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A LESSON ON DRAFTING OVERLY BROAD NONDISCLOSURE AGREEMENTS

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For anyone who drafts nondisclosure agreements – or nondisclosure covenants in other agreements – a recent decision by the United States Court of Appeals for the First Circuit is must reading. The case, *TLS Mgmt. and Marketing Servs. v. Rodríguez-Toledo*,¹ involved an employer’s action against a former employee for misappropriation of trade secrets and breach of a nondisclosure agreement. Although the trial court ruled for the employer on both counts, the Court of Appeals reversed, concluding that the employer had failed to establish that what was disclosed was a trade secret and that the nondisclosure agreement was unenforceable. Both aspects of the decision are noteworthy.

The Facts

The plaintiff, TLS Management (“TLS”) was a tax planning and consulting firm based in Puerto Rico. It advised clients on how to minimize federal and Puerto Rico tax liability. In doing so, it generated a Capital Preservation Report for each client (“Report”) and provided advice based on a tax arbitrage strategy (“Strategy”). The alleged trade secret portions of the Report were those not specific to any particular client. The Strategy involved having mainland clients outsource services to a Puerto Rican entity. The Puerto Rican entity would pay a corporate tax rate of 4% on the outsourcing fees, which the mainland client could deduct as a business expense. To access the earnings that accumulated in Puerto Rico, the mainland client would then borrow the funds from the Puerto Rican entity, until such time as they could be distributed on a tax-free basis.

After his departure from TLS, Rodríguez-Toledo provided competing consulting services. In so doing, he used a copy of a Report that he had downloaded and offered advice based on the Strategy. TLS sued. The trial court granted summary judgment on the claim for breach of the nondisclosure agreement and, after a non-jury trial, concluded that Rodríguez-Toledo had misappropriated trade secrets. Rodríguez-Toledo appealed.

The Decision

With regard to the claim for misappropriation of trade secrets, the court concluded that neither the Report nor the Strategy was a trade secret. The court began its analysis of the issue by looking to the Puerto Rico Trade Secret Act, which defines a “trade secret” as any information:

- (a) That has a present or a potential independent financial value or that provides a business advantage, insofar as such information is not common knowledge or readily accessible through proper means by persons who could make a monetary profit from the use or disclosure of such information, and
- (b) for which reasonable security measures have been taken, as circumstances dictate, to maintain its confidentiality.²

This definition is similar to the definition in the Uniform Trade Secrets Act,³ on which the Puerto Rico Act was based and which has been enacted in 48 states, the District of Columbia, and the U.S. Virgin Islands.⁴

The court then described the Report as a document that TLS customizes for a particular client. A typical Report is over a hundred pages long. Much of it contains public and general information, such as the meaning of tax terms, a comparison of different types of entities, and case law, regulations, and statutes on taxation. Much of the remainder contains individual client information.⁵ TLS acknowledged that neither the public information nor the client information were trade secrets.⁶ Unfortunately for TLS, at no time before or during trial did it identify what else in the Report was not generally known to the trade, and hence was a trade secret.⁷

With respect to the Strategy, the court ruled that, to a large extent, it consisted of public knowledge.⁸ The concept of tax arbitrage was hardly secret, and indeed TLS’s own Report described it as “well established.”⁹ And while TLS witnesses testified that the use of loans to repatriate the income was something TLS pioneered, Rodríguez-Toledo testified that it

Contents

<i>A LESSON ON DRAFTING OVERLY BROAD NONDISCLOSURE AGREEMENTS.</i>	1
DRAFTING A CHOICE-OF-LAW CLAUSE.	4
Recent Cases.	10

had been done for a long time and was a model taken from the U.S. Virgin Islands.¹⁰ Although the trial court had not resolved this conflict in the testimony, the Court of Appeals ruled that the failure to do so was of no consequence because TLS could not claim trade secret protection simply because its loan strategy was not publicly known. Instead, TLS had to establish that this aspect of the Strategy was not readily ascertainable from public sources. Because TLS had presented no evidence on that point, it had not shown that the Strategy was a trade secret.¹¹

On the claim for breach of the nondisclosure agreement, the court followed hornbook law that a nondisclosure agreement in an employment agreement, like a covenant not to compete, must be reasonable in scope.¹² That rule exists because an overly broad nondisclosure agreement, while not facially restricting competition, can nevertheless do so, and therefore raises the same policy concerns.¹³ The court then noted that a nondisclosure agreement can be overly broad if it restricts the former employee from using general knowledge acquired by the employee during the course of employment, prohibits disclosure of information that is not in fact confidential, or applies to information provided by a third party.¹⁴ The agreement between TLS and Rodríguez-Toledo did each of these things.

Subject to some exceptions, the agreement defined “confidential information” as:

All information[] regarding (“TLS”) business methods and procedures, clients or prospective clients, . . . costs, prices, products, formulas, compositions, methods, systems, procedures, prospective and executed contracts and other business arrangements;

any other information provided to [Rodríguez] by (“TLS”) or (“TLS”) Affiliates by or in connection with proposing or delivering (“TLS Services”);

The identities of agents, contractors, consultants, sales representatives, sales associates, subsidiaries, strategic partners, licensors, licensees, customers, prospective customers, suppliers, or other service providers or sources of supply . . . ; [and]

any other information that [Rodríguez] may obtain knowledge [sic] during his/her tenure while working at (“TLS”).

This definition, the court concluded, extended to public information and general knowledge not particular to TLS’s business, and its “astounding breadth” restricted Rodríguez’s freedom to compete.¹⁵ Hence, the nondisclosure agreement was unenforceable. It is important to note that, although this portion of the decision was based on Puerto Rico law, the court’s analysis appears to have broader implications and applicability. Following the lead of the Puerto Rico Supreme Court, the circuit court relied heavily on authorities from throughout the United States. Indeed, twelve of the fifteen cases the court cited

in this portion of the opinion were from state and federal courts outside Puerto Rico.¹⁶

The court concluded its opinion by declining TLS’s invitation to rewrite the agreement by narrowing its scope.¹⁷ In doing so, the court relied on a Puerto Rico Supreme Court decision that courts may not rewrite an overly broad non-competition agreement.¹⁸ The court observed in a footnote that courts in several other U.S. jurisdictions have similarly refused to reform overly broad nondisclosure agreements.¹⁹

The Takeaways

It is not uncommon for employment agreements to restrict the post-employment conduct of employees in three ways: (i) by prohibiting competition; (ii) by prohibiting the solicitation of co-employees, suppliers, or customers; and (iii) by prohibiting disclosure or use of trade secrets and other confidential information. All such restrictions are subject to a reasonableness test: they are an unreasonable restraint of trade, and hence unenforceable, if greater than needed to protect the employer’s legitimate interests or if the employer’s need is outweighed by the hardship imposed on the employee and the likely injury to the public.²⁰

Despite the fact that all three types of restrictions are subject to the same standard, traditional orthodoxy suggests that the level of scrutiny varies. Or, to put it another way, the employer’s interests underlying each type of restriction differ. For example, with respect to disclosure or use of confidential information, because it resembles a type of theft, contractual restrictions on such behavior receive the greatest judicial protection.²¹

Nevertheless, the First Circuit’s decision in *TLS Management* is a reminder that such protection is not unlimited. Contractual prohibitions against disclosure or use of confidential information do not – and cannot – extend to information that is not confidential. Transactional lawyers who draft overly broad definitions of “confidential information” risk leaving their clients with no protection at all.

