

The Transactional Lawyer

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Making Sure Standard Terms Are Part of Offers

Sara Fairburn Hurn

It is fairly common for a merchant to have a standard set of terms that the merchant hopes or expects will apply to all its sales agreements. However, merchants should not blithely assume that such standard terms will become part of the merchant’s sales agreements. As the recent decision in *Leica Geosystems, Inc. v. L.W.S. Leasing, Inc.*, [2012 WL 1957288](#) (D. Colo. 2012) suggests, when and how the terms are communicated to the merchant’s suppliers or customers might very well affect whether the terms will become part of any resulting agreement. The case is a cautionary tale for merchants and their counsel because it indicates that the merchant must do more than merely reference in its offers the existence of its standard terms.

Leica and L.W.S. Leasing entered into negotiations for L.W.S. Leasing to purchase an airborne laser sensing system from Leica for installation on one of L.W.S. Leasing’s helicopters. Over the course of several months Leica sent four written price quotations. Each quote stated that the sale would be subject to Leica’s Standard Terms and Conditions of Sale but none of the quotes included the standard terms or an electronic link to them. The day after the parties reached an oral agreement, Leica sent to L.W.S. Leasing a confirming invoice that contained a link to the terms. This was the first access to the terms that Leica provided to L.W.S. Leasing.

Even though Leica’s price quotes – *i.e.*, its offers – referenced the existence of Leica’s standard terms, and thus L.W.S. Leasing had notice that such terms existed, the court concluded that this was not sufficient to make those terms part of the offer. In short, the court declined to put the burden on L.W.S. Leasing to ask for the terms, and instead placed the responsibility of providing access to the terms on Leica. As a result, the court treated the terms in the confirmation as proposed additions to the agreement and analyzed them individually under U.C.C. § 2-207. Because L.W.S. Leasing did not assent to the terms, only the immaterial terms became part of the parties’ agreement.

It is important to understand that this case is not merely another decision dealing with a section 2-207 battle of the forms, applicable only to agreements for the sale of goods. The court’s conclusion – that Leica’s offer did not include the referenced standard terms – could apply to any type of agreement. The decision therefore has implications for transactional attorneys who advise and assist merchants engaged in almost any type of business.

That said, it is also important to recognize that the court did not rule that the offer must include the full text of the offeror’s standard terms for those terms to be part of the offer. The court merely held that a mere reference to the terms was inadequate. It may be sufficient if the offer references the standard terms *and* includes a link or other indication of how the offeree can access them. *See Spartech CMD, LLC v. Int’l Automotive Components Group North America, Inc.*, [2009 WL 440905](#) (E.D. Mich. 2009) (buyer’s standard terms were part of offers made by purchase orders that referenced the terms and indicated the web address at which the terms were available).

Reasonable transactional attorneys may disagree about how to advise their merchant clients to proceed. Although including the full text of a merchant’s standard terms in an offer provides the greatest assurance that the terms will be part of the offer, attorneys may conclude that their merchant clients need not go that far. What is undeniable after *Leica*, though, is that simply referencing standard terms in an offer, without making the terms accessible to the offeree through an electronic link or some other means is risky. Terms not made accessible until later place the burden on the offeree to seek the terms out, something the court in *Leica* was unwilling to accept because it

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impairs the offeree's meaningful opportunity to accept or reject the terms as part of the agreement.

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The Power of a Confirming Writing

Linda J. Rusch

Every business person understands that it is important to get the details of an oral agreement into a document and that sending a confirming document to the other party after reaching an oral agreement is good business practice. The court's analysis in *Apex LLC v. Sharing World, Inc.*, [142 Cal. Rptr. 3d 210](#) (Cal. Ct. App. 2012), illustrates just how important a confirming document can be in a UCC Article 2 sales transaction and in addition illustrates why someone who receives a confirming document should read it carefully and raise timely objections if necessary.

