The Transactional Lawyer

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The Perils of Participations (Redux)

John F. Hilson

In Hollywood, a sequel is often not quite as good as the original. In the case of *Southern Fidelity Managing Agency, LLC. v. Citizens Bank & Trust Company,* **2014 WL 129336** (D. Kan. 2014), the sequel is better than the original, but neither case deserves even a single "thumbs up."

An earlier **article** in this newsletter on the bankruptcy court decision discussed how that decision created some significant due diligence problems for those who acquire loan participations as well as for those who enter into subordination agreements with a lead lender. While the district court's decision avoids some of the problems of the bankruptcy court decision, it too employs questionable analysis on several points and leaves the fundamental issues in an unsatisfactory state.

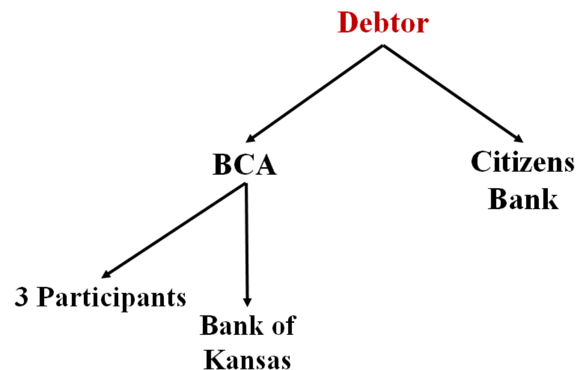
The Facts

In 2007, Brooke Capital Corp. ("Debtor") borrowed $12.38 million from its subsidiary, Brooke Capital Advisors, Inc. ("BCA"). To secure the loan, the Debtor granted BCA a security interest in stock ("Stock") that it owned in another subsidiary. BCA purported to perfect its security interest in the Stock through possession by the Debtor's attorney.

Subsequently, BCA entered into four participation agreements with respect to its secured loan to the Debtor. In three of those agreements, BCA purported to sell approximately 72¼% of the loan to three participants. Those agreements, however, also required BCA to repurchase the interests sold. In the fourth participation agreement, BCA sold approximately 14½% of the loan to Bank of Kansas, but that agreement contained no repurchase obligation.

After the participation agreements were completed, the Debtor granted a security interest in the Stock to Citizens Bank & Trust Company ("Citizens") to secure a pre-existing debt of approximately $9 million that was being restructured. In connection with that transaction, BCA and Citizens entered into an escrow agreement to perfect their respective security interests in the Stock. In addition, BCA, the Debtor, and Citizens entered into a so-called Payment Agreement (the "Payment Agreement") pursuant to which BCA agreed that if either the Debtor or BCA became entitled to receive, directly or indirectly, any proceeds from the sale of the Stock, it would immediately pay such proceeds to Citizens to the extent necessary to satisfy the Debtor's debt to Citizens.

Given the difficulty that the courts and the parties have had differentiating the various relationships, perhaps the following diagram will help to keep the transactions straight.



Soon after the transaction with Citizens, the Debtor filed for bankruptcy protection. Eventually, the Stock was sold and the proceeds were held pending resolution of a priority dispute between the participants, BCA, and Citizens.

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With respect to the three participants (other than Bank of Kansas), the bankruptcy court had ruled that their agreements were not true participation agreements, but disguised loans by the participants to BCA. From that premise, the bankruptcy court could have ruled that the participants were bound by the subordination agreement that BCA later entered into with Citizens. Instead, however, it ruled that the participants had at most unperfected security interests in the Stock, and that interest was subordinate to the security interest of Citizens.

The District Court's Analysis

On appeal, the participants did not challenge the bankruptcy court's re-characterization of their interest as a loan to BCA. That was probably wise given that BCA was obligated to repurchase their interests and, thus, BCA – not the participants – had the risk of loss. Instead, the participants claimed that, "recharacterization or not, they held a perfected security interest in the [Stock] by virtue of BCA's assignment and the operation of [§ 9-310(c)]." The Court referred this issue to a United States Magistrate Judge who issued a Report and Recommendation (the "Report") which the Court seemingly adopted verbatim. The relevant portion of the Report provided as follows:

> [A] review of the Participation Certificates shows that they provide that [sic] a security interest in the "Property" that was assigned and sold to Appellants. The Certificates describe Property" as including a "Pledge of 100% stock of FLAC." The bankruptcy court's recharacterization of the Participation Certificates from true participation interests to loans does not change or render invalid these provisions of the Participation Certificates.
> Because BCA assigned its perfected security interest in the FLAC stock to Appellants under the Participation Certificates, under [§ 9-310(c)] Appellants were not required to file to continue the perfected status of the security interest against creditors of and transferees from BCC (the original debtor). The recharacterization of Appellants' Participation Certificates as loans by the bankruptcy court does not make the Kansas statute governing the assignment of perfected security interests inapplicable.