Accordingly, when writing a nondisclosure agreement or a covenant of confidentiality in an agreement, transactional lawyers should do the following three things. First, in defining or otherwise identifying the information that is confidential, do not use broad statements such as those TLS used. Specifically, avoid phrases such as “all information obtained by [employee] in the course of [his/her] employment” and “all information provided to [employee] by [employer] relating to [employer’s] business.” Instead, craft the clause to deal with the type of information that the employer truly regards as confidential.

Second, add a provision expressly excluding from the scope of the restriction any information that becomes publicly available or is provided by a third party. The agreement in *TLS Management* expressly excluded information previously

disclosed by TLS to the general public, but the court ruled that this exclusion was too narrow because it did not exclude information that was otherwise publicly available or that TLS disclosed to the public after Rodriguez acquired it.²²

Third, include a savings clause expressly authorizing a court to narrow the clause if the court determines it is unreasonably broad. Such a clause might be drafted as follows:

Nondisclosure Savings Clause. If a court determines that [the clause restricting disclosure of confidential information, (the “Clause”)] is unenforceable because the scope of the information it treats as confidential is too broad, then [the Clause] will remain valid and fully enforceable to the greatest extent that the law permits, and a court of competent jurisdiction may modify [the Clause] in the least amount necessary to render [the Clause] enforceable.

It is important to understand, however, what while some courts are willing to rewrite a covenant not to compete,²³ and might also be willing to rewrite a nondisclosure agreement or confidentiality covenant, other courts will refuse the parties’ invitation to rewrite the agreement.²⁴ Thus, depending on the jurisdiction, such a savings clause might not be helpful, although it is unlikely to be harmful.

Even if the courts in the applicable jurisdiction will rewrite an unenforceable restriction, transactional attorneys must be aware of the approach that the courts will follow when performing that task. While some will edit the clause in any manner to achieve the parties’ stated desire, others follow what is known as the “blue pencil” rule. Under this approach, a court will not rephrase an overly broad restrictive covenant, but will merely strike out grammatically severable words and phrases.²⁵ Thus, the clause will be saved only if the reason for its infirmity can be removed by excising words.

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Notes:

1. [966 F.3d 46](#) (1st Cir. 2020).
2. P.R. Laws Ann. tit. 10, § 4132.
3. See Unif. Trade Secrets Act § 1(4) (1985).
4. Only New York and North Carolina have not enacted the Uniform Trade Secrets Act. See [ULC web page](#).
5. [966 F.3d at 53](#).
6. [Id.](#)
7. [Id. at 54](#).
8. [Id.](#)
9. [Id. at 55](#).
10. [Id.](#)
11. [Id. at 55–56](#).
12. [Id. at 57](#).
13. [Id. at 57–58](#).
14. [Id. at 58–59](#).
15. [Id. at 59](#).
16. [Id. at 57–60](#).
17. [Id. at 60–61](#).
18. [Id. at 60](#) (relying on *Arthur Young & Co. v. Vega III*, [1994 WL 909262](#) (P.R. 1994)).
19. [Id. at 60 n.13](#) (citing *AMP Inc. v. Fleischhacker*, [823 F.2d 1199](#), 1202 (7th Cir. 1987); *State Med. Oxygen & Supply, Inc. v. Am. Med. Oxygen Co.*, [782 P.2d 1272](#), 1273–75 (Mont. 1989); *Nasco, Inc. v. Gimbert*, [238 S.E.2d 368](#), 369–70 (Ga. 1977)).
20. See [RESTATEMENT \(SECOND\) OF CONTRACTS § 188](#) & cmts. b, d & g (1981).
21. See Dawn Mertineit, *1st Circ. Ruling Is Cautionary Trade Secret Tale For Employers*, [Law360](#) (Aug. 28, 2020) (describing non-disclosure agreements as “the least scrutinized of all restrictive covenants”).
22. [Id. at 59](#).
23. See, e.g., *PharMethod, Inc. v. Caserta*, [382 F. App’x 214](#) (3d Cir. 2010) (applying Pa. law); *Franklin v. Forever Venture, Inc.*, [696 N.W.2d 545](#) (S.D. 2005).
24. See cases cited *supra* n.19. See also *Kolani v. Gluska*, [75 Cal. Rep. 2d 257](#) (Cal. Ct. App. 1998) (upholding a trial court’s refusal to rewrite a covenant not to compete in an employment agreement despite the fact that the agreement contained a savings clause authorizing a court to rewrite the clause if it was “unfair”).
25. See, e.g., *Valley Med. Specialists v. Farber*, [982 P.2d 1277](#), 1286 (Ariz. 1999) (involving a covenant not to compete). See also *Kimball v. Anesthesia Specialists of Baton Rouge, Inc.*, [809 So. 2d 405](#) (La. Ct. App. 2001) (if a non-compete clause contains both a description of a localized area that complies with statutory law and an overly broad and invalid geographic limitation, the latter could be severed, but if the agreement lacks the former, a court cannot rewrite the clause so as to make it comply with the statute).



DRAFTING A CHOICE-OF-LAW CLAUSE

Stephen L. Sepinuck

Transactional lawyers frequently include a choice-of-law clause in the agreements they draft. Doing so generally avoids the uncertainty about what state's law governs and can avoid the cost of litigating the choice-of-law issue. To the extent that such a clause is included in a form that the client uses with all or many of its counter-parties, it can also help ensure that all of the client's contracts are governed by the same law.

It would be tempting to assume that transactional lawyers drafting choice-of-law clauses determine what state's law to select based on research; that is, they make an informed decision about what state's law is in the client's best interest. Unfortunately, that is not always the case.²⁶ Some transactional lawyers reflexively select the law of the client's home state or principal office, or select the law of a jurisdiction, such as New York or Delaware, that is widely believed to be well developed or conducive to business.²⁷ Occasionally, this means that the chosen law is disadvantageous to the party who drafted the agreement.²⁸

This article assumes that proper due diligence underlies the transactional lawyer's choice. The discussion below begins with a brief review of the limitations on contracting parties' ability to choose the law governing their relationship. It then explores five issues affecting how a choice-of-law clause should be drafted. With respect to each issue, the article suggests language (in blue) to include in such a clause, and thereby builds a comprehensive clause that is likely to be consistent with the intent of most contracting parties.

