

NO. 38358-6-II

COURT OF APPEALS STATE OF WASHINGTON
DIVISION II

TES LIQUIDATING, INC., formerly TACOMA ELECTRIC SUPPLY,
LLC, a Washington corporation,

Respondents.

v.

MARK E. SMITH, INDIVIDUALLY, and MCKENZIE ROTHWELL
BARLOW & KORPL, P.S., a Washington professional service
corporation,

Appellants.

BRIEF OF APPELLANTS

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A. INTRODUCTION

Eagle Electric's ("Eagle") employees were members of the International Brotherhood of Electrical Workers ("IBEW"), and Eagle was behind on payments for worker benefits. In May of 2005 IBEW took a note from Eagle in payment of this obligation. IBEW filed a financing statement that referenced a security interest in Eagle's bank accounts, but Eagle did not execute a security agreement at the time. TES Liquidating, Inc. ("TES") obtained a money judgment against Eagle for \$76,830.64 in October of 2005. In December of 2005 TES garnished Frontier Bank ("Frontier") which was indebted to Eagle for the amount on deposit. The bank filled out the form answer to the garnishment. IBEW, represented by the defendants Mark Smith of McKenzie Rothwell, ("Smith") filed a motion to intervene in the garnishment claiming their security interest had priority. Smith scheduled a hearing for December 16, 2005, on the issue, and the court continued the matter until the next month. In the interim, the bank realized that it had its own lien on these funds, filed an amended answer and ultimately received the bulk of the proceeds from the account. IBEW received nothing and was assessed CR 11 terms of \$2,000.00.

TES has brought this action against Smith, IBEW's attorneys claiming malicious prosecution, abuse of process, and interference with a business expectancy. Both parties made motions for summary judgment

and the court granted summary judgment to TES. None of TES's causes of action is maintainable, and the trial court should have dismissed the case outright. To prevail, TES must meet every element of at least one cause of action, and this it did not and cannot do. TES was never entitled to the funds in Eagle Electric's account, because Frontier Bank had a superior lien. Therefore, Smith's attempt to assert IBEW's claims could not have been the proximate cause of TES's "loss."

B. ASSIGNMENTS OF ERROR

Assignments of Error

1. The Trial Court erred in granting summary judgment to TES.
2. The Trial Court erred in not granting summary judgment to Smith.

Issues Relating to Assignments of Error

1. Where Smith contested several of TES's factual allegations including 1) that Frontier Bank disclaimed any interest in Eagle Electric's account, 2) that Smith was attempting to be deceptive, and 3) that the trial court in the underlying case was "prepared to enter judgment for TES" when it was TES that agreed to continue the garnishment hearing, were there issues of fact that precluded summary judgment to TES?
[Assignment of Error No. 1]

2. Where TES failed to submit uncontested evidence to support all of the elements of its claim for malicious prosecution, was it error to grant summary judgment? [Assignment of Error No. 1]

3. Where TES failed to submit uncontested evidence to support all of the elements of its claim for abuse of process, was it error to grant summary judgment? [Assignment of Error No 1]

4. Where TES failed to submit uncontested evidence to support all of the elements of interference with a business expectancy, was it error to grant summary judgment? [Assignment of Error No. 1]

5. Where TES failed as a matter of law to submit sufficient evidence to support a cause of action for abuse of process, malicious prosecution or interference with a business expectancy, was it error for the trial court to refuse to grant summary judgment on behalf of Smith? [Assignment of Error No. 2]

C. STATEMENT OF THE CASE

Eagle Electric's employees were members of IBEW, and Eagle was obliged to make payments to IBEW's benefit plan. Eagle had fallen behind in payments to the plan and executed a note on May 13, 2005, for the past due amounts. IBEW filed a financing statement on June 9, 2005, but Eagle did not obtain a security agreement from IBEW until December of 2005. CP 116-118.