The district court's analysis on this point is a bit fuzzy and continues the confusion displayed in the bankruptcy court's opinion. If the three participants had, in reality, made a loan to the lead lender (BCA), then their collateral was the lead lender's right to repayment from the borrower (the Debtor) – a payment intangible – not the Stock pledged by the borrower to secure that obligation. Attachment of their security interest in the payment intangible would also give them an attached security interest in the lead lender's security interest in the borrower's collateral. This is the teaching of UCC § 9-203(g). However, *a security interest in an obligation that itself is secured by stock (i.e., a security interest in a security interest)* is not the same thing as *a security interest in the stock*. Nevertheless, the Report and the court conflated the two different debtors (*i.e.*, BCA as the obligor that was obligated to the participants for a loan under the re-characterized participation agreement and the Debtor as the obligor that was obligated to repay the underlying loan) and, consequently, confused its analysis.

Next, the court proceeded to the participants' argument that BCA could not, without their consent, consent to the Debtor's grant of a second priority security interest in the Stock to Citizens or subordinate its security interest in the Stock. The court quoted the Report, which, in turn, quoted some, but not all, of the relevant language of the participation agreement. That language provided that BCA "will not, without [participant's] written consent, renew, extend or consent to the revision of the provisions of any note or security documents covered [sic] or waive any claim against [the Debtor]." From this, the Report and the district court concluded that because BCA was contractually prohibited from agreeing to the Debtor's request to grant Citizens Bank a second priority security interest in the Stock, it could not subordinate its first lien position to Citizens Bank's second lien without the participants' consent.

Citizens apparently did not directly contest this conclusion. Instead, it argued that the Report failed to recognize that the participants' interests, once re-characterized, were merely general intangibles, that UCC § 9-310(c), was inapplicable, and that therefore the participants did not have a perfected security interest in the Stock.

The Court rejected all of these points. As to the first, the court wrote that:

> [the participants'] initial financing arrangement with BCA may have been a participation agreement or a disguised loan, but that does not affect the validity of BCA's explicit assignment of its interest in the stock to the Appellants. Citizens argues that BCA did not actually assign its rights to the [Stock], but merely gave a security interests [sic] in a security interest, a mere general intangible. … The court rejects Citizens' argument. The terms of the Participation Agreement expressly provide that BCA assigned Appellants a security interest in the specific "Property," and this Property included the [Stock]. All of the parties understood this to mean a security interest in the stock itself.

With respect to perfection, the court concluded that the participants' interests in the Stock were perfected under § 9-310(a). In summary, the court stated that:

> BCA validly granted a security interest in the [Stock], and that this interest was perfected by BCA's possession of the [Stock] certificate. The court rejects the argument that [participants] held only a security interest in a security interest, based on a plain reading of the instruments involved. The assignment of the security interest in the [Stock] was a separate transaction which is not eliminated or nullified by recharacterization of the participation agreements into separate loans. The [participants] therefore had a valid security interest in the [Stock], and this interest was perfected by the operation of [§9-310(c)].

Problems with the District Court's Analysis

The court's analysis has numerous problems. First, because the three participants were re-characterized as lenders to BCA, their perfection or lack of perfection should have been immaterial. While their security interest in *BCA's assets* was not perfected, BCA's interest in *the Debtor's stock* was. The court seems to have overlooked the fact that the transactions involved two different debtors with different collateral or, even more troubling, was basing its decision on the notion that there were two separate transactions. Presumably, this latter explanation means that the participants made a loan to BCA and separately acquired an assignment of BCA's security interest in the Stock. A security interest separate from a secured obligation is, however, an absurdity.

With respect to the effectiveness of the Payment Agreement against the participants, the Court's focus on the language of the participation agreements may have been the right place to start (after all, if there had been no breach of the participation agreements, then the Court could have disposed of the issue summarily), but its conclusion is truly problematic. By limiting its analysis to the language of the participation agreements, the Court's approach makes the terms of the participation agreements binding on third parties. Even if the Court was correct that BCA breached the participation agreements by entering into the Payment Agreement, that does not necessarily mean that the subordination was ineffective.