Background on Contractual Choice of Law

In general, as to issues governed by a mandatory rule, rather than by default rule,²⁹ parties are free to select a state's law to apply if: (i) either the chosen state has a substantial relationship to the parties or to the transaction, or there is another reasonable basis for the parties' choice; and (ii) the law chosen would not violate a fundamental policy of the state whose law would apply in the absence of the parties' choice.³⁰ Courts are sometimes exceedingly willing to treat a legal rule as implementing a fundamental policy, and thus invalidate a contractual choice of law that would avoid the rule.³¹

Issue 1: "Interpret" or "Construe" vs. "Govern"

In theory, there is a difference between a choice-of-law clause that provides that a chosen state's law is to be applied in "interpreting" or "construing" the agreement and one that provides that the chosen law "governs" the contract. The former

appears to deal solely with interpretive issues, while the latter covers those issues plus other matters relating to the parties' contractual rights and obligations.³² Most courts to address this matter of phrasing have rejected this theoretical distinction and concluded that the wording does not matter.³³ That is because it is difficult to conceive of a reason why parties would want the law of one state to determine the meaning of their agreement and another state's law to determine their rights and duties. The most recent draft of the new Restatement (Third) of Conflict of Laws also follows this approach.³⁴

Nevertheless, there is some judicial support for a distinction between "interpret" and "govern" in a choice-of-law clause, including a 2017 decision by the U.S. Court of Appeals for the Second Circuit.³⁵ Accordingly, transactional lawyers should choose the broader verb, "govern," or, better yet, use some form of both "govern" and "interpret,"³⁶ as the following example does:

Choice of Law. Illinois law governs the interpretation of this agreement and the rights and obligations of the parties.

Issue 2: "Other Than Its Choice-of-Law Rules"

Another interpretive issue that can arise with respect to a choice-of-law clause is whether the parties have chosen the *whole* law of the specified state or merely that state's *internal* law. If the parties selected the whole law – which would include the state's choice-of-law rules – the result might be that those rules then lead to the application of some other state's law, effectively negating the parties choice. To deal with this, many transactional lawyers routinely draft choice-of-law clauses to expressly exclude the selected state's own choice-of-law rules. For example, they might draft the clause as follows:

Choice of Law. Illinois law, other than its conflict-of-law principles, governs the interpretation of this agreement and the rights and obligations of the parties.

Although this approach would at first blush appear to be an exercise of careful drafting, in all likelihood it is unnecessary. There appear to be only two cases in the past century in which a court interpreted a choice-of-law clause to refer to the whole law of the selected state, with the result that some other state's law controlled.³⁷ Those aberrations aside, courts uniformly conclude that a choice-of-law clause chooses only the internal law of the selected state, not its choice-of-law rules.³⁸ The Restatement follows the same approach.³⁹ The reason is easy to comprehend. When parties go to the trouble to select a state's law to govern their contractual relationship, it is extremely unlikely that they intend some other state's law to apply.

Moreover, expressly excluding the selected state's choice-of-law rules might present a problem. Several states allow

contracting parties to choose their respective bodies of law regardless of whether the state bears a substantial relationship to the parties or the transaction, provided the contract involves a set minimum amount of money.⁴⁰ If, pursuant to such a statute, the parties selected one of those state's law to govern their contract, the express exclusion of choice-of-law rules might remove the only basis for applying that state's law.⁴¹ This concern would not apply if the selection were not based on such a statute, but given the tendency of transactional lawyers to take boilerplate terms – such as a choice-of-law clause – from one agreement and insert them in another, it is probably wise to either omit the limiting language or rephrase it as follows:

Choice of Law. Illinois law, [excluding its conflict-of-law principles if those principles would result in the application of any other state's law](#), governs the interpretation of this agreement and the rights and obligations of the parties.

Issue 3: Substance vs. Procedure

Unless a contrary intent is manifested, courts interpret a choice-of-law clause as dealing only with substantive law, not procedural law.⁴² The underlying rationales for this distinction are several. First, it might be difficult for a forum to use some other state's procedural rules, particularly if multiple states' laws applied. Second, the chosen state typically has no interest in applying its procedural rules extraterritorially. Third, the contracting parties probably intended to invoke only the substantive law of the chosen state.⁴³

If procedural matters were limited to such things as the length, format, and due date of pleadings or how process may be served – matters relating to the judicial proceeding rather than to the transaction established by the contract – this approach would be unobjectionable. Unfortunately, several matters that courts occasionally regard as procedural can affect the contracting parties' substantive rights. These include who is a necessary party,⁴⁴ the burden of proof,⁴⁵ statutes of frauds, the parol evidence rule, and statutes of limitation. The current draft of the Restatement (Third) of Conflict of Laws takes the position that the law governing the contract supplies the applicable statute of frauds and parol evidence rule,⁴⁶ and also determines whether attorney's fees will be awarded pursuant to a contractual provision.⁴⁷ It takes a more nuanced approach with respect to statutes of limitation and repose, one that often results in the shortest limitations period.⁴⁸

The current judicial approach to these issues is mixed,⁴⁹ and there is significant disagreement with respect to statutes of limitation. A majority of states regard a statute of limitations as procedural, and apply the applicable statute of the forum state.⁵⁰ To avoid this result, a choice-of-law clause could select both the substantive and procedural law of the chosen state.⁵¹ But that

might bring in more than is intended and burden a court with trying to apply procedural rules with which it is unfamiliar. Instead, the clause should identify the specific rules of the chosen state's law that are or might be deemed procedural and which the parties want to apply. For example, the following should be sufficient to import the applicable statute of limitations from the chosen state,⁵² provided doing so does not violate a fundamental policy of the forum state⁵³:

Choice of Law. Illinois law, [including its statutes of limitations but excluding its conflict-of-law principles if those principles would result in the application of any other state's law](#), governs the interpretation of this agreement and the rights and obligations of the parties.

Issue 4: "the Contract" vs. "Claims Relating to the Contract"

In most states, a choice-of-law clause that selects the law of a state to govern "the contract" will apply only to contract claims; it will not cover tort claims or statutory claims.⁵⁴ Thus, claims of fraud or misrepresentation relating to the contract will be governed by the law chosen under traditional conflict-of-laws principles. So too will be statutory claims, such as a claim against a secured party for breaching the peace during a repossession or conducting a commercially unreasonable disposition.⁵⁵ In contrast, a clause that selects a state's law to govern "claims relating to the contract" or "the rights and obligations of the parties relating to the contract" will cover tort and statutory claims relating to or arising out of the contract.

This dichotomy has some linguistic appeal because it interprets the choice-of-law clause literally, and therefore empowers the drafter to determine the scope of the clause through careful phrasing. Unfortunately, the dichotomy is probably not consistent with the intent of those who actually draft such clauses. Research suggests that transactional lawyers usually intend that tort and statutory claims relating to a contract be decided pursuant to the law selected in the choice-of-law clause, and many were unaware that the language used could affect whether the clause applies to non-contract claims.⁵⁶ Accordingly, to achieve what is likely intended, the following language should be used:

Choice of Law. Illinois law, including its statutes of limitations but excluding its conflict-of-law principles if those principles would result in the application of any other state's law, governs the interpretation of this agreement and the rights and obligations of the parties [arising hereunder or relating hereto](#).

Issue 5: Law in Effect When Agreement is Signed or When Issue Litigated

Many contract terms are ambiguous with respect to some aspect of time. For example, a clause referring to revenue received from an “Affiliate” might mean an entity affiliated at the time the contract was made or at the time the revenue was received.⁵⁷ A clause in a title insurance contract referring the “value” of the insured property might mean the value at the time the policy was issued or the value at the time the loss occurred.⁵⁸ Similarly, a choice-of-law clause might refer to the law in effect when the agreement is signed or at the time when litigation occurs.⁵⁹

Although there are few cases dealing with this issue, it might be desirable to specify the relevant time in the choice-of-law clause. On the assumption that contracting parties might not wish to subject themselves to all future – and currently unknowable – changes in the law, the following language restricts the choice to the law in effect on the date of the agreement:

Choice of Law. Illinois law, as in effect on the date of this agreement, including its statutes of limitations but excluding its conflict-of-law principles if those principles would result in the application of any other state’s law, governs the interpretation of this agreement and the rights and obligations of the parties arising hereunder or relating hereto.