On October 28, 2005, plaintiff TES Liquidating, Inc. obtained a money judgment against Eagle Electric, Inc. for \$76,883.64. CP 2. On November 28, 2005, TES garnished Eagle's bank account at Frontier Bank. CP 2, 23-25. On December 6, 2005, Frontier Bank filed the completed answer TES had provided, answering that it was indebted to Eagle in the sum of \$62,051.35. CP 28-30. The answer did not claim that Frontier had a perfected security interest or lien on the account. On December 7, 2005, Smith, representing IBEW, moved to intervene in the garnishment proceedings and enjoin those proceedings. IBEW claimed it had a prior perfected security interest in the funds. CP 32-38. The Trial Court did not grant Smith's motion to intervene nor did it issue any injunction to halt the proceedings. TES's counsel and the Trial Court agreed between themselves to hold off on the garnishment at the December 16, 2005 hearing. CP 155-159.

On January 6, 2006, Frontier Bank filed an Amended Answer, stating:

On the date of the issuance of the Writ of Garnishment, defendant Eagle Electric, Inc. had a bank account at Frontier Bank with a balance of \$62,051.35. However, the funds in the bank account were subject to the first priority security interest of Frontier Bank as demonstrated by the attached Note, Security Agreement, and UCC Financing Statement. The secured loan balance exceeded \$300,000. As a result, there was no debt owing by the bank to Eagle Electric.

Moreover, the bank's interest in the funds under the loan documents is superior to any interest of plaintiff under the Writ of Garnishment.

CP 43, 42-51. The Court then "... concluded that the bank had a security interest in the account that had priority over the judgment secured by TES." CP 5. On January 13, 2006, TES successfully argued against IBEW's motions to intervene and to enjoin. CP 53-54. Based on recognition of the bank's priority position by the Court, TES agreed with the bank to release its garnishment, in return for the receipt of \$8,000.00 from the Eagle account. CP 6. On January 18, 2006, the court entered an order denying IBEW's Motion to Intervene and granting CR 11 terms in the amount of \$2,000.00 against IBEW. CP 56-57.

This action followed. TES alleged three causes of action: malicious interference with a business expectancy, malicious prosecution and abuse of process. CP 6-10. Both parties made motions for summary judgment. CP 70-81, 83-95. The court granted TES's motion. CP 194-198. The trial court ruled, "And I agree that it seems to me that [Smith's Intervention] caused the judgment not to be entered that day. And the proximity of the correction of the answer on garnishment doesn't convince me that therefore TES Liquidating never would have collected on that judgment." RP 22:24-23:4.

D. ARGUMENT

1. The summary judgment standard.

The purpose of summary judgment is to avoid useless trials on issues which cannot be factually supported, or, if factually supported, could not, as a matter of law, lead to a result favorable to the non-moving party. *Burris v. General Ins. Co. of America*, 16 Wn. App. 73, 553 P.2d 125 (1976). If the moving party shows the absence of a genuine issue of material fact, the non-moving party must set forth specific facts showing a genuine issue for trial. The moving party may meet this burden by merely pointing out to the court the absence of evidence to support a non-moving party's case. *Young v. Key Pharmaceuticals, Inc.*, 112 Wn.2d 216, 225, 770 P.2d 182 (1989). To defeat this summary judgment motion, the nonmoving party must come forward with evidence sufficient to establish the existence of any disputed elements that are essential to that party's case, and for which that party will bear the burden of proof at trial. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986).

The function of an appellate court in summary judgment is the same as that of trial court. The appellate court hears the matter *de novo*. *Hisle v. Todd Pac. Shipyards Corp.*, 151 Wn.2d 853, 860, 93 P.3d 108 (2004). Summary judgment is appropriate only if "the pleadings, depositions, answers to interrogatories, and admissions on file, together

with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.” CR 56(c). *Segaline v. Dep’t of Labor & Indus.*, 144 Wn. App. 312, 182 P.3d 480 (2008).

2. The Trial Court’s perception of sufficient undisputed facts for summary judgment is in error.

“I think the plaintiff had a property interest. I absolutely believe that.” RP 15:21-22. The Trial Court’s conclusion that TES had a property interest in Eagles account at Frontier Bank, illustrates the problem with awarding TES summary judgment regardless of the legal grounds. While no cause of action supports judgment under these facts, even if it did, TES is not entitled to judgment, because issues of fact must be resolved in TES’s favor first.

