at all, other than linking the concept with a bank and several loose references to traditional forms of bank accounts.
9. U.C.C. § 9-336(c).
10. U.C.C. § 9-336(b).
11. U.C.C. § 9-102(a)(9).
12. U.C.C. § 9-102(a)(64).
13. Example 2 in comment 2 to § 9-332 defines “funds” as “credits” in this way. It is a pity that this definition did not make its way into § 9-102(a).



## Avoiding Ambiguity: Part Two – Syntactic Ambiguity

*Stephen L. Sepinuck*

Part One of this Article, which appeared in the June issue of this newsletter, offered advice on how to avoid contextual ambiguity.<sup>1</sup> This second installment offers advice on how to avoid syntactic ambiguity.

### The Causes of Syntactic Ambiguity

Syntactic ambiguity arises from sentence structure, that is, from the manner in which a word or phrase relates to or affects other words or phrases in the sentence. For example, consider the following clause in a settlement agreement (described in Part One of this Article):

all claims for the avoidance or recovery of transfers  
**in the amount of \$59,999.99 or less** are released.

Does the modifying phrase (in blue) refer to the amount of “claims” or the amount of “transfers”? The distinction can matter if a single claim totaling \$60,000 or more arises from multiple transfers, each of which is less than that amount.<sup>2</sup>

Detecting syntactic ambiguity is a bit like spotting both pictures in an ambiguous image. In some cases, such as the following image of a vase or two faces, created by Edgar Rubin, it is fairly easy:



Notice that the faces are in white and the vase is in black. However, more complex ambiguous images, with each picture in both colors, can be more difficult to discern. Do you see both a woman’s face and a saxophonist in the following image?



Or how about the picture *My Wife and My Mother-in-Law* by W.E. Hill:



In general, it takes attention and practice to see both pictures. The same is true with respect to syntactic ambiguity. Fortunately, however, although the causes of syntactic ambiguity are probably legion, there are common patterns and frequent culprits. Experience suggests that transactional lawyers would be well advised to be on constant vigil for three: conjunctions, prepositions, and modifiers.

### Conjunctions

Conjunctions, such as “and” and “or,” can create ambiguity. Consider, for example, an offer to buy “ten black and white dresses.” It could refer to: (i) ten bi-colored dresses (each both black and white); or (ii) ten dresses, some of which are black and some of which are white.<sup>3</sup> In short, it is unclear whether the phrase “black and white” refers to each dress or to the collection of dresses. Now consider this example from a company’s employee manual:

Supervisory and salaried employees are entitled to four weeks of paid vacation each calendar year.

Does the sentence cover only employees who are both supervisory and salaried, or does it also cover employees who fall under only one of those descriptors?

The conjunction “or” has an even greater potential for ambiguity. The word can be exclusive (either . . . or) or inclusive (and/or), and context does not always make

it clear which is intended. This potential ambiguity is compounded somewhat when “or” is part of a negative phrase (e.g., “not X or Y”). In such a case, the phrase might mean: (i) neither X nor Y; (ii) not either or both of them; or (iii) one and only one of them is not true.<sup>4</sup>

A phrase containing both “and” and “or” can be even more problematic. For example, a phrase in the structure of “if X and Y or Z” might mean “if (X and Y) or Z” or it might mean “if X and (Y or Z).” The former is satisfied by Z alone; the latter is not. Often there is no way to discern what the author meant.<sup>5</sup>

### Prepositions

The careless selection of a preposition can sometimes cause a clause to mean something different from what the writer intended. For example, an option requiring notification *on* the anniversary date of the agreement is different from one requiring notification *before* the anniversary date.<sup>6</sup> This particular example is likely to be obvious to the writer. Occasionally, however, the preposition chosen can affect the meaning in more subtle ways. For example, a clause authorizing a “regular associate *with* a law firm” to share compensation earned by the firm might be different from a clause authorizing “a regular associate *in* a law firm” to share compensation earned by the firm.<sup>7</sup> A forum-selection clause that refers to the courts *of* a specified state is more restrictive than one that refers to courts *in* a specified state, because it excludes federal courts.<sup>8</sup> A written agreement referring to personal property “located *on* said land” might or might not include piping and other property located beneath the surface.<sup>9</sup>

In extreme cases, the preposition used can render the clause ambiguous. Consider the following clause, dealing with proceeds of a copyright infringement action, in a publication agreement between a publisher and two co-authors:

The balance of the proceeds shall be divided equally between the Authors and the Publisher.