Conclusion and Caveat

The final version of the clause should work for most agreements and achieve the desires of most contracting parties and the transactional lawyers who represent them. That said, transactional lawyers should be aware that there are some things that even a well-drafted contractual choice-of-law cannot do. First, as discussed in the Background section of this article, the chosen law will not be followed if doing so would violate a fundamental policy of the state whose law would otherwise govern. The best way to guard against that possibility is to include a mandatory choice-of-forum clause that requires litigation in the state whose law is selected in the choice-of-law clause.⁶⁰

Second, a choice-of-law clause might not govern contract formation questions.⁶¹ After all, a court cannot logically give effect to the parties’ contractual choice of law until it determines that the parties do in fact have a contract.

Third, to opt out of a treaty or international convention, when that is permitted, the choice-of-law clause must do more than merely choose a particular state’s law. That is because the treaty or convention is deemed to be part of that state’s law.⁶² The parties must expressly exclude application of the treaty or convention if they want it not to apply.

Finally, a contractual choice of law is unlikely to determine the law governing issues that arise more by operation of law than from the relationship of the parties. Specifically, the choice might not be relevant to issues that affect the rights of third parties. Such issues might include whether a transfer is voidable under fraudulent transfer law,⁶³ whether a party has successor liability,⁶⁴ or whether a party had sufficient rights in property to grant a security interest in it.⁶⁵

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Notes:

1. See LEA BRILMAYER ET AL., CONFLICT OF LAWS: CASES AND MATERIALS 698 (7th ed. 2015) (“[S]urprisingly often, the parties do not even bother to research the chosen law before they include a clause selecting it”).

2. See John F. Coyle, *The Canons of Construction for Choice-of-law Clauses*, 92 WASH. L. REV. 631, 635 (2017) (referring to the “extensive academic literature that explores why parties choose to have their contracts governed by the law of states such as New York or Delaware); Theodore Eisenberg & Geoffrey Miller, *Ex Ante Choices of Law and Forum: An Empirical Analysis of Corporate Merger Agreements*, 59 VAND. L. REV. 1975, 1981–83 (2006) (noting that the merger and acquisition agreements studied frequently selected Delaware, New York, or California law to govern but observing that the choice of law often aligned with the state of incorporation, which was frequently Delaware, and that the choice of Delaware law was actually less common than the choice of Delaware as the place of incorporation).

3. See, e.g., 1-800-Got Junk? LLC v. Superior Court, 116 Cal. Rptr. 3d 923 (Cal. Ct. App. 2010) (a franchisor was bound by a Washington choice-of-law clause in its franchise agreement with a California franchisee even though Washington law provided greater protection for franchisees than California law with respect to termination); Mail Boxes Etc. USA, Inc. v. Considine, 1999 U.S. Dist. LEXIS 23380 (W.D. Wash. 1999) (a non-compete clause in a franchise agreement was unenforceable under the chosen law of California even though the franchise was located in Washington and the clause would be enforceable under Washington law); Atlas Subsidiaries, Inc. v. O & O, Inc., 166 So. 2d 458 (Fla. Ct. App. 1964) (a promissory note was usurious under the chosen law of Florida even though payments were due at the lender’s place of business in Pennsylvania); Pisacane v. Italia Societa Per Azione Di Navigazione, 219 F. Supp. 424 (S.D.N.Y. 1963) (a clause in steamship ticket limiting to one year the time to bring suit was invalid under the chosen law of Italy).

4. With respect to default rules – rules of law that fill in the gaps in the parties’ agreement – contracting parties have greater latitude. They may select any state’s law to govern. See [RESTATEMENT \(SECOND\) OF CONFLICT OF LAWS § 187\(1\)](#) (rev. 1988); [RESTATEMENT \(THIRD\) OF CONFLICT OF LAWS, Preliminary Draft No. 6, § 8.01\(3\)](#) (Sept. 29, 2020) (hereinafter “[RESTATEMENT \(THIRD\), Prelim. Draft 6](#)”). See also U.C.C. § 1-301 cmt. 1 (“an agreement as to choice of law may sometimes take effect as a shorthand expression of the intent of the parties as to matters governed by their agreement, even though the transaction has no significant contact with the jurisdiction chosen”). The chosen state need not bear any relationship to either the transaction or the parties. For example, if parties are free to designate where a party’s performance will occur or where payment is to be made, and under the law of some states the default rule is that payment and performance occur where the buyer is located whereas under the law of other states the default rule is that payment and performance occur where the seller is located, then the parties may decide that issue simply by choosing one state’s law to apply. See [RESTATEMENT \(THIRD\), Prelim. Draft 6](#), at § 8.01 cmt. h, ill. 7 & 8.

5. See *id.* § 8.01(2). Cf. [RESTATEMENT \(SECOND\) OF CONFLICT OF LAWS § 187\(2\)](#) (limiting the “fundamental policy” exception to a state “which has a materially greater interest than the chosen state in the determination of the particular issue”).

Some statutes limit this freedom by preventing a forum state from applying another jurisdiction’s law to a particular type of contract. See [RESTATEMENT \(THIRD\), Prelim. Draft 6](#), at § 8.02(2)(b) & cmt. g (indicating that every state has enacted statutes directing courts to disregard “outbound” choice-of-law clauses for some types of contracts, and identifying common examples as construction contracts, credit agreements, distributor contracts, employment contracts, and franchise contracts). The Uniform Commercial Code requires that the chosen state’s law bear a reasonable relation to the transaction rather than a substantial relationship to either the transaction or the parties. See U.C.C. § 1-301(a). See also U.C.C. § 1-301(c) (identifying several provisions of the Uniform Commercial Code that specify the applicable law which contracting parties are not free to alter).

6. See, e.g., [BMO Harris Bank v. Richland Express, Inc., 2018 WL 8299883](#) (E.D. Ark. 2019) (agreements selecting Texas and Utah law and providing for a default rate of interest that would be usurious under Arkansas law violated a fundamental policy of Arkansas); [Rincon EV Realty LLC v. CP III Rincon Towers, Inc., 213 Cal. Rptr. 3d 410](#) (Cal. Ct. App. 2017) (although a loan agreement selected New York law as the governing law, and its waiver of the right to a jury is enforceable in New York, the agreement’s jury waiver clause was unenforceable in California litigation because it violates a fundamental policy of the state and California has a materially greater interest in the

matter than does New York); [Madden v. Midland Funding, LLC, 237 F. Supp. 3d 130](#) (S.D.N.Y. 2017) (application of Delaware law pursuant to a choice-of-law clause in the parties’ credit card agreement would violate a fundamental public policy of New York because Delaware does not cap the interest rate that parties may agree to whereas New York has a criminal usury statute); [Nutracea v. Langley Park Invs. PLC, 2007 WL 135699](#) (E.D. Cal. 2007) (clauses in stock purchase agreement selecting New York law as the governing law and New York as the forum for all litigation between the parties were unenforceable because of California’s strong policy in preventing fraud on California corporations and New York’s minimal interest in the litigation); [In re Miller, 341 B.R. 764](#) (Bankr. E.D. Mo. 2006) (default rate of interest on business loan, though valid under Iowa law that the parties had chosen in their agreement, violated Missouri law, was against fundamental policy of Missouri, and was therefore unenforceable). See also [RESTATEMENT \(THIRD\), Prelim. Draft 6](#), at 42–46 (collecting cases ruling that a matter was fundamental policy and cases to the contrary); cases cited *infra* note 22.