Certainly, there are some bases for that conclusion and the Court would have been well advised to consider them. BCA, by entering into the participation agreements with the three re-characterized participants, is deemed to have granted each of them a security interest in a payment intangible, together with the liens securing that payment intangible. § 9-201(a) provides that a security agreement is effective not only between the parties thereto, but also against "creditors." Each participation agreement was a security agreement because once it is re-characterized its language of outright assignment should be viewed as creating a security interest rather than an outright sale of the payment intangible. Therefore, each participation agreement would be binding on "creditors." While no doubt this language is intended to mean that it is binding on creditors of the seller/debtor (i.e., BCA) the language is not so limited and one could argue that it is also binding on creditors of the account debtor (i.e., the Debtor).

This argument should not prevail nor be particularly persuasive, however. The UCC is clear that, unless displaced by a particular provision, principles of law and equity, including specifically the law of principal and agent, supplement the Code's provisions. § 1-103(b). When a participant allows the lead lender to remain the only secured party of record, a principal-agent relationship is created. Thus, the Court should have examined whether BCA had actual or apparent authority to enter into the Payment Agreement on behalf of the participants. Review of the participation agreement itself may be sufficient to determine whether *actual* authority existed, but would not be sufficient to determine whether *apparent* authority existed.

Implications for Drafting and Due Diligence

Citizens has appealed the district court's ruling to Tenth Circuit Court of Appeals. Pending the outcome of that appeal, there are several practical implications of the case. First, participants should consider filing a financing statement. Certainly a true participant – that is, a true buyer of a payment intangible – is automatically perfected. § 9-309(3). However, a participant with a right of recourse against the lead lender may be, indeed very likely will be, deemed to have made a secured loan to that lender, in which case perfection as to the payment intangible would require filing. There will often be significant resistance to and probably little need for such a filing when the lead lender is a major financial institution. However, when, as in this case, the lead lender is an affiliate of the borrower, filing may be the prudent thing to do. Moreover, such a filing will guard against the possibility that some court will think it is needed to remain perfected in the account debtor's collateral. That aspect of the Court's decision in *Southern Fidelity* is simply wrong, but who is to say what other courts will be misled by it.

Second, the participation agreement should clearly indicate what the lead lender may and, more important, may not do with respect to the participation interest without the participant's consent. For example, it should expressly prohibit the lead lender not merely from substituting or releasing collateral but also from subordinating the lien.

Third, the court's decision creates significant due diligence challenges. Of course, because the interest of a true buyer of a payment intangible is automatically perfected, anyone considering the purchase of a participation interest cannot readily determine if the lead lender still owns the right to payment. Normally, the purchaser deals with this through representations and warranties, but representations and warranties protect the purchaser only when the lead lender is a creditworthy entity that can be relied upon to stand behind those representations and warranties. When the lead lender is an affiliate of the borrower, such representations and warranties may not be worth the ink used to print them.

The Court's decision expands this due diligence problem to almost everyone who enters into a subordination agreement. It leads to the conclusion that if the lender has sold a participation and if the participation agreement prohibits subordination of the relevant security interests, then, without the consent of the participant(s), the subordination agreement will not be binding on the participant even though the creditor that hoped to gain seniority under the subordination agreement may have made a new loan or otherwise relied upon the subordination agreement. This is the result even though there may be no ready way for the counterparty to the subordination agreement to determine whether there are participants and, if so, whether the subordination agreement requires their consent.

One might be tempted to argue that a contrary decision would not have avoided this problem but merely shifted it to the other party. In other words, if the subordination agreement were binding on a prior participant despite contractual provisions prohibiting the subordination, there would be little the participant could do to protect itself. However, that may not be true. There may be ways in which a true participant could take away the lead lender's apparent authority to act on the participant's behalf. For example, a participant might insist that the lead lender file an amendment to its financing statement. That amendment could state that: (i) the lead lender has sold a participation interest in the secured obligation; and (ii) the lead lender no longer has authority to release collateral or enter into a subordination agreement with respect to the participation interest. Given the uncertainty about whether other courts will follow the decision in *Southern Fidelity,* participants should consider taking this approach. In any event, the morals are to beware, to understand the risks, and, most important, to explain them to the client.

