

# The Transactional Lawyer

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## The Danger of Writing Amounts in Both Words and Numerals

Charles Nichols

While it is common for promissory notes, mortgages, and guarantees to express dollar amounts both in words and in Arabic numerals, a recent case illustrates the extreme danger this practice poses to the lender. In *Charles R. Tips Family Trust v. PB Commercial LLC*, [2014 WL 4085496](#) (Tex. Ct. App. 2014), a promissory note, deed of trust, and guaranty all described the debt as “ONE MILLION SEVEN THOUSAND AND NO/100 (\$1,700,000.00) DOLLARS.” The documents thus contained a \$693,000 discrepancy between the amount described by the written words and the amount depicted by the Arabic numerals. Looking to § 3-114, the court ruled that the words in the promissory controlled over the numerals. The court then concluded that, under the common law of Texas, the same was true for the deed of trust and the guaranty. Based on this, the court then ruled that the documents were unambiguous. As a result, the creditor was not permitted to use parol evidence to show that the amount actually loaned was \$1.7 million and was limited to recovering \$1.007 million.

The court’s ruling that the words controlled over the numerals is unassailable. See U.C.C. § 3-114 (“If an instrument contains contradictory terms . . . words prevail over numbers”); *Dawson v. Andrus*, [612 F.2d 1280](#) (10th Cir. 1980). Its conclusion that parol evidence was inadmissible to show the amount of the debt is more questionable. In *Winn & Associates PLLC v. EmCare Physician Providers, Inc.*, [2014 WL](#)

[3573443](#) (E.D. Okla. 2014), for example, the court allowed parol evidence to be used to determine that an agreement that referred to “thirty-five (\$35,000) dollars” meant \$35,000, not \$35. That case did not involve a negotiable instrument, however, so § 3-114 was not applicable.

The decision in *Charles R. Tips Family Trust* is troubling for lenders but also instructive. One argument in favor of writing amounts in both words and numerals is that it can avoid the mistakes attributable to a misplaced decimal point or omitted digit. However, all this really demonstrates is that using numerals is problematic; it does not show that using both words and numerals is the proper solution. Indeed, using both goes against the general advice to avoid repetition in contract documents because repetition can lead to ambiguity, and numerous legal commentators counsel against it. KENNETH A. ADAMS, *A MANUAL OF STYLE FOR CONTRACT DRAFTING* §§ 14.1–14.10 (3d ed. 2013); BRYAN GARNER, *LEGAL WRITING IN PLAIN ENGLISH*, § 39 (2001); Benjamin Whetsell, [Writing Numbers Two \(2\) Times in Contracts](#), Paper Software Blog (May 13, 2013).

More important, the *Charles R. Tips Family Trust* case suggests that no useful purpose is achieved by using both words and numerals to indicate amounts. If the words control and parol evidence is inadmissible, the numerals become irrelevant as a matter of law. Because the eyes of the proofreader might naturally be drawn to Arabic numerals rather than spelled out words, the numerals are worse than irrelevant when the amounts are also expressed in words, they are dangerous.

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### Contents

<i>The Danger of Writing Amounts in Both Words and Numerals</i> .....	1
<i>Term Sheets, Letters of Intent, and Agreements to Agree: Ensuring Recovery of Expenses and Break-up Fees</i> .....	2
<i>Recent Cases</i> .....	3



## Term Sheets, Letters of Intent, and Preliminary Agreements: Ensuring Recovery of Expenses

*Stephen L. Sepinuck*

In the process of negotiating loans and other financing arrangements, the prospective lender often wishes to: (1) avoid any obligation to lend until it completes its due diligence and executes a final, written agreement; and (2) bind the prospective borrower to reimburse the lender's expenses and pay a break-up fee if the borrower chooses not to do the deal or obtains other financing for the deal. A recent case interpreting New York law, *White Winston Select Asset Funds, LLC v. InterCloud Systems, Inc.*, [2014 WL 4105492](#) (D.N.J. 2014), casts doubt on the prospective lender's ability to achieve these two goals, but with careful drafting lenders should be able to avoid the traps into which the lender in the case fell.