7. This distinction comports with the Uniform Commercial Code’s differentiation between an “agreement,” which is defined as the parties’ bargain in fact, and a “contract,” which is defined as the total legal obligation that results from an agreement. See U.C.C. § 1-201(b)(3), (12).

8. See, e.g., [Catlin Specialty Ins. Co. v. J.J. White, Inc., 309 F. Supp. 3d 345](#), 355–56 (E.D. Pa. 2018) (applying New York interpretive principles); [SPX Corp. v. Shop Equip. Specialists, Inc., 2001 WL 36512993](#) (W.D. Mich. 2001) (following *Kipin*); [Kipin Indus., Inc. v. Van Deilen Int’l, Inc., 182 F.3d 490](#), 493–94 (6th Cir. 1999) (applying Michigan conflicts principles); [Eckert Int’l, Inc. v. Gov’t of Sovereign Democratic Republic of Fiji, 834 F. Supp. 167](#), 170 (E.D. Va. 1993); [Hammel v. Ziegler Fin. Corp., 334 N.W.2d 913](#), 916 (Wis. Ct. App. 1983); [Boatland, Inc. v. Brunswick Corp., 558 F.2d 818](#), 821–22 (6th Cir. 1977); [C.A. May Marine Supply Co. v. Brunswick Corp., 557 F.2d 1163](#), 1165–66 (5th Cir. 1977). See also John F. Coyle, *A Short History of the Choice-of-Law Clause*, [92 U. COLO. L. REV. 1147](#), 1190–92 (2020); John F. Coyle, *The Canons of Construction for Choice-of-Law Clauses*, [92 WASH. L. REV. 631](#), 656–61 (2017) (hereinafter “*Coyle, Canons*”) (discussing the issue at some length and citing additional authority for the proposition that this approach is so widely followed that courts frequently conclude that a choice-of-law clause containing the words “interpret” or “construe” supplies the governing law without discussion).

9. See [RESTATEMENT \(THIRD\), Prelim. Draft 6](#), at § 8.03(2)(f).

10. See, e.g., [Arnone v. Aetna Life Ins. Co., 860 F.3d 97](#), 107–08 (2d Cir. 2017); [In re Marriage of Procter, 125 P.3d 801](#), 803 (Or. Ct. App. 2005); [Heating & Air Specialists, Inc. v. Jones, 180 F.3d 923](#), 930 (8th Cir. 1999) (based on Arkansas

law); *R.R. v. M.H.*, [689 N.E.2d 790](#) (Mass. 1998); *America's Favorite Chicken Co. v. Cajun Enters.*, [130 F.3d 180](#), 182 (5th Cir. 1997); *Dollar Sys., Inc. v. Avcar Leasing Sys., Inc.*, [890 F.2d 165](#), 171 (9th Cir. 1989); *Boat Town U.S.A., Inc. v. Mercury Marine Div. of Brunswick Corp.*, [364 So. 2d 15](#), 17 (Fla. Dist. Ct. App. 1978). *See also* *MC v. Northrop Corp.*, [685 N.E.2d 127](#), 132–35 (Ind. Ct. App. 1997) (resolving a conflict between two choice-of-law provisions).

11. *See* *Coyle, Canons*, [92 WASH. L. REV. at 660–61](#) (referring to two choice-of-law clauses that used the verbs “governed,” “construed,” and “interpreted,” and thereby “eliminate all doubt as to the parties’ intent”).

12. *Carlos v. Philips Bus. Sys., Inc.*, [556 F. Supp. 769](#), 774 n.4 (E.D.N.Y. 1983); *Duskin v. Pennsylvania-Cent. Airlines Corp.*, [167 F.2d 727](#), 732 (6th Cir. 1948).

13. *See, e.g., Ciena Capital Funding, LLC v. Krieges, Inc.*, [394 P.3d 39](#), 43 (Ariz. Ct. App. 2017); *Ministers & Missionaries Benefit Bd. v. Snow*, [45 N.E.3d 917](#), 923 (N.Y. 2015); *Lehman Bros. Holdings, Inc. v. Universal Am. Mortg. Co.*, [12 F. Supp. 3d 1355](#), 1360 (D. Colo. 2014); *IRB-Brasil Resseguros, S.A. v. Inepar Invs., S.A.*, [982 N.E.2d 609](#), 612 (N.Y. 2012); *Rabe v. United Air Lines, Inc.*, [636 F.3d 866](#), 871 (7th Cir. 2011); *Weiss v. La Suisse, Société d’Assurances sur la Vie*, [293 F. Supp. 2d 397](#), 402 (S.D.N.Y. 2003); *Chan v. Soc’y Expeditions, Inc.*, [123 F.3d 1287](#), 1297 (9th Cir. 1997); *Amoco Rocmount Co. v. Anschutz Corp.*, [7 F.3d 909](#), 920 (10th Cir. 1993); *Economu v. Borg-Warner Corp.*, [652 F. Supp. 1242](#), 1246–47 (D. Conn. 1987); *Reger v. National Ass’n of Bedding Mfrs. Grp. Ins. Tr. Fund*, [372 N.Y.S.2d 97](#), 117–18 (Sup. Ct. 1975); *Siegelman v. Cunard White Star*, [221 F.2d 189](#), 193–94 (2d Cir. 1955).

14. *See* [RESTATEMENT \(SECOND\) OF CONFLICT OF LAWS §§ 186](#) cmt. b; [187\(3\)](#) & cmt. h; [RESTATEMENT \(THIRD\), Prelim. Draft 6](#), at § 8.03(2)(c) & cmt. f.

15. *See* Cal. Civ. Code § 1646.5 (\$250,000); Del. Stat. tit. 6, § 2708 (\$100,000); Fla. Stat. § 685.101 (\$250,000); 735 Ill. Comp. Stat. 105/5-5 (\$250,000); N.Y. Gen. Oblig. Law § 5-1401(1) (\$250,000).

16. *See* *Coyle, Canons*, [92 WASH. L. REV. at 647](#) n.75 (discussing this possibility).

17. *See* [RESTATEMENT \(SECOND\) OF CONFLICT OF LAWS §§ 122–143](#).

18. *See* [RESTATEMENT \(THIRD\) OF CONFLICT OF LAWS, Preliminary Draft No. 5](#), § 5.09 cmt. a (Oct. 23, 2019) (hereinafter “[RESTATEMENT \(THIRD\), Prelim. Draft 5](#)”). *See also* *Coyle, Canons*, [92 WASH. L. REV. at 648](#) (discussing the first and third rationales).

19. *See* [RESTATEMENT \(THIRD\), Prelim. Draft 5](#), at § 5.12.

20. *See id.* at §§ 5.21, 5.23, 5.24.