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Successors & Assigns Clauses

Stephen L. Sepinuck

A boilerplate term commonly found in agreements of all types is a successors and assigns clause. A typical example is as follows:

> **Successors and Assigns.** This Agreement is binding on and inures to the benefit of the parties and their respective [permitted] successors and assigns.

Unfortunately, when phrased in that manner, the clause may well serve no purpose. Several authorities support that conclusion.

In NEGOTIATING AND DRAFTING CONTRACT BOILERPLATE, a necessary reference work and guide for any transactional lawyer, Tina Stark identifies the following five potential purposes for such a clause:

1. To Bind an Assignee to Perform
2. To Require a Nonassigning Party to Render Performance to an Assignee
3. To Indicate that Rights Are Assignable
4. To Indicate that Duties Are Delegable
5. To Bind the Parties to the Contract

However, it is questionable whether the clause serves any of these purposes.

To Bind an Assignee to Perform. In general, an assignment is a transfer of *rights*, not of *duties*. Duties, in turn, are *delegated*, not *assigned*. *See* Restatement (Second) of Contracts §§ 317, 318. That said, an assignment of "the contract" or of "all my rights under the contract" generally constitutes both an assignment of rights and a delegation of duties. *See* Restatement (Second) of Contracts § 328; U.C.C. § 2-210(5). *But see In re Mortgages Ltd.*, **427 B.R. 780** (D. Ariz. 2010) (Arizona does not follow § 328; an assignment of the contract does not delegate duties).

In any event, it is not clear that the agreement between the assignor and the nonassigning party would or could impact the duties of an assignee or successor. Stark cites cases ruling that a typical successors and assigns clause implies that an assignee is bound to perform and others ruling to the contrary. In all likelihood, though, this issue is governed more by the language of the agreement between the assignor and the assignee than by the language in the agreement being assigned.

To Require a Nonassigning Party to Render Performance to an Assignee. In general, contracting parties are permitted to assign their contractual rights. *See* Restatement (Second) of Contracts § 317(2). Although there are exceptions to this general principle, the fact remains that an effective assignment transfers to the assignee the right to the nonassigning party's performance. *Id.* at § 317(1). A clause in the agreement confirming that the nonassigning party remains bound is therefore unnecessary.

To Indicate that Rights Are Assignable. The parties to an agreement generally can restrict the ability of one or both of them to assign their contractual rights, provided they use the language necessary to do so. *See* Restatement (Second) of Contracts §§ 317(2)(c), 322. *But cf.* U.C.C. §§ 9-406, 9-408. On the other hand, an agreement that expressly provides that rights are assignable will be binding even over a later objection. Restatement (Second) of Contracts § 323(1). According to Stark, some courts have relied on a successors and assigns clause when concluding that assignment is permitted while other courts have deemed the clause immaterial to the issue. What is undeniable, however, is that if the purpose of the clause is to make rights assignable, then the typical clause is poorly phrased. A better phrasing would be something such as the following:

> **Assignment.** Either party may assign any or all of its rights under this Agreement.

To Indicate that Duties Are Delegable. According to Stark, some courts have relied on a successors and assigns clause to determine that otherwise nondelegable duties are in fact delegable. Other courts have ruled that the clause does not convert nondelegable duties into delegable ones. In any event, if the purpose is to permit delegation, then the typical clause should be rewritten to expressly so provide.

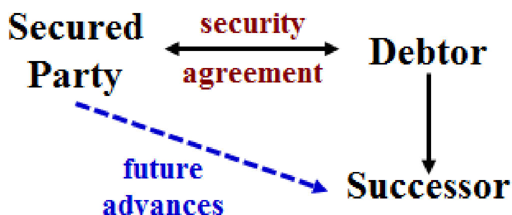
To Bind the Parties to the Contract. On its face, the typical clause indicates that the parties intend to be legally bound. However there is no requirement that an agreement contain such a statement and thus if this is the only purpose of the clause, it is completely unnecessary.

