

DISPATCHES FROM THE TRENCHES

**Know What Your Getting Into
Understanding the Risk of Successor Liability**

By Kenneth P. Weinberg

This issue of Dispatches from the Trenches discusses lender control liability, which Uniform Commercial Code statute of limitations applies when goods are financed on vendor paper that is subsequently assigned to a funder; whether a debtor's nickname is "seriously misleading" for purposes of filing a financing statement; and whether an early payment termination is "reasonable" under Georgia law.

Cardinal Fastener & Specialty Co. v. Progress Bank, 2003 U.S. App LEXIS 11867.

Occasionally, lessors will take a security interest in the stock, membership interest or other ownership interests of the lessee. There are many issues regarding this sort of security interest, and the rules governing how to "perfect" a lessor's rights in such ownership interests are complex and full of pitfalls. In addition to the complexity and resulting legal expenses necessary to properly evidence a lessor's lien on such ownership interest, there are other risks involved.

This case provides a nice example of the risk of successor liability. Progress Bank was a fully secured lender to Allied Nut & Bolt Company (debtor). Cardinal Fastener was an unsecured creditor with a practically worthless default judgment against debtor. Debtor's financial problems were severe and debtor surrendered its assets to Progress who took over management of debtor's business and began the process of liquidating it.

Cardinal, who received nothing during the liquidation, sued Progress, alleging that Progress was liable for debtor's obligations under a variety of theories, including theories of corporate successor liability and lender control liability. The idea was that Progress was the corporate successor of debtor and therefore became liable for monies debtor owed to Cardinal.

Fortunately for Progress and for secured lenders, generally, the circuit court rejected Cardinal's argument and held that Progress did not attempt to merge its banking business with debtor's in an effort to continue manufacturing screws, nuts, and bolts. The court noted that Progress acquired debtor's assets only to protect Progress's own investment and to minimize further depletion of debtor's assets. Nonetheless, the lesson is clear. A lessor should be careful prior to taking over management of a lessee because such actions may open claims that the lessor is liable for all of the debts of the lessee.

DaimlerCrysler Serv. N. Am. v. Ouimette, 830 A.2d 38 (Vt. 2003).

Vendor-financers and those funders purchasing vendor paper should be aware that the shorter four-year statute of limitations contained in Article 2 of the Uniform Commercial Code may apply in lieu of the six-year statute of limitations provided by Article 9 of the UCC.

In this case, Duane Ouimette and Stephanie Faulkner (the purchasers) purchased an automobile from a dealership along with an extended warranty and insurance agreement. The purchasers made an initial down payment and financed the remaining payments through a "simple interest retail installment sales contract." As security for their obligations under that contract, the purchasers granted the dealership a security interest in the automobile. The dealership immediately assigned its rights to Chrysler Credit Corp., which later became DaimlerChrysler Services North America.

When the purchasers failed to make the required payments, DaimlerChrysler repossessed and sold the car and terminated the warranty and insurance contracts. Five years later, DaimlerChrysler sued the purchasers for the deficiency. When the purchasers failed to appear at trial, DaimlerChrysler moved for default judgment against them.

The court denied DaimlerChrysler's motion for default judgment, holding that the claim was barred by the four-year statute of limitations for sales contracts under Article 2 of the UCC and that the claims did not benefit from the six-year statute of limitations for secured transactions under Article 9 of the UCC. The Vermont Supreme Court affirmed, holding that it was appropriate for the trial

court to raise the statute of limitations of its own accord, because "to hold otherwise would obligate the court to issue judgment against a party that has not made an appearance no matter how old or unjust the claim."

The court held that DaimlerChrysler's claim was governed by Article 2 of the UCC and not by Article 9, because the claim was nothing more than "an action to enforce the obligation of a buyer to pay the full sale price to the seller." The key here was that, although the retail installment contract operated as a security agreement and the rights were assigned to DaimlerChrysler, the ultimate funder, the transaction really related to a sale of goods and the Article 2 statute of limitations therefore applied.

The court also rejected DaimlerChrysler's argument that the extended warranty and insurance agreements, which was also secured by a lien on the automobile, rendered the overall transaction a secured loan. The court viewed the additional payment obligations with respect to the warranty and insurance as merely "incidental parts" of the sales contract.

In re Kinderknecht, 51 U.C.C. Rep. Serv. 2d 1234 (D. Kan. 2003).

In a case before the U.S. Bankruptcy Court in Kansas, a Chapter 7 trustee attempted to set aside a security interest that was listed in the individual debtor's commonly used nickname. The trustee claimed that because the interest was not in the debtor's formal legal name, the security interest was "seriously misleading" and ineffective as of the date the debtor filed for bankruptcy and that the secured party was, therefore, unperfected.

Notwithstanding the UCC's lack of clarity on the issue, the court held that Revised Article 9 does not prohibit the use of a nickname in financing statements. The court noted the new rule regarding whether an incorrect name makes a financing statement "seriously misleading" so that it is ineffective. That rule, contained in Section 9-506 of the UCC states "if a search of the records of the filing office under the debtor's correct name, using the filing offices standard search logic, if any, would disclose a financing statement that fails sufficiently to provide the name of the debtor ... , the name provided does not make the financing statement seriously misleading."

In the case at bar, the relevant search logic did reveal the filing. The court also stated that a lender should consider the possibility that a financing statement may be filed under the debtor's nickname and should therefore search under that name.

Baez v. Banc One Leasing Corp., 348 F.3d 972. (11th Cir. 2003)

In a case involving the early termination of a car lease, the lessee argued that the early termination option in the lease ran afoul of Georgia's Uniform Commercial Code provision that required damages to be "reasonable in the light of the then anticipated harm caused by the default or other act or omission." The court held that the early termination provision in appellant's automobile lease, which provided that appellant pay the amount of actual depreciation of the car during the time it was held, plus interest, was reasonable under both the Consumer Credit Protection Act and the Georgia Commercial Code.

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