21. *See id.* at §§ 5.28, 5.29. Of course, if the parties have a written agreement with a choice-of-law clause, there is unlikely to be an issue with the statute of frauds.

22. *See id.* at §§ 5.15(3). A contract term providing that one party is responsible for the other party’s attorney’s fees might run afoul of a statute in the forum state that makes such a clause reciprocal, thereby entitling the prevailing party to attorney’s fees. *See* Cal. Civ. Code § 1717; Fla. Stat. § 57.105(7); Mont. Code § 28-3-704; Or. Rev. Stat. § 20.096; Utah Code § 78B-5-826; Wash. Rev. Code § 4.84.330. Such a statute might embody a fundamental policy of the state, leading a court to apply the statute regardless of what the contract states. *See, e.g., First Intercontinental Bank v. Ahn*, [798 F.3d 1149](#), 1156–57 (9th Cir. 2015) (because California Civil Code § 1717, which makes reciprocal a contractual clause awarding attorney’s fees to only one of the contracting parties, is fundamental policy of the state, it applies to litigation in California even though the parties’ promissory note had a valid clause choosing application of Georgia law); *Capital One Bank v. Fort*, [255 P.3d 508](#) (Or. Ct. App. 2011) (reciprocity statute was fundamental policy of the state and overrode choice-of-law clause in consumer’s credit card contract).

23. *See id.* at § 5.30, providing that: (i) a statute of limitations of the forum state applies if that would bar the claim; (ii) a statute of limitations of the state whose substantive law governs the contract applies if that would bar the claim, unless maintenance of the claim would promote a substantial interest of the forum state; and (iii) a statute of repose of the state whose substantive law governs the contract applies if that would bar the claim. *Cf.* [RESTATEMENT \(SECOND\) OF CONFLICT OF LAWS § 142](#) (as amended in 1988).

24. *See* *Coyle, Canons*, [92 WASH. L. REV. at 649](#) (“Courts have long quarreled, for example, over whether statutes of frauds and burdens of proof should be categorized as substantive or procedural.”).

25. *See id.* at 649–54 (citing and discussing cases). *See also* *Citizens Bank v. Merrill, Lynch, Pierce, Fenner and Smith, Inc.*, [2012 WL 5828623](#) (E.D. Mich. 2012) (applying Michigan procedural law, including its six-year statute of limitations, instead of the chosen law of New York, with its three-year limitations period, to tort and contract claims brought under New York law).

26. Apparently, several courts have ruled that a choice-of-law clause will be effective to import the procedural law of the chosen state if the clause expressly provides that the chosen state’s law governs “enforcement” of the contract. *See* *Coyle, Canons*, [92 WASH. L. REV. at 655 & n.113](#). But given the vagueness of the word “enforcement,” and how simple it is to use other terminology that more clearly imports procedural law,

transactional lawyers should employ other terminology to achieve that result.

27. See Coyle, *Canons*, [92 WASH. L. REV. at 688–91](#) (suggesting that transactional lawyers do intend to import the statutes of limitations in the chosen state’s law but do not intend to import other procedural law, such as rules of pleading).

28. See *Burroughs Corp. v. Suntogs of Miami, Inc.*, [472 So. 2d 1166](#), 1169 (Fla. 1985) (ruling that contracting parties may shorten the applicable statute of limitations indirectly, by selecting the law of a jurisdiction with a shorter limitations period, even though Florida law prohibits parties from shortening statutes of limitation directly via contract). *But see Industrial Indem. Ins. Co. v. United States*, [757 F.2d 982](#), 987 (9th Cir. 1985) (suggesting that the parties’ choice of Illinois law, with its 12-month limitations period, violated fundamental policy of Idaho); *Central States, Southeast and Southwest Areas Pension Fund v. Aalco Exp. Co., Inc.*, [592 F. Supp. 664](#), 667 n.2 (E.D. Mo. 1984) (suggesting that a statute of limitations of the forum state was fundamental policy that could not be abrogated through the selection of another state’s law).

29. See, e.g., *Thompson and Wallace of Memphis, Inc. v. Falconwood Corp.*, [100 F.3d 429](#), 433 (5th Cir. 1996) (a loan contract providing that the “agreement and its enforcement” were to be governed by New York law did not preclude application of Texas Deceptive Trade Practices Act or tort claims arising under Texas law); *Northeast Data Sys., Inc. v. McDonnell Douglas Computer Systems Co.*, [986 F.2d 607](#) (1st Cir. 1993) (a contract clause providing that “[t]his Agreement and the rights and obligations of the parties hereto shall be governed by and construed in accordance with the laws of California” covered all contract claims, whether motivated by bad intent or not, but did not cover a fraud in inducement claim because it “concerns the validity of the formation of the contract, it cannot be categorized as one involving the rights or obligations arising under the contract”); *Valley Juice Ltd. v. Evian Waters of France, Inc.*, [87 F.3d 604](#) (2d Cir. 1996) (contract providing that “the Agreement is to be governed by the laws of the State of New York” did not apply to claim under Massachusetts Unfair Trade Practices Act); *Maltz v. Union Carbide Chemicals & Plastics Co.*, [992 F. Supp. 286](#) (S.D.N.Y. 1998) (language providing that the agreement was “to be construed in accordance with the law of New York” did not apply to tort claims); *Sunbelt Veterinary Supply, Inc. v. International Business Systems US, Inc.*, [985 F. Supp. 1352](#) (M.D. Ala. 1997) (“this agreement and the terms hereof shall be governed by and construed in accordance with the laws of the State of Florida” did not encompass tort claims); *Shelley v. Trafalgar House Public Ltd.*, [918 F. Supp. 515](#) (D.P.R. 1997) (“this letter shall be subject to and construed in accordance with the laws of the State of New York” did not apply to tort claims). *But cf. Masters Group Int’l, Inc. v. Comerica Bank*, [352 P.3d 1101](#) (Mont. 2015) (a forbearance agreement stating that it

“shall be governed and controlled in all respects by the laws of the State of Michigan” covered not only claims for breach of contract and breach of the covenant of good faith, but also tort claims for fraud arising out of a contract); *Pyott-Boone Electronics Inc. v. IRR Trust for Donald L. Fetterolf*, [918 F. Supp. 2d 532](#) (W. D. Va. 2013) (a clause providing that “This Agreement shall be governed by the laws of the State of Delaware without regard to any jurisdiction’s conflicts of laws provisions” encompasses all disputes that arise from or are related to the agreement); *Nedlloyd Lines B.V. v. Superior Court*, [11 Cal. Rptr. 2d 330](#) (Cal. 1992) (a choice-of-law clause providing that the “agreement shall be governed by and construed in accordance with Hong Kong law” encompassed tortious breaches of fiduciary duties created by the agreement). See also *See* RESTATEMENT (THIRD), *Prelim. Draft 6*, at § 8.03(2)(a), (b) & cmts. c, d, e; Coyle, *Canons*, [92 WASH. L. REV. at 666–79](#).

30. See *McDonald v. Wells Fargo Bank*, [374 F. Supp. 3d 462](#) (W.D. Pa. 2019) (a clause in a security agreement providing that Ohio law “appl[ies] to this contract,” was a narrow choice-of-law clause; Ohio law governed the debtor’s breach of contract claim but, under traditional conflicts-of-law principles, Pennsylvania law governed the debtor’s claims against the secured party for conversion, improper notification, and conducting a commercially unreasonable sale of the collateral).