Of course, the discussion so far deals only with assignees (and delegates), not successors. However, because a successor – *e.g.*, the survivor in a corporate merger – succeeds by operation of law to the rights and obligations of the predecessor, it is highly doubtful that the typical successors and assigns clause is needed to affect the rights and duties of the parties. Moreover, the clause apparently does nothing to or for an entity that acquires one of the contracting parties in a manner that does not make the entity a successor. *See Nature's Plus Nordic A/S v. Natural Organics, Inc.*, **2013 WL 5942257** (E.D.N.Y. 2013) (entity that purchased a

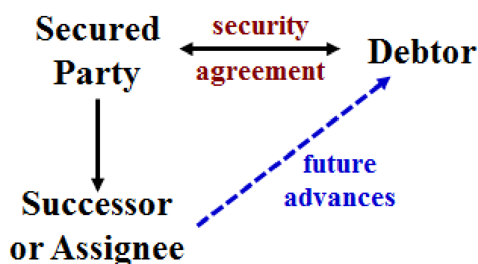
party to a contract that included a clause purporting to bind successors and assigns did not have standing to bring a breach of contract claim in its own name).

Based on all this, Ken Adams, another notable contract drafting maven, has recommended that the typical successors and assigns clause be scrapped. In his blog, **Adams on Contract Drafting**, he concluded that the clause served no useful purpose. He then lamented that clause's incoherence "helps ensure its survival – because drafters are unsure what function it serves, they're loath to delete it."

Before joining in his recommendation, it is worth noting that there might be a sixth purpose for a successors and assigns clause, a purpose closely related to purposes 1 and 2 above: to bind either the nonassigning party or the successor or assignee to an extension of the contractual relationship. For example, a security agreement might provide that it secures future loans made by the secured party to the debtor and after-acquired property of the debtor. A successors and assigns clause might be an attempt to ensure that a successor to the debtor is bound by those terms.



Alternatively, the clause might be an attempt to have the collateral secure future advances made by an assignee or successor of the secured party.



Similarly, a guaranty might promise repayment of future loans made by the creditor to the principal obligor. A successors and assigns clause might be an attempt to cover credit extended by a successor or assignee.

However, it is far from clear that a typically worded successors and assigns clause would achieve either of these purposes.

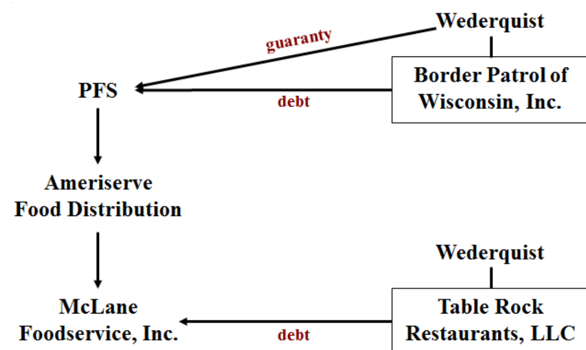
With respect to the former, the clause is probably unnecessary. Article 9 expressly provides that a successor to the debtor – a "new debtor" in Article 9's parlance, *see* §§ 9-102(a)(56), 9-203(d) – is bound by an after-acquired property clause. § 9-203(e). While the Code and comments are conspicuously silent about whether future advances to the new debtor are secured by the collateral, that is probably because the liability of both the new debtor and the collateral for such advances goes without saying. After all, the new debtor is bound not merely by the *security interest*, but by the *security agreement* entered into by the original debtor. *See* § 9-203(d). Thus, if the security agreement with the original debtor purports to make the collateral secure future advances, that should be sufficient to cover advances the secured party makes to the new debtor. Moreover, this result should not be unfair. A new debtor, as a successor that becomes liable as a matter of law for all the original debtor's contractual obligations, should be charged with notice of the security agreement. Accordingly, by accepting a future advance, a new debtor should expect that the advance is secured.

With respect to the second example, the typical clause is probably insufficient. While a successor steps into the shoes of the predecessor and an assignee acquires the rights of the assignor, encumbering the collateral with liability for future loans made by a successor or assignee could greatly prejudice a debtor who lacks notice of the succession or assignment. Consider a scenario in which Debtor grants a security interest to X to secure existing and future debts. Debtor then borrows from Y, not knowing that Y has become a successor or assignee of X. It would be rather inequitable for the collateral to secure that new indebtedness and, because of that, it is unlikely that a court would interpret a traditionally worded successors and assigns clause as having that effect.

Similarly, while a court might interpret a continuing guaranty as covering future loans made by a successor to the original creditor, it is unlikely that a court would interpret the guarantee – even one with a successors and assigns clause – as extending to an assignee of the original creditor because that could greatly expand the obligation of the guarantor in ways that were outside the reasonable contemplation of the parties. Indeed, a recent decision of the Fifth Circuit so

ruled. *See McLane Foodservice, Inc. v. Table Rock Restaurants, LLC*, 736 F.3d 375 (5th Cir. 2013).