The facts of *White Winston* are fairly simple. White Winston entered into negotiations to provide InterCloud Systems, Inc. \$5 million to be used to redeem preferred stock and to provide working capital. The parties agreed to a Term Sheet that purported to outline aspects of the intended financing and that obligated InterCloud to: (i) pay White Winston a breakup fee if InterCloud obtained funding elsewhere; and (ii) reimburse White Winston's fees. The Term Sheet further provided that the obligations of the parties would be null and void as of a specified termination date, with the exception of these two payment obligations. InterCloud obtained \$10 million from another source and White Winston sued to recover the break-up fee and its expenses. The court dismissed the complaint.

In canvassing New York law on preliminary agreements, the court observed that generally they impose no legal obligation on the parties. However, two types of preliminary agreements do create binding obligations. The first, which the court labeled Type I agreements, arises when the parties have reached agreement on all issues requiring negotiation, intend to be bound, and desire merely more elaborate formalization of the agreement. Both parties in the *White Winston* case agreed that the Term Sheet was not a Type I agreement. The second, a Type II agreement, expresses a mutual commitment to contract on agreed major terms while recognizing that other terms remain

to be negotiated. The court then identified five factors courts consider in determining whether a Type II agreement exists.

- (1) whether the intent to be bound is revealed by the language of the agreement;
- (2) the context of the negotiations;
- (3) the existence of open terms;
- (4) partial performance; and
- (5) the necessity of putting the agreement in final form, as indicated by the customary form of such transactions.

The court concluded that the Term Sheet evidenced a clear intent *not* to be bound, and thus was not a Type II agreement, because it expressly provided that it "does not constitute a commitment letter, an agreement to enter into a commitment letter, or an offer to enter into a commitment letter and shall not be deemed to obligate the investor, its affiliates, partners, or principals to close the financing under any terms or circumstances." Although the court *seemed* to acknowledge that a Type II agreement can include both binding and non-binding parts, the court ruled that the Term Sheet did not "contain explicit language" stating that InterCloud's payment obligations were binding or otherwise enforceable.

The court then went on to suggest in dicta that even if the Term Sheet were a Type II agreement, the "sole" obligation would be to negotiate in good faith, and thus the break-up fee would still be enforceable.

The court's analysis and conclusions are questionable for three reasons. First, to reach its conclusion that the Term Sheet evidenced the parties' intent not to be bound, the court quoted portions that dealt only with the obligations of White Winston. Nothing in the quoted passages indicated that the Term Sheet was not intended to bind InterCloud. Second, the court cited and relied on *FCS Advisors, Inc. v. Fair Finance Co.*, [2009 WL 1403869](#) (S.D.N.Y. 2009), which dealt with a similar situation: a signed letter of intent for a \$75 million loan which provided that it was non-binding except for the prospective borrower's duty to pay the prospective lender's expenses and, if the borrower obtained funding elsewhere, a \$1.5 million break-up fee. Yet the court in *FCS Advisors* held that borrower was liable for both the lender's expenses and the break-up fee. The *White Winston* court distinguished *FCS Advisors* on the basis that the provisions on reimbursement and the break-up fee did not explicitly state they were binding or enforceable. However, given that the Term Sheet did state that the parties' obligations would be null and void as of the

termination date but excepted from this rule the clauses dealing with reimbursement of expenses and payment of the break-up fee, the court's conclusion seems rather strained. Third, the court's dicta suggesting that the only obligation of a Type II agreement is to negotiate in good faith is completely at odds with the ruling in *FCS Advisors*.

Despite these criticisms, the *White Winston* decision remains problematic for prospective lenders. To deal with it, lenders' counsel might wish to structure a similar arrangement not as a preliminary agreement, but as a mutually binding agreement relating to the application for financing. In other words:

- (1) The prospective lender agrees to expend time and resources to review and consider the prospective borrower's application; and in return
- (2) The prospective borrower agrees to:
  - (i) reimburse the prospective lender's expenses; and (ii) pay a break-up fee if specified conditions are met.

Structured this way, there is clearly consideration for each party's promise and those mutual promises create a binding contract, not an unenforceable preliminary agreement. However, the prospective lender has not promised to make the loan (a point that should probably be stated expressly in the documents).