First, plaintiff respondent claims that Frontier disclaimed any interest in the account in its answer. Frontier filled out the garnishment form it was given by TES. The form did not make any provision for affirmative defenses or qualifications to the answer. Therefore Frontier did not initially assert its prior lien on the account. CP 28-30. Frontier filed an amended answer on January 6, 2006 asserting its prior lien. CP 42-51. TES could not have sought entry of judgment against Frontier until judgement debtor Eagle’s twenty days to controvert Frontier’s answer had

run, December 27, 2005. RCW 6.27.210. The time for the individual judgment debtors in *TES v. Eagle Electric* to claim exemptions, twenty-eight days, had not passed. RCW 6.27.160. Assuming the Cabuags, the owners of Eagle, received their copies of the answer the same time Frontier filed its answer would thus be January 3, 2006. Frontier amended its answer on January 6, 2006. TES must factually demonstrate that it would have applied for a judgment in time to enter judgment before that day. There is no such showing.

Second, there was no evidence before the court that TES would have or did note up the issue for entry of judgment against Frontier before January 6, 2006. The trial court ignored this gap in the proof. RP 13:1-16. TES argues that the motion to intervene and hearing on December 16, 2005, interfered with the garnishment process and entry of judgment against Frontier. The trial court disregarded the fact that the December 16, 2005 hearing was brought by IBEW and was not for the purpose of entering a judgment against Frontier by TES. RP 22:24-23:4. As a matter of law the motion could have had no affect, because TES would not have been entitled to a judgment against Frontier until at least January 4, 2006, and TES's attorney agreed to this continuance and never noted the matter for entry of judgment. CP 159. Frontier, acting in its own interest, filed an amended answer asserting its prior and senior lien before the plaintiff-

respondent took steps to enter judgment against it on its original answer. TES, thus, cannot prove that that judgment would ever have been entered against Frontier at any time before it filed its amended answer on January 6, 2006 but for the intervention of IBEW.

TES must also prove that the trial court would not have entertained an appropriate motion by Frontier to amend its answer to the writ of garnishment or a motion under CR 59 or 60 to correct any judgment which might have been entered against it because Frontier would have been entitled to such relief. A virtually identical set of facts appears in *Savannah Bank & Trust Company v. Keane*, 126 Ga. App. 53, 189 S.E. 2d 702 (1972). There a garnishment was served on the bank and it mistakenly answered that it was indebted without mentioning a security interest in the funds. A few days later after it had paid the garnished funds into the registry of the court and they were being held by the plaintiff's attorney, Savannah filed a "motion for reconsideration" to recover the funds, because the original answer was in error. The funds were pledged to the bank for a loan. The Georgia Court of Appeals held that "the garnishee had a right to amend its answer" at that stage of the proceedings. 189 S.E.2d at 704. It seems unlikely that a court in Washington would mete out less justice to Frontier than the Georgia Court did to Savannah

Bank.¹

Finally, TES must show that it would have prevailed in a dispute over Frontier's priority; that is, IBEW's actions were the proximate cause of its loss. That issue was never resolved in the trial court, because the parties settled, CP 121-125, but TES admitted that its lien was junior to Frontier's in its complaint. CP 5. Thus TES cannot prove this final element. The proximate cause of TES's loss was its lack of priority.

3. Plaintiff has suffered no cognizable harm.

Any discussion of proximate cause leads logically to the issue of damages to TES. TES's claims rest on the assumption that Smith's alleged wrongful intervention blocked entry of judgment against Frontier on its original answer. TES ignores the admitted fact that Frontier's interest in the account was senior to its garnishment "lien." CP 5.

RESTATEMENT (SECOND) OF TORTS, § 903 Comment a. states in part:

When there has been harm only to the pecuniary interests of a person, compensatory damages are designed to place him in a position substantially equivalent in a pecuniary way to that which he would have occupied, had no tort been committed.

¹ The *Savannah* court did not reach the issue of who had a right to the funds, but that is not in dispute in this case; Frontier had priority.