In that case, Border Patrol of Wisconsin, Inc., purchased nine Taco Bell franchises with financing provided by PFS, a division of Pepsico. Wederquist, who owned 25% of Border Patrol, guaranteed Border Patrol's debt to PFS. PFS then sold its U.S. and Canadian operations to Ameriserve Food Distribution, Inc., which three years later transferred them to McLane Foodservice Inc. in a bankruptcy sale. McLane then sold goods on credit to Table Rock Restaurants, LLC, an entity in which Wederquist held a 40% interest. When Table Rock ceased operations, McLane sued Wederquist to recover the $447,000 due.



The guaranty agreement covered "any and all indebtedness . . . to Creditor now or hereafter existing" and also provided that it would inure to the benefit of and be enforceable by Creditor's assigns. Nevertheless, the Fifth Circuit affirmed a judgment in favor or Wederquist. It did so not on the basis that the only debt guaranteed was that of Border Patrol, not Table Rock, but on the basis that the guaranty did not cover credit extended *by McLane*. The court wrote:

> That the Guaranty inures to McLane's benefit does not mean that the Guaranty secures credit extended by McLane. . . . [T]he Guaranty only secures credit extended by PFS and its affiliates. . . . [T]he most logical interpretation of [the successors and assigns clause] is that it simply provides that the successors, transferees, and assigns of PFS and its affiliates may enforce the Guaranty to collect debts resulting from credit extended by PFS and its affiliates.

Id. at 379.

The lesson from this discussion is that if the parties intend to cover future advances made by or to a successor or assign, they should expressly so state in the future advances clause, rather than relying on a traditionally worded successors and assigns clause. Such a clause serves no clear purpose and can be safely discarded.

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Recent Cases

SECURED TRANSACTIONS

Attachment Issues

Commercial Law Corp. v. FDIC,
2014 WL 413934 (E.D. Mich. 2014)
Even if the security agreement between a law firm and its bank client, which purported to secure the client's obligation to pay for legal services, was signed before the FDIC took over, a fact the FDIC disputed, the security interest was nevertheless not effective against the FDIC because there was no evidence that the security agreement was approved by the bank's board of directors or that such an approval was reflected in the minutes of a board meeting, as required by 12 U.S.C. § 1823(e).

In re STN Transport Ltd.,
2014 WL 585311 (Bankr. S.D. Tex. 2014)
Even if a person who puts up collateral but is not an obligor on the secured debt qualifies as a "debtor" for the purposes of the Uniform Fraudulent Transfer Act, the corporation that owned trucks allegedly used to collateralize a loan to one of its directors did not grant a security interest in the trucks because the director lacked authority to bind the corporation. The director lacked actual authority because the document purporting to grant that director authority to act for the corporation was signed only by that sole director, not by both of the directors. The director lacked apparent authority because the corporation did nothing to create the appearance that the director was authorized to act on the corporation's behalf.

In re Salander-O'Reilly Galleries, LLC,
2014 WL 1101050 (Bankr. S.D.N.Y. 2014)
Bank's blanket lien on art gallery's inventory attached to a consigned painting even though the security agreement provided that: (i) goods held on consignment were excluded from the borrowing base; and (ii) the gallery warranted that it had ownership of all "collateral." However, a dispute about whether the consignor actually retrieved the painting after the consignment agreement expired and then returned the painting to the gallery for exhibition purposes prevented summary judgment on the issue of priority between the consignor and the bank.

Vehicle Dev. Corp. v. Livernois Vehicle Dev., LLC,
2014 WL 409744 (E.D. Mich. 2014)
Bank with a perfected security interest in all inventory and equipment of a Michigan borrower that operated a vehicle repair facility did not have a security interest in the 81 trucks that a Singapore company provided to the borrower for conversion from left-hand drive to right-hand drive. The written agreement expressly stated that title to the trucks remained with the Singapore company and thus the borrower lacked sufficient rights in the trucks for the bank's security interest to attach to them. Moreover, the trucks did not fit within the definition of either equipment or inventory.

Blanken v. Kentucky Highlands Investment Corp.,
2014 WL 800487 (E.D. Ky. 2014)
Language in a security agreement defining "excluding property" to consist of "any contract, lease, license, or other agreement that contains a provision prohibiting the assignment or grant of a security interest therein" did not exclude equipment that the debtor acquired in a transaction structured as a lease but which was really a sale with a retained security interest even though those transaction documents prohibited future encumbrances. Equipment is not a "contract, lease, license, or other agreement." Moreover, the prohibition on further encumbrances was ineffective under § 9-407 to prevent the attachment of a second security interest.