Use of the word “between” suggests that the Publisher gets half the recovery and the Authors collectively get the other half. However, given that there are three parties, the clause could be interpreted to mean that each gets one-third.<sup>10</sup>

### Modifiers

The misuse of modifiers is undoubtedly the most common cause of syntactic ambiguity. Some modifiers are inherently ambiguous. For example, the phrase “not

any” could mean “not all” or it could mean “none.” This problem was litigated recently in connection with a lease of retail space in a shopping center.<sup>11</sup> The lease contained the following term (slightly simplified):

**Termination.** Tenant may terminate this Lease if at least 100,000 square feet of Floor Area is **not** being operated on **any** one of the Anchor Store Areas.

The clause could refer to a situation when any single Anchor Store is not being operated sufficiently (*i.e.*, not all Anchor Stores) or only when no Anchor Store is being operated sufficiently (none).<sup>12</sup>

More commonly, it is the placement of a modifier that creates ambiguity. In general, a modifying word or phrase modifies whatever immediately follows it. Thus, consider the following clause from a distributorship agreement that I was recently asked to review:

Distributor shall only sell the Products to Approved Dealers.

The word “only” is clearly misplaced. It is not intended to modify the verb “to sell,” and thus prohibit leasing or donating the Products. However, what is intended is less clear; it could be either of the following:

Distributor shall sell **only** the Products to Approved Dealers.

Distributor shall sell the Products **only** to Approved Dealers.

The first creates a restriction on selling other products to Approved Dealers; the second restricts to whom the Distributor may sell the Products. A distributorship agreement might, depending on the circumstances, do either of these things. In fact, after reading the entire agreement, the parties’ intended meaning was still not evident, although it was most likely the latter.

When a modifying word or phrase precedes a list, it is often ambiguous whether the modifier applies only to the first item or to all of them. For example, a promissory note might call for interest at a higher, default rate if the maker:

... fails to pay when due any **installment of** principal, interest, or other amount due under this Note.

Does the phrase “installment of” modify only the first noun – “principal” – or does it modify all of them? This could matter if the maker failed to pay the debt at maturity.<sup>13</sup>

The same ambiguity can result if the modifier follows a list. For example, a security agreement might contain the following clause:

**Use of Collateral.** Borrower shall not sell, lease, license or encumber **outside the ordinary course of business** all or any part of the collateral.

Does the phrase in blue modify only “encumber” or does it also modify the other verbs? Similarly, a sales agreement might identify the property to be sold as:

... all inventory, equipment, accounts, and general intangibles **used in or arising out of the operation of the Business.**

Does the blue phrase modify only “general intangibles” or also the other nouns? This could matter greatly if the seller had multiple lines of business, only one of which was being sold and fell within the agreement’s definition of the capitalized term.

Courts have used a variety of conflicting approaches to resolve this kind of ambiguity.<sup>14</sup> Consequently, the drafter of a clause cannot be sure that a court will ultimately interpret the clause as the drafter intended.

### Techniques to Avoid Syntactic Ambiguity

**1. Search for Common Sources.** Before finalizing a transaction document, search for conjunctions and for the adverb “not.” This can readily be done using the word search feature of a document contained in a word processing or pdf file. Then read carefully each clause in which one or more of them appears to make sure there is no ambiguity.

**2. Move Modifiers.** Review the document for modifying clauses and phrases. For each, contemplate whether moving the modifier to a different position in the sentence creates a different meaning. If so, evaluate where to place the modifier to produce the desired meaning.

Be advised, however, that moving the modifier might not always remove the ambiguity. Let us revisit the clause discussed above from a security agreement:

**Use of Collateral.** Borrower shall not sell, lease, license or encumber **outside the ordinary course of business** all or any part of the collateral.

The modifying phrase could simply be moved to the beginning of the sentence:

**Use of Collateral.** Borrower shall not **outside the ordinary course of business** sell, lease, license or encumber all or any part of the collateral.

This helps somewhat but does not fully remove the ambiguity. Adding a comma before and after the modifying clause would also help, by suggesting that the clause modifies the entire list. However, in the words of one court, “[a] comma, often a matter of personal style, is a very small hook on which to hang a change in [meaning] of substantial proportions.”<sup>15</sup>

So, the placement of modifiers can be important, and moving or setting them off with commas should be considered, both as a method of checking for ambiguity and as a potential way to remove ambiguity. But sometimes another solution is needed.