TES was always in a junior position to Frontier. It conceded in the underlying action that its claims were subordinate to the bank's with regard to the garnished funds. Assuming *arguendo*, that TES ever had any property interest in the funds, that claim necessarily would yield to the Frontier lien. RCW 62A.9A.327(1). The trial court mistakenly believed that TES acquired a property interest senior to Frontier because of Frontier's initially incomplete answer. RP 15:21-22. While TES presumably obtained a provisional interest of some nature in the account upon service of the writ on the garnishee defendant Frontier, the priority between TES and Frontier would be determined at the earliest when judgment was entered against Frontier. This never happened and TES was therefore always junior to Frontier. All parties to a garnishment have a right to litigate the merits of their position. *Finch v. Western Nat'l Bank*, 24 Cal. App. 331, 141 P. 261 (1914).

Omicron Co., Inc. v. United States Fidelity and Guaranty Company, 21 Wn.2d 703, 152 P.2d 716 (1944) illustrates our Supreme Court's view of the lack of pecuniary standing for one pursuing a claim for property to which he does not have a real interest. This is simply another way of saying that TES has suffered no damage, because its claims were always subject to a senior claim by the bank. In *Omicron*, the real estate broker Carlson, applied \$1,000.00 of Mathewson's money as a

down payment on an apartment house Omicron was selling. Mathewson denied Carlson's authority to make the payment, and, after Omicron refused to refund the earnest money, successfully sued for return of the funds. After paying the judgment, Omicron sued Carlson's surety. The Supreme Court, in reversing the trial court's award to Omicron stated:

... [I]t is certain that Omicron was not damaged in the sum of \$1,000. The sole and only reason why Mathewson recovered the \$1,000 from Omicron in the first action (*Mathewson v. Carlson, et al.*), is because Omicron never had any ownership or right to the \$1,000 or any part of it. It was Mathewson's money all the time. Omicron was no more legally damaged in the sum of \$1,000 by being compelled to return Mathewson's money to him than it would have been damaged in a like sum had it been compelled to return to its rightful owner \$1,000 which it found on the street.

TES found Frontier's wallet on the street. When Frontier realized the loss or, as TES theorizes, when Frontier saw TES and IBEW fighting over it, Frontier took the money back. Frontier Bank was always the rightful owner of the money in Eagle's account; it owed Eagle a debt, but subject to its lien and that lien was superior to any lien TES or IBEW may have had.

4. TES failed to make out a claim for malicious prosecution.

Actions for malicious prosecution are not favored in the law, although they are readily upheld where the proper elements are established, *see Clark v. Baines*, 150 Wn.2d 905, 911, 84 P.3d 254 (2004).

There are strong, long-standing policy reasons that such suits are disfavored.

The right of free allegations in a pleading has always been considered privileged. Courts are instituted to grant relief to litigants, and are open to all who seek remedies for injuries sustained; and unnecessary restraint, and fear of disastrous results in some succeeding litigation, ought not to hamper the litigant or intimidate him from fully and fearlessly presenting his case. If the charges prove to be unfounded, costs have been prescribed by the legislature as the measure of damages.

Abbott v. Thorne, 34 Wash. 692, 695, 76 Pac. 302 (1904). The rule established in *Abbott* is very much in force today.

Washington courts have “strictly limited the right to bring suit for malicious prosecution of civil actions, reasoning that such suits intimidate prospective litigants and that the public policy favors open courts in which a plaintiff may fearlessly present his case.” This court has previously declined to rely on California malicious prosecution case law because California does not adhere to Washington’s restrictive view of malicious prosecution claims. Therefore, even if the cases cited by Stutzman supported his view, which they do not, they would not necessarily be persuasive.

Brin v. Stutzman, 89 Wn. App. 809, 821, 951 P.2d 291 (1998).