Perfection Issues

In re Northern Beef Packers Ltd. P'ship,
2014 WL 948470 (Bankr. D.S.D. 2014)
Even if equipment lessor had a blanket security interest in the debtor's other assets, that security interest became unperfected when the lessor amended its financing statement to restate the collateral to consist only of the equipment covered now or in the future by a lease or security agreement between it and the debtor.

In re Lozar,
2014 WL 910352 (Bankr. N.D. Ohio 2014)
Secured party with a security interest in a motorcycle perfected by notation on the certificate of title became unperfected when, upon receiving a check – later dishonored – for the secured obligation, it noted a lien release on the certificate and returned the certificate to the debtor.

Priority Issues

Millennium Bank v. UPS Capital Business Credit,
2014 WL 972232 (Colo. Ct. App. 2014)
Secured party that, pursuant to an intercreditor agreement, had priority in subcontractor's general intangibles but not accounts, had priority in the subcontractor's breach of warranty claim against a paint seller even though the damages were measured by the cost of the extra services provided to the contractor in several repainting efforts, for which the contractor did not pay the subcontractor. The subcontractor did not any render services to the paint seller and the contractor was not liable for the cost of the extra services, and hence the claim was not an account.

Wakefield Kennedy, LLC v. Baldwin,
2014 WL 910029 (D. Utah 2014)
Debtor that, pursuant to a contract to sell a note and mortgage, placed the note into escrow had insufficient rights remaining in the note to grant a security interest in the note superior to the rights of the buyer.

Enforcement & Liability Issues

Blanken v. Kentucky Highlands Investment Corp.,
2014 WL 800487 (E.D. Ky. 2014)
The assignee of a secured party in a transaction structured as a lease of equipment but which was really a sale with a retained security interest, who, after the debtor's default, entered into an agreement with the debtor to reduce the debtor's monthly payments and eliminate the debtor's purchase rights did not, thereby, accept the collateral in full satisfaction of the secured obligation because the debtor thought it was merely a lessee, not the owner, and thus could not have consented to an acceptance of the collateral. Whether the assignment was a disposition and whether the assignee acted in good faith so as to cut off a junior security interest were questions that could not be resolved prior to discovery.

Phillips v. Phillips,
2014 WL 902683 (Minn. Ct. App. 2014)
Even though *enforcement* of a security interest is insulated from avoidance under the Uniform Fraudulent Transfer Act § 8(e), the *grant* of a security interest to an insider on account of an antecedent debt while the debtor is insolvent can be an avoidable fraudulent transfer under § 5(b) if the insider had reasonable cause to know of the debtor's insolvency.

BANKRUPTCY

In re Webb,
2014 WL 464068 (8th Cir. 2014)
Married couple that signed a joint venture agreement to operate a rice farming business did not thereby create a separate entity because the agreement expressly provided that it did not create a partnership, the couple never filed a partnership tax return or formally transferred assets to the joint venture, and the husband testified that he did not distinguish between the venture and himself. Accordingly, the business assets were property of the couple's bankruptcy estate and a bank claiming a security interest in the assets was subject to the automatic stay.

Mercury Companies, Inc. v. Comerica Bank,
2014 WL 561993 (D. Colo. 2014)
Because a plan must be specific and unequivocal for a debtor to retain claims, and the plan in this case merely included the general statement that "any and all Causes of Action accruing to the Debtor, . . . not released or compromised pursuant to this Plan, . . . shall remain assets of the Estate, and the Debtor shall have the authority to prosecute such Causes of Action for the benefit of the Estate," the debtor lacked authority to prosecute a claim against its lender for breach of the credit agreement.

GUARANTIES & RELATED MATTERS

HSBC Realty Credit Corp. (USA) v. O'Neill,
2014 WL 486529 (1st Cir. 2014)
Lender was entitled to summary judgment against guarantor despite the guarantor's claims of fraudulent inducement because, even if the lender stated that it would proceed against the collateral before seeking payment from the guarantor, the guaranty expressly waived any such right of the guarantor, expressly indicated that the lender made no representations to the guarantor, and contained a merger clause. Therefore, evidence of the alleged inducement was inadmissible. The fact that the guaranty was limited to $8.1 million did not make it ambiguous as to whether it was the first $8.1 million or last $8.1 million of the principal obligation.