### 3. Tabulate.

Whenever a modifier accompanies a list, tabulate the list and put the modifier either in the flush portion of the clause (if it is intended to modify the whole list) or with a single tabbed item (if it is intended to modify only one item).

For example, depending on the intended meaning, the sales agreement could be reformatted as one of the following alternatives:

... all:  
     inventory,  
     equipment,  
     accounts, and  
     general intangibles  
**used in or arising out of the operation of the Business.**

... all:  
     inventory,  
     equipment,  
     accounts, and  
     general intangibles **used in or arising out of the operation of the Business.**

Each alternative removes the ambiguity. Tabulation such as this would also remove the syntactic ambiguity in the security agreement discussed above. It is a solution that takes a little space but makes the language used much easier to understand.

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**Notes:**

1. See Stephen L. Sepinuck, *Avoiding Ambiguity: Part One – Contextual Ambiguity*, [6 The Transactional Law. 1](#) (2016).
2. See *In re Evergreen Solar, Inc.*, [2014 WL 300965](#) (Bankr. D. Del. 2014).
3. Perhaps less likely, the offer might alternatively refer to twenty dresses, ten of each color.
4. For example, consider the statement “ninety percent of students failed math or English.” That statement could mean that: (i) 90% percent failed at least one of those courses; or (ii) 90% failed one and only one of those courses. Now consider the statement “ninety percent of students did not pass math or English.” That could mean that: (i) 90% failed both of those courses; (ii) 90% failed at least one of those courses; or (iii) 90% failed one and only one of those courses.
5. For a statute containing an example of such a clause, see Mont. Code § 61-4-503 (referring to a defect that substantially impairs “the use and market value or safety” of a motor vehicle).
6. See *Marvin H. v. Morehead*, [798 F.3d 487](#) (7th Cir. 2015).
7. See *In re Ferguson*, [445 B.R. 744](#) (Bankr. N.D. Tex. 2011).
8. See, e.g., *Irsik & Doll Feed Servs., Inc. v. Roberts Enters. Inv., Inc.*, [2016 WL 3405175](#) (D. Kan. 2016) (distinguishing the phrase “courts of the State of Kansas,” which is limited to state tribunals, from “courts in the State of Kansas,” which is not); *Yancy v. Int’l Fid. Ins. Co.*, [2016 WL 2997375](#) (E.D. Va. 2016) (distinguishing “courts of Maryland,” which is limited to state tribunals, from “courts in Maryland,” which is not, and citing numerous cases in support); *Composite Fabrics of Am., LLC v. Edge Structural Composites, Inc.*, [2015 WL 7076383](#) (W.D.N.C. 2015) (an agreement providing that “the Courts of the State of North Carolina shall have exclusive jurisdiction” over disputes between the parties limited the chosen forum to state courts); *Frankford Crossing Shopping Ctr. Dallas, Tx. Ltd. P’ship v. Pho Partners, LLC*, [942 F. Supp. 2d 366](#) (W.D.N.Y. 2013) (similar).
9. See *Aaron Ferer & Sons v. Richfield Oil Corp.*, [150 F.2d 12](#) (9th Cir. 1945).
10. This example is taken from a publication agreement that I and a co-author signed with a publisher. We chose to ignore the ambiguity.
11. See *Security Square Holding, LLC v. Security Wards, LLC*, [2015 WL 7421072](#) (Md. Ct. App. 2015).

12. The court did not address – presumably because neither party so argued – the fact that the clause suffered from two other ambiguities. First, instead of referring to one or all Anchor Stores that were not being sufficiently operated, it could be referring to the square footage of space not being operated. In other words, it is unclear whether the square footage of space not being operated can be aggregated (*i.e.*, the square footage of different stores combined) or whether the numerical threshold requires that amount of space to be not operated in a single store). Second, the clause could refer to the square footage that is being operated or the square footage that is not being operated. In other words, if one Anchor Store had 400,000 of square feet of Floor Area, is the termination right triggered if 150,000 square feet is operated and 250,00 square feet is not?

13. See *Karmely v. Wertheimer*, [737 F.3d 197](#) (2d Cir. 2013).

14. See *id.* at 205 (discussing approaches and cases). See also *Lockhart v. United States*, [136 S. Ct. 958](#) (2016) (dealing, over a strong dissent, with a similar ambiguity in a criminal statute).