Courts require proof of five elements in malicious prosecution cases: 1) That the prosecution claimed to have been malicious was instituted or continued by the defendant; 2) That there was want of probable cause for the institution or continuation of the prosecution; 3) That the proceedings were instituted or continued through malice; 4) That the proceedings terminated on the merits in favor of the plaintiff, or were abandoned; and 5) That the plaintiff suffered injury or damages as a result

of the prosecution. *Peasley v. Puget Sound Tug & Barge Company*, 13 Wn.2d 485, 125 P.2d 681 (1942). In civil proceedings such as this, there are two additional elements: 6) Arrest or seizure of property; and 7) Special injury sustained (that is, injury or damage that is not the necessary result of such proceedings). *Gem Trading Company v. Cudahy Corp.*, 92 Wn.2d 956, 964-65, 603 P.2d 828 (1979).

Several of the seven elements are either in dispute factually or legally unsupportable.

There was probable cause for this action. TES's claim assumes that because IBEW did not prevail and the trial court thought the matter worthy of censure, its position was without merit.² TES claims IBEW's note was not a proper security agreement, and while a promissory note has been found adequate to create a security interest, *In Re Amex-Protien Development Corp.*, 504 F.2d 1056 (9th Circ., 1974), the note from Eagle Electric to IBEW was not. Nonetheless, there is authority for the proposition that once a proper security agreement attaches, it relates back to the filing of the financing statement.

A second issue exists regarding the extent of the lien asserted by NationsCredit, and whether that lien extends to include certain inventory located in Las Cruces, New

² It seems the trial court in this action considered Smith a dastard. "I mean, that's pretty strong, I think, that Mr. Smith is -- I hesitate before I say perpetrating a fraud on the Court, but that's what it appears to me." RP 9:10-12. This view is not justified, but is not directly in issue here.

Mexico. Citizens Bank takes the position that the absence of a security agreement between Camp Town and Chrysler Wholesale, the original filer of the financing statement, prevents NationsCredit from proving the intention of the parties with respect to location of inventory. This argument disregards N.M. Stat. Ann. § 55-9-312(5)(a), since that statute allows the current security agreement between NationsCredit and Camp Town to relate back to the financing statement. The Court is not required to discern the intentions of the parties at the time the financing statement was originally filed but instead to examine the intent of the debtor and the ultimate assignee of the financing statement. This intent is memorialized in the December 21, 1993, security agreement between Camp Town, Inc. and NationsCredit.

In re Camp Town Inc., 197 B.R. 139, 144 (B.C.N.M. 1996).

In *Camp Town*, the sequence of events is meticulously set out by the court. The original financing statement was filed on August 20, 1987, no security agreement was actually entered until a year later. In March of 1993 the original creditor assigned the financing statement and security to National Credit, which did not enter into another security agreement until December 21, 1993. The bankruptcy court held that the security interest was good, because it related back to the original financing statement, which was itself, filed years before. “[A]s a general rule under Article 9 of the UCC, priority of collateral is determined by the order in which the claimant files a financing statement or otherwise perfects a security interest in the specified collateral, whichever occurs earlier...a subsequent security agreement and security interest will relate back to the existing

financing statement providing that statement was continuously maintained and encompassed the same collateral.”³ *Johnson v. Star Brewing, Inc.*, No. CV-97-177-JE (D. Ore. September 30, 1997)(Slip Op. 13). While IBEW did not champion this position at the court below, the reason for not doing so are obvious, the bank security interest predated IBEW’s by about two years, and contesting that would have been pointless.

The proceedings were not instituted and continued through malice. IBEW had a legitimate debt from Eagle Electric. IBEW had a legitimate business reason for attempting to recover that debt. Whether it ultimately proved unsuccessful or not does not create even an inference of malice as the requirements have long been understood. “[T]he requirement that malice be shown as part of the plaintiff’s case in an action for malicious prosecution may be satisfied by proving that the prosecution complained of was undertaken from improper or wrongful motives or in reckless disregard of the rights of the plaintiff.” *Peasley v. Puget Sound Tug & Barge Co.*, *supra*, 13 Wn.2d at 502.

Plaintiff can also not establish that it suffered any injury. This issue is discussed thoroughly in Section D.3, *supra*.