31. See Coyle, *Canons*, [92 WASH. L. REV. at 696–700](#).

32. See *Ellington v. EMI Music, Inc.*, [21 N.E.3d 1000](#) (N.Y. 2014).

33. See *First Am. Title Ins. Co. v. Johnson Bank*, [372 P.3d 292](#) (Ariz. 2016).

34. *Cf. Kia Motors America, Inc. v. Glassman Oldsmobile Saab Hyundai, Inc.*, [706 F.3d 733](#) (6th Cir. 2013) (interpreting a contractual reference to “applicable law” – not in a choice-of-law clause – as not including future changes to the law).

35. This is not a complete solution because the issue is whether the chosen law would violate a fundamental policy of *the state whose law would otherwise govern*. That state might not be the forum state.

36. See, e.g., *Life Plans, Inc. v. Security Life of Denver Ins. Co.*, [800 F.3d 343](#), 357 (7th Cir. 2015) (“A contract’s choice-of-law provision may not apply if the contract’s legality is fairly in doubt, for example, if the contract is unconscionable, or if there is some other issue as to the validity of the very formation of the contract”); *B-S Steel of Kansas, Inc. v. Texas Industries, Inc.*, [439 F.3d 653](#), 661 n.9 (10th Cir. 2006) (referring to the “logical flaw inherent in applying a contractual choice of law provision before determining whether the underlying contract is valid”). See also *Hanwha Corp. v. Cedar Petrochemicals, Inc.*, [760 F. Supp. 2d 426](#) (S.D.N.Y. 2011) (to determine if the parties formed a contract for the international

sale of goods, the formation rules in the United Nations Convention on Contracts for the International Sale of Goods applied even though both parties had attempted to opt out of that treaty). *But see* RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ [198](#), [199](#), [200](#) (indicating that an effective choice of law governs the parties' capacity to contract, the requirements of a writing, and other issues of validity); RESTATEMENT (THIRD), *Prelim. Draft 6*, at § 8.02 cmt. c, ill. 2 & 3 (suggesting that the chosen state's law would govern such matters as capacity to contract and the requirement of consideration if the chosen state has a substantial relationship to the parties or to the transaction, or there is otherwise another reasonable basis for the parties' choice).

37. *See, e.g.*, *Honey Holdings I, Ltd. v. Alfred L. Wolff, Inc.*, [81 F. Supp. 3d 543](#), 551-52 (S.D. Tex. 2015) (merely choosing a state's law to apply is insufficient, without more, to show a clear intent to opt out of the United Nations Convention on Contracts for the International Sale of Goods); *It's Intoxicating, Inc. v. Maritim Hotelgesellschaft mbH*, [2013 WL 3973975](#), at *17 (M.D. Pa. 2013) (merely selecting one state's law to govern is not sufficient to opt out of the application of the CISG); *BP Oil Int'l, Ltd. v. Empresa Estatal Petroleos*, [332 F.3d 333](#) (5th Cir. 2003); *Travelers Prop. Cas. Co. of Am. v. Saint-Gobain Technical Fabrics Canada Ltd.*, [474 F. Supp. 2d 1075](#) (D. Minn. 2007); *American Mint LLC v. GOSoftware, Inc.*, [2006 WL 42090](#) (M.D. Pa. 2006); *Ajax Tool Works, Inc. v. Can-Eng Mfg. Ltd.*, [2003 WL 223187](#) (N.D. Ill. 2003); *Asante Techs., Inc. v. PMC-Sierra, Inc.*, [164 F. Supp. 2d 1142](#) (N.D. Cal. 2001). *But see* *American Biophysics Corp. v. Dubois Marine Specialties*, [411 F. Supp. 2d 61](#) (D.R.I. 2006). *See also* Stephen L. Sepinuck, *Gotcha!: Caught in the Explicitness Trap*, [8 THE TRANSACTIONAL LAWYER 1](#), 4 (June 2018) (criticizing this rule); Coyle, *Canons*, [92 WASH. L. REV. at 693-79](#) (concluding, on the basis of empirical research, that this rule does not comport with the intent of those who draft choice-of-law clauses).

38. *See* Uniform Voidable Transactions Act § 10(b) (providing that the local law of the jurisdiction in which the debtor is located when the transfer is made governs whether the transfer is voidable).

39. *See, e.g.*, *Berg Chilling Sys., Inc. v. Hull Corp.*, [435 F.3d 455](#) (3d Cir. 2006).

40. *See* Stephen L. Sepinuck, *What Choice Do I Have? – Choice-of-Law Clauses Governing Attachment of a Security Interest*, [10 The Transactional Lawyer 9](#) (June 2020).



Recent Cases

SECURED TRANSACTIONS

Scope Issues

In re Le Tote, Inc.,

[2020 WL 6875575](#) (Bankr. E.D. Va. 2020)

A securitization trust, which had a security interest in several landlords' right to payment under a master lease with a retailer, had no right to enforce the master lease. The security interest was not governed by Article 9 because § 9-109(d)(11) excludes from Article 9's scope "the creation or transfer of an interest in or lien on real property, including a lease or rents thereunder." Although there is an exception for security agreements covering personal and real property pursuant to § 9-604, and the master lease allegedly included contract rights and general intangibles, that did not mean that Article 9 applied to, or that the trust could enforce, the obligation to pay rent.

Attachment Issues

Rozenman v. Rozenman,

[2020 WL 6495081](#) (Ariz. Ct. App. 2020)

Creditors of an incarcerated man did not acquire a security interest in his membership interests in several limited liability companies because, at the time he purported to grant the security interest, his property was held in receivership. Under the doctrine of *custodia legis*, property held in receivership is not subject to attachment or garnishment, and may not be sold without leave of court.

In re CP Liquidation of Cleveland, Inc.,

[2020 WL 6877156](#) (Bankr. E.D. Tenn. 2020)

Language in an application for credit submitted to a seller of pharmaceuticals on behalf of a corporate buyer, and which purported to grant the seller a security interest, was effective even though the application was signed by a prospective buyer of the corporation two weeks before the sellers signed a power of attorney authorizing the buyer to take actions on behalf of the corporation. Even though the sale of the corporation was never consummated and the sellers had no knowledge of the grant of the security interest, the corporation nevertheless ratified the prospective buyer's action. The prospective buyer became the corporation's express agent, had knowledge of the grant of the security interest, and his knowledge could be imputed to the corporation.

Priority Issues

The Calhoun Law Firm, PLC v. Midfirst Bank,

[2020 WL 6503615](#) (Ariz. Ct. App. 2020)

A bank that claimed to have a perfected security interest in the proceeds of the debtor's settlement of a lawsuit had priority over

the law firm that represented the debtor in the litigation and that negotiated the settlement because the firm had no charging lien. The firm's fees were based on the hours worked and were to be paid monthly, and thus there was no evidence that the firm looked to the potential recovery for payment.

Enforcement Issues

In re Integrity Graphics, Inc.,

[2020 WL 6812880](#) (Bankr. D. Conn. 2020)

A recital in the debtor's prepetition assent to a secured party's sale of collateral, which stated that the "[p]rice, preparation of the collateral, method, manner, time, and place[,] is commercially reasonable," was not binding on the debtor's bankruptcy trustee, who, in seeking to avoid any transfer or waiver of rights in connection with the assent, had alleged that the debtor received no consideration for the assent.