Apex, a broker, was in the business of buying and selling cottonseed. Sharing World, also a broker, was in the business of purchasing cottonseed for sale to farmers in South Korea. When Sharing World received an order for cottonseed from one of its customers, it would contact Apex and ask for a quote of price and quantity. Apex would respond with an offer to sell the quantity at a stated price and give Sharing World 24 hours to accept. Once Sharing World accepted the offer, Apex would send a written document with the quantity, price, and period of time for shipment. The parties had done business in this manner from 2002 through 2009. During a time of market volatility for cottonseed in 2008 and 2009, Apex and Sharing World entered into in this manner 12 contracts for the purchase of a total of 19,375 tons of cottonseed. Sharing World refused to take delivery of 14,625 tons of cottonseed, and eventually Apex resold the undelivered cottonseed to other buyers and sued Sharing World for damages for breach of contract. Sharing World argued that it was not obligated to take delivery of the cottonseed because the parties had an oral condition precedent to contract formation. Specifically, before Sharing World would be bound to purchase the cottonseed, Sharing World had to receive letters of credit from its buyers. The appellate court rejected that argument through its construction of the

written document and by its application of the parol evidence rule.

Apex's practice of sending a written document with quantity, price, and period of time for shipment of the cottonseed helped Apex on three distinct Article 2 issues that the appellate court discussed. First, the court found that the written document was a confirming memorandum for purposes of satisfying the statute of frauds under UCC § 2-201(2) (between merchants confirmation), and thus it was irrelevant that Sharing World had not signed any of the documents. Second, the court found that the written document was a confirmation for purposes of UCC § 2-207(2) (between merchants, unobjected to terms in confirmation that are not a material alteration of the terms become part of the parties' contract). Because Sharing World had not objected to any of the terms in the confirmation, a term specifying that particular industry trading rules governed the parties' transaction had in fact become part of the contract of the parties.

Third, and most important with respect to Sharing World's argument regarding the oral condition precedent to contract formation, the court ruled that the confirmation was a complete and final expression of the parties' agreement on quantity and price for an unconditional sale and purchase of the cottonseed, for purposes of the parol evidence rule in UCC § 2-202, and that evidence of the alleged oral condition precedent to contract formation was inconsistent with the written terms regarding an unconditional sale of a set quantity of cottonseed at a set price. The court decided the alleged oral condition precedent was inconsistent with the written terms because it was the type of term that the parties would have put in the document if it was part of their agreement, and thus was barred from evidence by the parol evidence rule. While the court acknowledged that some courts have held that the parol evidence rule does not bar evidence of a condition precedent to contract formation, *see, e.g.,* RESTATEMENT (SECOND) OF CONTRACTS § 217 (a writing is not integrated with respect to an oral condition precedent to which the parties have agreed), the court construed this alleged oral condition precedent to be "at most" a condition to delivery, not a condition to contract formation given that the written document required that Apex tender the cottonseed to Sharing World even if the alleged oral condition had not been fulfilled.

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Drafting Security Agreements to Make Sales Out of Trust Result in Nondischargeable Claims

Stephen L. Sepinuck

Secured parties who find their collateral gone and its proceeds dissipated often seek to have the now unsecured portion of their claims declared nondischargeable in the debtor's bankruptcy. Traditionally, they have sought to invoke § 523(a)(6) by claiming that the debtor's actions resulted in a willful and malicious injury. Those claims have met with only limited success. Following the Fourth Circuit's decision in *In re Strack*, [524 F.3d 493](#) (4th Cir. 2008), secured parties, particularly those lending against inventory, have additionally or alternatively sought to invoke § 523(a)(4), which covers claims for "defalcation while acting in a fiduciary capacity." In *Strack*, the court ruled that because the security agreement required the corporate debtor to segregate the proceeds of collateral – inventory of farming machinery – and "hold them in trust" for the secured party, the debtor's CEO and majority shareholder had a fiduciary obligation to the secured party and his failure to remit the proceeds of collateral to the secured party made his debt on a guaranty nondischargeable under § 523(a)(4).