³ The District Court relied on former ORS 79.3120. Title 9 of the UCC has since been substantially amended, but RCW 62A.9A-322 is functionally the equivalent. It provides that as to conflicting, perfected security interests, “Priority dates from the earlier of the time of filing ... or the security interest ... is first perfected . . .” RCW 62A.9A-322(a)(1).

The plaintiff cites no authority for the proposition that IBEW's motion to intervene and enjoin was a seizure. At most, TES argues that IBEW's attempted intervention prevented TES from completing its seizure by entry of judgment against Frontier. At best, TES would only acquire an interest arguably senior to Frontier when judgment against Frontier entered. TES' interest in the account was precisely the same on January 6, 2006 when the bank filed its amended answer as it was on December 7, 2005 when IBEW sought to intervene. IBEW never seized any interest in the account held by TES.

There was no special injury. TES admitted that, "A valid motion to intervene would not ordinarily result in any immediately financial injury to a party in a given case." CP 91. Thus it appears TES' claim of "injury" is based upon 20/20 hindsight, for it is certain that IBEW would not have attempted to intervene unless it was in hope of recovering, and had it known that the bank had a security interest in the property that it would assert, it would have been wasting its time.

If we consider this as just a garnishment case, the underlying ownership of the property seized or threatened has always been a defense to the attachment or garnishment. "In a suit by the defendant in attachment against the plaintiff in attachment and his surety, to recover upon the bond, it is a complete defense that the property seized under the

attachment, by garnishment or otherwise, was not in fact the property of the defendant in attachment. As the right of the defendant in attachment is to recover only for the actual damage sustained as a result of the issuance of the attachment, the truth concerning the ownership of the property seized by the attachment may be inquired into and relied upon by the plaintiff in attachment and his surety, in a suit upon the bond.” *Massachusetts Bonding & Ins. Co. v. United States Conservation Co.*, 31 Ga. App. 716, 721, 122 S.E. 728, 731 (1924). Washington has always placed the burden on the garnishor to prove the propriety of the garnishment. *See, Huzzy v. Culbert Construction Co.*, 5 Wn. App. 581, 489 P.2d 749 (1971). Here it was TES that tried to seize the property of Frontier and that claim it admits was wrong. It can hardly have an action against other claimants who were wrong as well.

5. TES did not make out a claim for abuse of process.

Washington courts have adopted the RESTATEMENT OF TORTS definition of abuse of process:

One who uses a legal process, whether criminal or civil, against another primarily to accomplish a purpose for which it is not designed, is subject to liability to the other for harm caused by the abusive process.

RESTATEMENT (SECOND) OF TORTS, § 682.

The Supreme Court said in *Gem Trading Company, supra*, 92

Wn.2d at 963 n. 2:

In abuse of process cases, the crucial inquiry is whether the judicial systems process, made available to insure the presence of the defendant or his property in court, has been misused to achieve another, inappropriate end. In *Fight v. Lee*, 11 Wn. App. 21, 27-28, 521 P.2d 964 (1974), the court stated that the essential elements of abuse of process were: (1) the existence of an ulterior purpose – to accomplish an object not within the proper scope of the process – and (2) an act in the use of legal process not proper in the regular prosecution of the proceedings. The mere institution of a legal proceeding even with a malicious motive does not constitute an abuse of process.

In *Batten v. Abrahms*, 28 Wn. App. 737, 744-750, 626 P.2d 984 (1981), the court further clarified the gist of abuse of process as the use of legal process for a collateral purpose, *i.e.*, to seek advantage, gain or pressure on an issue outside or beyond the scope of the litigation itself. “The great majority of legal authorities concur with the foregoing definition of the tort and its essential elements that it is a matter of bringing action (A) to accomplish purpose (B).” 28 Wn. App. at 745.

There was no collateral purpose in Smith’s advancing a claim of superior right to the contested funds, no matter how ill founded the factual premise was. IBEW’s purpose in initiating and maintaining the underlying case was precisely the relief sought in the pleading; namely, to establish priority of IBEW’s claimed security interest. There was no

collateral purpose, and therefore there was no abuse of process.