15. *In re Newbury Cafe, Inc.*, [841 F.2d 20](#), 22 (1st Ct. 1988). Numerous cases have been decided, in part, on the presence or absence of a comma. See, e.g., *United States v. Ron Pair Enters., Inc.*, [489 U.S. 235](#) (1989) (interpreting the Bankruptcy Code); *Am. Int’l Group, Inc. v. Bank of Am.*, [712 F.3d 775](#) (2d Cir. 2013) (interpreting a statute); *Shelby County State Bank v. Van Diest Supply Co.*, [303 F.3d 832](#) (7th Cir. 2002) (interpreting a security agreement); *Berkshire Aircraft, Inc. v. AEC Leasing Co.*, [84 P.3d 608](#) (Kan. Ct. App. 2002) (interpreting a contract); *Judson v. Associated Meats & Seafoods*, [651 P.2d 222](#) (Wash. App. 1982) (interpreting a statute that had been amended to remove a comma); *Reeves v. Am. Sec. & Trust Co.*, [115 F.2d 145](#), 146 (D.C. App. 1940) (interpreting a will).



## Recent Cases

### SECURED TRANSACTIONS

#### *Attachment Issues*

*In re White*,

[2016 WL 3177247](#) (Bankr. D.N.M. 2016)

The documents for a third loan between a credit union and one of its customers, which described the collateral

as including “all property securing other plan advances and loans received in the past or in the future” and which also stated that “[c]ollateral securing other loans with the credit union may also secure this loan” were ambiguous and did not clearly describe the vehicles that secured the prior two loans.

*In re Omni Enterprises, Inc.*,

[2016 WL 3213562](#) (Bankr. D. Alaska 2016)

Although the debtor paid off in full a 2009 bank loan secured by, among other things, deposit accounts, and although a 2013 loan from and security agreement with the same bank did not expressly include deposit accounts in the collateral, the debtor’s deposit accounts were nevertheless encumbered because the 2009 security agreement covered future advances. Although the 2013 security agreement contained an integration clause, that clause provided that the agreement, “together with any Related Documents, constitutes the entire understanding and agreement of the parties,” and the term “Related Documents” was defined to include existing security agreements.

*In re Thornton*,

[2016 WL 3092280](#) (Bankr. S.D. Ind. 2016)

A security agreement that described the collateral as a manufactured home and “all goods that are or may hereafter by operation of law become accessions to it” covered the fireplace, smoke detector, furnace, water heater, electric main, built in dishwasher, shower and tub because each of these items could not be detached without causing injury and had little independent utility if removed. However, the security interest did not extend to the refrigerator, ice maker, oven, gas washer or gas dryer because these goods would have independent utility if they were removed from the home and could be removed without injury.

*Eaglebank v. BR Professional Sports Group, Inc.*,

[2016 WL 2946166](#) (3d Cir. 2016)

Even if a security agreement would be rendered invalid if the debtor lacked authority to enter into the underlying loan agreement – a point the circuit court did not resolve but expressed considerable doubt about – and even if the district court erred in concluding that the debtor’s CFO had actual authority to borrow the funds, the CFO nevertheless had apparent authority to do so because, by virtue of his position, the CFO was cloaked with such authority, the debtor’s counsel assured the lender in an opinion letter that the debtor could enter into the loan, and the debtor’s Board of Managers passed a specific resolution authorizing the CFO to enter into the loan agreement and borrow money “without limitation.”

*Mac Naughton v. Harmelech*,

[2016 WL 3771276](#) (D.N.J. 2016)

The debtor’s lawyer, who drafted a security agreement authenticated by the debtor purporting to grant the lawyer a security interest in “all of [the debtor’s] . . . personal property,” which agreement was ineffective because the super-generic language did not reasonably describe the collateral, was not entitled to have the security agreement reformed due to unilateral mistake. Such a mistake requires fraud or unconscionable conduct by the other party to be actionable, and there was no allegation that the debtor was at fault given that the attorney drafted the agreement. The attorney was not entitled to an equitable lien for the same reason.

### *Enforcement Issues*

*Bob Smith Automotive Group, Inc. v. Ally Financial Inc.*,

[2016 WL 3613402](#) (Md. Ct. of App. 2016)

Even though the debtor executed a demand promissory note and security agreement simultaneously, and the security agreement required the debtor to remit to the secured party the amount advanced on each vehicle as it was “sold or leased,” that language did not alter the demand nature of the note. Accordingly, the secured party did not have to prove a default or demonstrate that it acted in good faith in demanding payment.