Unfortunately for secured parties, they have had only limited success with this argument. Some courts have expressed skepticism that the inclusion of trust language in a security agreement changes the debtor-creditor relationship into a fiduciary one. See *In re Goldstein*, [2011 WL 5240335](#) (Bankr. N.D. Ill. 2011). More are willing to entertain the premise that a security agreement *can* create a fiduciary relationship but have ruled that a simple statement that the debtor holds proceeds of collateral in trust for the secured party is insufficient for this purpose. See, e.g., *In re Leonard*, [2012 WL 1565120](#) (Bankr. E.D. Tenn. 2012) (but nevertheless holding debt nondischargeable under § 523(a)(6)); *In re Schoen*, [407 B.R. 420](#) (Bankr. W.D. Okla. 2009). See also *In re Nail*, [680 F.3d 1036](#) (8th Cir. 2012) (state statute does not create fiduciary duties merely because it refers to the debtor as a "trustee" of proceeds because it imposes no trust-like duties such as segregation of the funds). Even a clause requiring the debtor to use the proceeds to pay the secured party is insufficient if the agreement does not require the debtor

to segregate the proceeds. See *In re Goldstein*, [2011 WL 5240335](#); *In re Franceschini*, [2010 WL 3952870](#) (Bankr. S.D. Tex. 2010).

However, if the security agreement expressly provides that the debtor holds the proceeds of collateral in trust for the secured party, forbids the debtor from commingling the proceeds with other funds, and requires the debtor to promptly use the proceeds to pay the secured party, then the failure of the debtor – or its controlling principal – to comply will render the resulting debt nondischargeable under § 523(a)(4). See, e.g., *In re Chachula*, [2011 WL 2551187](#) (Bankr. N.D. Ill. 2011). Therefore, counsel for lenders who wish to invoke § 523(a)(4) if the debtor sells collateral "out of trust" should consider having the debtor agree to some version of the clause below. Although the decisions cited above do not refer to a duty of care, the clause below notably references a duty of care to enhance the argument that the debtor's duties with respect to proceeds truly are fiduciary obligations.

Express Trust and Fiduciary Duties.

All Proceeds of Collateral [other than trade-in vehicles?] will, as soon as Debtor acquires rights in them, automatically be held in trust for Lender and will remain trust property until remitted or transferred to Lender. Except to the extent that Lender authorizes Debtor in this Agreement, or otherwise in writing, to use any such Proceeds for some other purpose, Debtor shall remit or transfer such Proceeds to Lender within [] [hours / days] of receipt thereof. Until such Proceeds are remitted or transferred to Lender, Debtor shall maintain such Proceeds separate from Debtor's other property and shall administer, protect, and care for such Proceeds for Lender's benefit. [Debtor is not entitled to any compensation for or reimbursement of expenses incurred in performing these duties.]

One additional point is worth making. Most of the cases on this issue involved a borrower that was a registered organization, has no assets remaining, and has been or will soon be liquidated. Consequently, the secured party sought to make nondischargeable the liability of the debtor's controlling shareholder or member, who had usually guaranteed the secured obligation. To be successful in this endeavor, the secured party must demonstrate that the secondary obligor had actual knowledge of the fiduciary duty that the primary obligor breached. See, e.g., *In re McDermott*, [434 B.R. 271](#) (Bankr. N.D.N.Y. 2010). It may therefore be useful for transactional lawyers

representing the lender to include in the guaranty agreement a representation by which the guarantor acknowledges that proceeds of collateral are held in trust and that the duties to segregate them, care for them, and to pay them to the secured party are fiduciary obligations.

Proceeds Held in Trust.

Guarantor acknowledges that, pursuant to the terms of the Security Agreement, Proceeds of Collateral are automatically held in trust for Lender and, except to the extent that Lender authorizes Debtor in the Security Agreement, or otherwise writing, to use any such Proceeds for some other purpose, Debtor: (i) must remit or transfer such Proceeds to Lender within [] [hours / days] of receipt thereof; and (ii) until such Proceeds are remitted or transferred to Lender, must maintain such Proceeds separate from Debtor's other property and must administer, protect, and care for such Proceeds for Lender's benefit. Guarantor acknowledges that these duties of Debtor are fiduciary obligations. Guarantor shall assist Debtor in complying with and fulfilling these fiduciary duties and shall not in any way interfere with Debtor's compliance with or fulfillment of these fiduciary duties.

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Recent Cases

SECURED TRANSACTIONS

– Description of the Collateral

In re Doctors Hospital of Hyde Park, Inc.,
[2012 WL 2054459](#) (Bankr. N.D. Ill. 2012)

Documents executed contemporaneously with security agreement would not be considered in determining scope of collateral covered. Security agreement that described the collateral to include general intangibles “relating to the Facility” encompassed general intangibles relating to the *operation* of the debtor’s medical facility, not merely the land and building, and thus covered the settlement of claims relating to the operation of the facility. However, to the extent those

claims were tort claims, rather than contract claims, the security interest did not attach to the settlement proceeds because § 9-108(e) requires a more specific description than by collateral type for commercial tort claims.