There is another benefit to this proposed structure. In a traditional term sheet or letter of intent, including the ones at issue both in *FCS Advisors* and *White Winston*, the break-up fee is essentially liquidated damages for the prospective borrower's breach. Thus, there is always the chance that the obligation to pay the break-up fee might be invalidated as a penalty, an argument the court in *FCS Advisors* considered but rejected. If, however, the documents are structured as suggested above, the prospective borrower does not promise to refrain from seeking or obtaining funding elsewhere. Without such a promise, the break-up fee is not a measure of liquidated damages for breach. Instead, the borrower's promise to pay the break-up fee is merely a covenant subject to a condition and that covenant should not be subject to analysis as a possible penalty. See, e.g., *Best v. U.S. National Bank of Oregon*, [714 P.2d 1049](#) (Or. Ct. App. 1986); *Jacobs v. Citibank*, [462 N.E.2d 1182](#) (N.Y. 1984); *Hoffman v. Security Pacific National Bank*, [176 Cal. Rptr. 14](#) (Cal. Ct. App. 1981) (all ruling that the fee a bank charges its checking account customers for writing a check drawn on insufficient funds could not be an

invalid penalty because the customer had no duty to refrain from writing such a check). See also *Perdue v. Crocker National Bank*, [702 P.2d 503](#), 515 (Cal. 1985) (expressly agreeing with this portion of the *Hoffman* decision).

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## Recent Cases

### SECURED TRANSACTIONS

#### *Scope Issues*

*In re Purdy*,

[2014 WL 3953729](#) (6th Cir. 2014)

50-month leases of dairy cows were true leases even though the lessee had no right to terminate and 50 months exceeds the economic life of dairy cows, 30% of which need to be culled each year. The relevant good was the herd of cattle, which had an economic life far greater than the lease term, not the individual cows originally provided.

#### *Priority Issues*

*Mercedes-Benz Financial v. Powell*,

[2014 WL 3844013](#) (Mich. Ct. App. 2014)

The buyer who purchased a vehicle after a bank's security interest in the vehicle was removed from the certificate of title with a forged release of lien could have taken free of the security interest if the buyer had no notice of any fraud or irregularity in the title and he paid valuable consideration for the vehicle, so as to qualify as a good faith purchaser.

*Hartford Fire Insurance Co. v. Columbia State Bank*,

[2014 WL 4435865](#) (Wash. Ct. App. 2014)

Even though the agreement between an insurer and a contractor for a surety bond provided that "[a]ll money paid [under the construction contract] shall be impressed with a trust for the purpose of satisfying the obligations of the Bond," the insurer had no claim against the contractor's secured lender for applying a progress payment deposited into a control account to the secured obligation. The agreement was not with

the owner who provided the funds, did not provide that payments be held in trust for subcontractors, and did not actually require that the funds be “held” at all, merely “impressed” with a trust. Therefore, the contract provided for the creation of a trust at some point in the future, after the insurer made payment on the bond, which was after the secured party acted.

### *Enforcement Issues*

*3455 LLC v. NP Properties, Inc.*,

[2014 WL 3845696](#) (N.D. Ga. 2014)

Landlord that had a security interest in the tenant’s equipment to secure the obligation to pay rent was entitled to simply retain the equipment remaining on the leased premises because the lease also provided that upon being dispossessed, the tenant’s “equipment shall be deemed conclusively to be abandoned and may be appropriated, sold, stored, destroyed or otherwise disposed of by Landlord without written notice . . . and without obligation to account for them,” and such a term is enforceable under Georgia law.

*Spellman v. Independent Bankers’ Bank of Florida*,

[2014 WL 3871264](#) (Fla. Ct. App. 2014)

Bank that, after default, had the collateralized shares of stock reissued in the name of the bank’s subsidiary and then tried but failed to sell the stock at a public sale was entitled to a judgment against the debtor for the full amount of the secured obligation. A secured party does not dispose of the collateral merely by having it re-titled in its own name and there is no reason not to apply that rule to a re-titling in a subsidiary’s name.

### *Liability Issues*

*Bankdirect Cap. Fin. v. Insurance Co. of State of Pa.*,

[2014 WL 4087198](#) (N.Y. App. Div. 2014)

The trial court properly denied summary judgment on the claim of a putative assignee of an insurance premium financing agreement against the insurer for refunding the premium to the broker because it was unclear whether: (i) the policy holder transferred its entire interest or merely a security interest in the return premium; (ii) the original financier properly notified the insurer of its interest; (iii) the original financier assigned its interest to the putative assignee; and (iv) the putative assignee properly notified the insurer of the assignment.

*Davidson v. Capital One Bank (USA)*,

[2014 WL 4071891](#) (N.D. Ga. 2014)

Entity that bought credit card receivables was not a debt collector for purposes of the Fair Debt Collection Practices Act even if the cardholders were in default at the time the receivables were purchased because the buyer was admittedly not in a business the principal purpose of which was to collect debts and it was not regularly collecting debts owed to another.