LENDING & CONTRACTING

Mercury Companies, Inc. v. Comerica Bank,
2014 WL 561993 (D. Colo. 2014)
Even if the reorganized debtor had standing to assert a claim against its lender for breach of the credit agreement, because the debtor failed to provide audited financial statement that was contractually required, the lender acted within its rights in declaring a default and accelerating the debt, even if the debtor's breach was immaterial and even if the debtor substantially performed its contractual obligations. The lender did not by its silence waive its rights or create a basis for estoppel.

Justinian Capital SPC v. WestLB AG,
2014 WL 702105 (N.Y. Sup. Ct. 2014)
Champerty defense prevented investor's assignee from prosecuting contract and fraud actions against manager of portfolio of mortgage-backed securities because the assignee did not acquire or pay for the notes themselves but instead merely promised to remit to the seller 85% of any recovery.

Ventura Cty. Bus. Bank v. California Bank & Trust,
2014 WL 540473 (Cal. Ct. App. 2014)
Buyer of loan participation had no right to rescind purchase due to mutual mistake even though the bank that originated the loan had falsely represented and warranted that the debtor was not in default because the participation agreement expressly indicated that the buyer had reviewed the loan document and had made an independent investigation and evaluation of borrower's financial condition, the value of the collateral, and the priority of the lien, and thus put the risk of mistake about the borrower's default on the buyer.

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In re Lyondell Chemical Co.,
[2014 WL 350716] (S.D.N.Y. 2014)
Hedge fund had no cause of action against investment banker for tortious interference with contract based on banker's alleged wrongful conduct in denying the hedge fund the opportunity to participate as lender in a bankruptcy debtor's exit financing because the "Confidential Information Memorandum for Public Investors" sent by the debtor was not an offer that, upon acceptance, would lead to a binding agreement. The memorandum stated that it was solely for informational purposes and that it created no legal obligation unless and until a definitive agreement was executed.

Diversified Realty Servs., Inc. v. Meyers Law Group,
[2014 WL 547034] (N.D. Cal. 2014)
Term in loan agreement for DIP financing which stated that "the liens and security interest of Lender, . . . shall be subordinated . . . to the prior payment of or provision for such fees and expenses of professionals retained by the Debtor or the Committee" provided not merely for lien subordination but also for debt subordination, and as a result the lender could be required to disgorge payments received from the debtor to compensate the unpaid professionals.

Regions Bank v. Sabatino,
[2014 WL 644758] (Ohio Ct. App. 2014)
Credit agreement that required the lender to provide notification of default before suspending or reducing the line of credit, but said nothing about notification before termination of the line of credit and acceleration of the debt did not require notification before the lender could exercise those rights. Language in the agreement suggests that the reason for requiring notification of suspension or reduction was so that the lender "can restore [his] right to credit advances," a situation inapplicable to termination of the line of credit and acceleration of the entire balance due.

Berent v. CMH Homes, Inc.,
[2014 WL 813874] (Tenn. Ct. App. 2014)
Arbitration clause in retail installment sales contract for a mobile home was unconscionable because it required the buyer to arbitrate all of his claims but permitted the seller or its assignee to use judicial process to enforce its security interest and to seek preliminary injunctive relief.

In re Fisher,
[2014 WL 801160] (Tex. 2014)
Forum-selection clause in both a stock purchase agreement and the buyer's promissory note providing that the state and federal courts in Tarrant County, Texas were the exclusive forum for "any proceeding arising out of or relating to this Agreement" covered the seller's action against the buyer's principals for breach of fiduciary duty and fraud because those actions were essentially efforts to collect on the promissory note and thus arose out of the contracts.

Call Center Techs., Inc. v. Grand Adventures Tour & Travel Pub. Corp.,
[2014 WL 859344] (D. Conn. 2014)
Entity formed by secured creditors to acquire the assets of the debtor at a foreclosure sale and which, after the sale, operated the same business at the same locations with mostly the same employees under mostly the same management and which assumed some liabilities of the debtor by honoring the vacation time of the debtor's employees, giving discounts to customers who had lost deposits, and paying the reservation deposit of one customer, has whatever liability the debtor had for breach of contract under the continuity of enterprise theory of successor liability even though there was no fraud or continuity of ownership.

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