*Pool v. Drive Time Car Sales Co.*,

[2016 WL 3416372](#) (N.M. Ct. App. 2016)

A car-purchase agreement that provided for arbitration of a wide array of claims but excepted the credit-seller’s use of self-help remedies was substantively unconscionable even though it allowed the buyer to seek a court injunction against repossession or sale. Such relief is unlikely to ever be available to the buyer and thus the arbitration provision was unconscionably one-sided.

### **BANKRUPTCY**

*In re Energy Future Holdings Corp.*,

[2016 WL 3135827](#) (Bankr. D. Del. 2016)

The first-lien noteholders, who were paid the full amount of the outstanding principal and interest in the debtors’ bankruptcy, were not entitled to recover the amount of the prepayment premium from the second-lien noteholders, who received a partial payment on their notes from the debtor, because the first-lien noteholders were entitled to the prepayment premium only if there was an optional redemption of the first-lien notes, and there was not. Instead, the notes were automatically accelerated when the debtors filed for bankruptcy protection.

*In re Intervention Energy Holdings, LLC*,  
[2016 WL 3185576](#) (Bankr. D. Del. 2016)

An amendment to an LLC operating agreement, made as a condition to a secured lender entering into a forbearance agreement, that made the lender a member of the LLC, required the unanimous consent of all members to file a bankruptcy petition, and eliminated the lender's fiduciary duties as a member, was tantamount to an absolute waiver of the LLC's right to seek bankruptcy protection and was thus void as against federal public policy.

## LENDING & CONTRACTING

*Maybank v. BB&T Corp.*,  
[2016 WL 3188923](#) (S.C. 2016)

The term in a wealth management agreement between a bank and its customer that disclaimed liability "for any incidental, indirect, special, consequential or punitive damages" with respect to the services provided was not against public policy and was sufficient to bar liability for punitive damages. However, because the term did not mention "statutory" or "multiple" damages, it did not prevent the trebling of the jury's damages award for willful violation of the state Unfair Trade Practices Act.

*In re WBH Energy, LP*,  
[2016 WL 3049666](#) (Bankr. W.D. Tex. 2016)

Even though a party to a joint operating agreement with the debtor prevailed in its action to prevent the debtor from continuing to act as the operator under that agreement, it was not entitled to attorney's fees pursuant to a provision in the agreement awarding attorney's fees to the prevailing party in legal proceedings "to enforce any financial obligation," because the litigation was not about enforcing a financial obligation.

*Irsik & Doll Feed Servs., Inc. v. Roberts Enter. Inv., Inc.*,  
[2016 WL 3405175](#) (D. Kan. 2016)

The forum selection clause in each of 27 security agreements covered actions to enforce each of the 27 related promissory notes – which lacked a forum selection clause – because each note and security agreement expressly referenced each other and were part of a single, integrated transaction. The clauses, by referring to "courts of the State of Kansas," rather than to "courts in the State of Kansas," were limited to state tribunals.

*Mortgage Grader, Inc. v. Ward & Olivo, LLP*,  
[2016 WL 3434529](#) (N.J. 2016)

An attorney who withdrew from a law firm – that was structured as a limited liability partnership – after another attorney in the firm gave a client allegedly deficient advice was not liable to the client even though the firm allowed its malpractice coverage to lapse when winding up its affairs. The requirement in the rules of court that law firms organized as LLPs maintain malpractice insurance does not extend to a firm's windup period when the firm has ceased to provide legal services and it does not require purchase of tail insurance coverage. Moreover, violation of such a disciplinary rule does not result in automatic conversion of a law firm organized as an LLP into a general partnership.

*In re Kitchens Brothers Manufacturing Co.*,  
[2016 WL 3699341](#) (Bankr. S.D. Miss. 2016)

Because the parties' loan and security agreement expressly provided that the Termination Date could be extended "in the sole and unrestricted discretion" of the lender, and that the lender "shall be under no obligation whatsoever to extend the initial Termination Date, or to further extend any subsequent Termination Date to which the Lender has previously agreed," the parties had rendered inapplicable the general obligation of good faith and fair dealing. Accordingly, the lender's refusal to accept the debtor's dirt-for-debt proposal could not be a breach of the implied duty of good faith. Even if the general obligation of good faith did apply, the lender's refusal did not violate it.



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