*Prairie State Bank & Trust v. Deere Park Assocs.*,

[2014 WL 4557298](#) (Ill. Ct. App. 2014)

Bank with a perfected security interest in the debtor’s inventory and proceeds had no conversion claim against a subsequent lender that, in facilitating the debtor’s liquidation sales, retained commissions, paid itself, and paid unsecured creditors because the bank had waived its security interest during the course of its relationship with the debtor by making loans without sufficient inventory collateral, renewing at least one of the loans when it knew of the going-out-of-business and inventory-reduction sales, failing to require the debtor to keep its business accounts on deposit with the secured party, failing to communicate with the defendant after receiving its purchase-money notice and obtaining knowledge of the sales, failing to take any action other than “rolling over notes” after the debtor issued bad checks, and failing to obtain recent income and asset statements from the debtor.

### **BANKRUPTCY**

*In re Delta Produce, LP*,

[2014 WL 4443414](#) (W.D. Tex. 2014)

Despite the provisions in a bankruptcy court order appointing a special counsel to adjudicate and pay PACA claims, the special counsel was not entitled to an award of fees because the PACA trust lacked sufficient assets to pay all the PACA claims and PACA does not permit trust assets to be used to pay other creditors of the produce buyer ahead of the PACA claimants. The special counsel was, in essence, performing a duty of the produce buyer.

*In re Lanois*,

[2014 WL 4449805](#) (Bankr. D.R.I. 2014)

Undersecured mortgagee whose claim was subject to modification in Chapter 13 proceeding was not entitled to reimbursement for mortgage insurance despite language in agreement providing for it because such insurance protected the unsecured portion of the mortgagee’s claim, not the secured portion.

## GUARANTIES

*In re Gentry,*

[2014 WL 4723879](#) (D. Colo. 2014)

Because the guaranty agreement signed by the sole shareholders of a corporation defined the indebtedness as all obligations of the corporation and any advances or transactions that “modify, refinance, consolidate or substitute” those debts, whether “voluntarily or involuntarily incurred,” the obligation of the guarantors was modified and reduced by the confirmed Chapter 11 plan of the corporation, which effectively eliminated the unsecured portion of the creditor’s claim.

## LENDING &amp; CONTRACTING

*Sumitomo Mitsui Banking Corp. v. Credit Suisse,*

[2014 WL 4209247](#) (N.Y. Sup. Ct. 2014)

The buyer of a loan participation had no right to payment from the seller when the debtor refinanced the original unsecured bridge loan with a secured loan because, even though the transaction was structured as a new loan, the economic reality of the transaction was merely a replacement of unsecured debt with an equal amount of secured debt from the same lenders; no new money was loaned to the debtor and there was no reduction in the lenders’ exposure, and thus the transaction was not a “cash distribution” within the meaning of the participation agreement. The buyer was entitled only to a proportionate share of the secured loan.

*Mill Financial, LLC v. Gillett,*

[2014 WL 4356172](#) (N.Y. App. Div. 2014)

Creditor stated cause of action against another lender for breach of intercreditor agreement by alleging that the other lender failed to provide required notification of its enforcement actions against the debtor by which the lender acquired a right to approve a new chairman of the debtor’s board of directors. Although the intercreditor agreement precluded consequential damages, the creditor alleged that the lack of notice prevented the creditor from protecting its position and led to a sale of the debtor’s business at a price that wiped out the creditor’s security interest, and the court could not conclude as a matter of law that such losses were an indirect loss that did not flow naturally from the lender’s breach.

*Dameron Hospital Ass’n v. AAA Northern California, Nevada and Utah Ins. Exch.,*

[176 Cal. Rptr. 3d 658](#) (Cal. Ct. App. 2014)

[2014 WL 4379083](#) (Cal. Ct. App. 2014)

Although a medical services provider is permitted in its contract with a health insurer to preserve its right to seek recovery of its customary billing rates from third-party tortfeasors who injure the insured patients it treats, the provider did not do so in this case because the contract did not expressly reserve the provider’s right to recover its customary billing rates for emergency room services from anyone, did not mention liens, third party tortfeasors, or liability insurers for third party tortfeasors, and expressly stated that the provider’s acceptance of the insurer’s payment would constitute “payment in full for Covered Services.”



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