In re SOL, LLC,

[2012 WL 2673254](#) (Bankr. S.D. Fla. 2012)

Security agreement’s description of collateral to include “real estate listings and listing agreements and . . . the proceeds and products therefrom” did not include the debtor’s contracts, receivables, and rights to commissions from sales not generated from the debtor’s listings, and thus did not include rights to commissions from sales in which the debtor represented the buyer in the transaction.

In re Salander-O'Reilly Galleries, LLC,

[2012 WL 2878122](#) (S.D.N.Y. 2012)

Because the loan agreement excluded goods consigned to the debtor from the borrowing base, those goods might also be excluded as collateral even though the collateral description covers all inventory.

– Authorization of Termination Statement

In re Hickory Printing Group, Inc.,

[2012 WL 2994841](#) (Bankr. W.D.N.C. 2012)

Security interest became unperfected when secured party mistakenly filed termination statement and did not become re-perfected when secured party filed correction statement. Subsequently filed new financing statement did re-perfect the security interest but on a date that allowed the security interest to be avoided as a preference.

– Notification of Disposition

VFS Leasing v. Bric Constructors, LLC,

[2012 WL 2499518](#) (Tenn. Ct. App. 2012)

Secured party was not entitled to summary judgment on the reasonableness of the disposition notification it provided because the notification merely indicated the date after which the collateral would be sold at a private sale when in fact the collateral was sold via a public online auction, pursuant to the secured party’s normal practice whenever its efforts to sell through a private online offering are unsuccessful.

– Other Enforcement Issues

In re Crossover Financial I, LLC,

[2012 WL 2564361](#) (Bankr. D. Colo. 2012)

Clause in security agreement providing that, upon default, the debtor's rights as the sole member of limited liability company to vote and give consents, waiver or ratifications shall cease and that the secured party vote any or all of the pledged interest did not operate automatically; Colorado law requires a secured party to enforce the security agreement and become admitted as a member before the secured party may exercise voting rights associated with a membership interest pledged as collateral.

Arrowhead Cap. Fin., Ltd. v. Seven Arts Pictures PLC,

[2012 WL 2478306](#) (N.Y. Sup. Ct. 2012)

Lender with subordinated debt and junior security interest was, despite standstill agreement, entitled to judgment against the debtor and to foreclose on the collateral after the senior lender assigned the note to one of the borrowers because the assignment was without the required consent of the junior and effectively meant that nothing remained due on the senior note.

BANKRUPTCY

In re Coastal Broadcasting Systems, Inc.,

[2012 WL 2803745](#) (Bankr. D.N.J. 2012)

Clause in subordination agreement authorizing senior lender to vote the claims of the subordinated creditors was enforceable in bankruptcy. Because the senior creditor approved the plan and would be deemed to have voted the claims of subordinated creditors, the plan could be confirmed even though it extinguished the subordinated creditors' claims.

GUARANTIES & RELATED MATTERS

Mid-Wisconsin Bank v. Koskey,

[2012 WL 2094339](#) (Wis. Ct. App. 2012)

Although bank's statement to guarantor that it would pay off the existing lender and obtain a first lien on the collateral was not an actionable promise because of the integration clause in the guaranty, it was a misrepresentation that entitled the guarantor to rescind the guaranty.

LENDING, CONTRACTING & COMMERCIAL LITIGATION

Crastvell Trading Ltd. v. Marengere,

[2012 WL 2327749](#) (Fla. Ct. App. 2012)

Forum-selection clause in loan agreements was not binding on the debtors' affiliates or their controlling shareholder because the agreements expressly indicated that there were no third-party beneficiaries entitled to enforce the agreements.

Niday v. GMAC Mortgage, LLC,

[2012 WL 2915520](#) (Or. Ct. App. 2012)

Although assignee of mortgage note also acquires the mortgage securing the note, the assignee cannot foreclose nonjudicially in Oregon without previously having recorded the assignment. Using MERS as an agent does not avoid this requirement.



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