CNH Diversified Opportunities Master Account, L.P. v. Cleveland Unlimited, Inc., [2020 WL 6163305](#) (N.Y. 2020)

Even though the collateral agent for secured note holders accepted the collateral in full satisfaction of the secured obligation pursuant to the instructions of a majority of the note holders, and the indenture expressly provided that the agent was authorized to use remedies provided for by the UCC, the dissenting note holders retained the right to sue under the notes and associated guarantees. The indenture provided that the right of a note holder to enforce payment shall not be impaired without the consent of such note holder, and the collateral agent's authority was expressly subject to this provision, so the acceptance of collateral could not affect the dissenting note holders' rights.

St. Francis Holdings, LLC v. Averill,

[2020 WL 6746329](#) (M.D. Fla. 2020)

The assignee of a lessor's rights to payment under an equipment finance lease was entitled to enforce the forum-selection clause in the lease. The assignment agreement expressly granted the assignee the right to "take all legal or other proceedings which Assignor could have taken . . . including, . . . the enforcement of rights and remedies," and the right to "deal with the Assigned Contract . . . in such a manner as Assignor could have in the absence of this Assignment," and hence was more than a mere assignment of the right to payment.

CIBC Bank USA v. JH Portfolio Debt Equities, LLC,

[2020 WL 5848379](#) (N.D. Ill. 2020)

Complete diversity of jurisdiction was not shown to exist in an administrative agent's action against the debtors because, even though the agent and the debtors were citizens of different states, and the agent was one of the lenders, the agent had not pled the citizenship of the seven other lenders that the agent represented. All the lenders were the real parties in controversy for the purposes of diversity jurisdiction, in part because they could control whether the agent brought suit.

Liability Issues

Plotch v. 435 East 85th Street Tenants Corp.,

[2020 WL 6164002](#) (N.Y. Sup. Ct. 2020)

The high bidder at a disposition of shares in a cooperative apartment, who purchased the shares subject to the terms of the proprietary lease, had no cause of action against the secured party or the company that managed the cooperative when that company refused to approve the transfer of the lease to the high bidder due to his litigious history. The proprietary lease was clear that transfer of the lease was subject to the approval of the company and under New York law a contract vendee has no standing to enforce a cooperative proprietary lease. Moreover, § 9-407 does not override the approval requirement because that provision applies to a term that requires consent to the creation or enforcement of a security interest in a lease contract; it does not apply to a provision in the terms of sale requiring approval by the cooperative's manager.

FDIC v. Murex LLC,

[2020 WL 6646159](#) (S.D.N.Y. 2020)

An ethanol distributor that sold \$69 million in receivables to a bank was obligated to the FDIC, as the assignee of the bank, to repurchase receivables because the sales agreement required repurchase if any warranty or representation made by the distributor was materially inaccurate or incorrect when made and the distributor misrepresented that the receivables arose out of a bona fide, arm's-length sale of goods that the account debtor had accepted. The distributor regularly sold a quantity of ethanol to its principal trading partner, which immediately sold the same quantity of ethanol back to the distributor for a penny per gallon. As a result of the simultaneous nature of the paired transactions, no actual ethanol was moved, and each party ended up with the same amount of ethanol as when it began, as well as a receivable. The distributor then sold the receivables generated, paid the proceeds to its trading partner, and, until the trading partner went bankrupt, would later be repaid. The end result that the transactions amounted to short-term loans to the trading partners. They were not bona fide sales of ethanol. Although the transaction did give rise to real receivables, the misrepresentations were material because, had the bank appreciated the true nature of the transaction it would have been alerted to trading partner's need for liquidity, a fact that plainly increased the risk to the bank that the trading partner would be unable to pay its obligations.

BANKRUPTCY

In re Ultra Petroleum Corp.,

[2020 WL 6276712](#) (Bankr. S.D. Tex. 2020)

A creditor's right to a make-whole payment upon early repayment is in the nature of liquidated damages, not unmatured interest. That is because the amount due is not in return for the use or forbearance of money, but instead for the loss suffered due to early repayment, and in fact could be zero when

reinvestment rates are high. Hence the right to the make-whole payment is not disallowed under § 502(b)(2). Moreover, because the debtor was solvent at the time of confirmation, and the solvent-debtor exception survived enactment of § 502(b), the debtor had to pay post-petition interest at the contractual default rate on claims treated as unimpaired.

LENDING, CONTRACTING & COMMERCIAL LITIGATION

Mentis Sciences, Inc. v. Pittsburgh Networks, LLC,
[2020 WL 5637697](#) (N.H. 2020)

An information technology company that contracted to provide data storage for an engineering firm was not liable for the cost of recreating data that was lost when the company's storage system failed without a proper backup because the contract contained a clause disclaiming "indirect, special, incidental, punitive or consequential damages, including but not limited to loss of data." The cost of replacing the lost data was a consequential damage that was properly disclaimed and the contract did not leave the engineering firm without any remedy because it did not disclaim direct damages.

Premier Bank, LLC v. Emerald Grande, LLC,
[2020 WL 5823532](#) (N.D.W. Va. 2020)

Clauses in loan documents requiring the borrower to pay the attorney's fees incurred by the lender "in connection with the enforcement of this Agreement" or "to collect" on the note did not cover attorney's fees incurred in monitoring the bankruptcy case of another entity that had filed an administrative expense claim in the debtor's bankruptcy case, in objecting to the administrative expense claim, or in seeking to convert the debtor's Chapter 11 case to a Chapter 7 case.

Loughlin v. Meghji,
[132 N.Y.S.3d 65](#) (N.Y. Sup. Ct. App. Div. 2020)

A term in an agreement entitling the substantially prevailing party to double attorney's fees incurred was not an unenforceable penalty. Because the plaintiff had received a judgment for \$1 in nominal damages, the plaintiff was the substantially prevailing party under the terms of the agreement and was therefore entitled to double attorney's fees.

Sutton v. David Stanley Chevrolet, Inc.,
[2020 WL 6041803](#) (Okla. 2020).

A car seller that, when presenting four documents to the buyer to sign, implied that several merely verified information relating to the transaction – e.g., about the car purchased and the car traded in – had a duty to disclose that one of the documents contained an arbitration clause, and the seller's failure to do so constituted fraudulent inducement. Consequently, the arbitration clause was not enforceable.

In re Shoot the Moon, LLC,
[2020 WL 6588407](#) (Bankr. D. Mont. 2020)

Summary judgment could not be issued on whether the debtor's sale of future receivables was a true sale or a secured loan. Factors suggesting the transaction was a loan include that: (i) the putative buyer obtained a perfected security interest in assets beyond those allegedly sold; (ii) the buyer obtained a personal guaranty of "payment" and a confession of judgment against both the seller and the guarantor; (iii) the seller had a continuing obligation to provide financial statements upon request; (iv) email messages between the parties referred to the relationship as one involving loans; and (v) payments were made from a deposit account or a related entity, rather than by the seller. On the other hand, the transaction documents referred to the transaction as a sale, contained a reconciliation provision, and lacked a fixed duration.



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