6. TES failed to make out a claim for tortious interference with a business expectancy.

A claim for tortious interference with a contractual relationship or business expectancy requires five elements: (1) the existence of a valid contractual relationship or business expectancy; (2) that defendants had knowledge of that relationship; (3) an intentional interference inducing or causing a breach or termination of the relationship or expectancy; (4) that defendants interfered for an improper purpose or used improper means; and (5) resultant damage. *Commodore v. University Mechanical Contractors, Inc.*, 120 Wn.2d 120, 137, 839 P.2d 314 (1992); *Roger Crane & Assocs.*, 74 Wn. App. at 777-78.

Leingang v. Pierce County Medical Bureau, 131 Wn.2d 133, 157, 930 P.2d 288 (1997). TES meets none of the elements of this tort. There was never a business relationship, just a garnishment, and Smith could not interfere with it. Smith's motives were legitimate and the loss was caused by the Frontier lien, not Smith's actions. The interference must likewise be by an improper method or means.

We believe that the right balance has been struck by our colleagues on the Oregon Supreme Court. Rejecting the prima facie tort approach of the first Restatement and declining to adopt in toto the implication of the second RESTATEMENT that a plaintiff prove that the interference was "improper" under the factors listed in § 767, that court, in an opinion by Justice Linde, redefined the tort as "wrongful interference with the economic relationships". *Top Serv. Body Shop, Inc. v. Allstate Ins. Co.*, 283 Or. 201, 204, 582 P.2d 1365, 1368 (1978). Thus, a cause of action for tortious interference arises from either the defendant's pursuit of an improper objective of harming the plaintiff or the use of wrongful means that in fact cause injury to plaintiff's contractual or business relationships. *Top Serv.*,

582 P.2d at 1368. A claim for tortious interference is established

when interference resulting in injury to another is wrongful by some measure beyond the fact of the interference itself. Defendant's liability may arise from improper motives or from the use of improper means. . . . No question of privilege arises unless the interference would be wrongful but for the privilege Even a recognized privilege [however] may be overcome when the means used by defendant are not justified by the reason for recognizing the privilege.

Top Serv., at 209-10. Interference can be "wrongful" by reason of a statute or other regulation, or a recognized rule of common law, or an established standard of trade or profession. Therefore, plaintiff must show not only that the defendant intentionally interfered with his business relationship, but also that the defendant had a "duty of non-interference; i.e., that he interfered for an improper purpose . . . or . . . used improper means . . ." *Straube v. Larson*, 287 Or. 357, 361, 600 P.2d 371 (1979).

We adopt the Oregon formulation of this tort and follow other courts in doing so. *See Leigh Furniture & Carpet Co. v. Isom, supra; Anderson v. Dairyland Ins. Co.*, 97 N.M. 155, 637 P.2d 837, 840-41 (1981). It is one that best comports with our previous opinions on this subject and best reflects the underlying spirit of the modifications made in the second Restatement. Implicit in our previous cases dealing with tortious interference has been some showing that the interference complained of be "wrongful" in some way or that plaintiff had a "duty of non-interference." Thus, in *King* we found that the City was under a "duty to act fairly and reasonably in its dealings with the plaintiffs" and that this duty was breached when the City wrongfully refused to grant a building permit. *King*, at 247-48. However, matters of privilege or justification continue to be affirmative defenses to be raised by the defendant.

Pleas v. Seattle, 112 Wn.2d 794, 804, 774 P.2d 1158, (1989).

The first element cannot be met, because legal proceedings are not a business relationship. The only case found where the plaintiff asserted that legal proceedings could be a malicious interference is *Leingang v. Pierce County Medical Bureau*, *supra*, and the court flatly rejected the argument.

The purposeful interference denotes purposefully improper interference. *Schmerer v. Darcy*, 80 Wn. App. 499, 505, 910 P.2d 498 (1996). Intentional interference requires an improper objective or the use of wrongful means that in fact cause injury to the person's contractual relationship. *Schmerer*, 80 Wn. App. at 505. Exercising in good faith one's legal interests is not improper interference. *Schmerer*, 80 Wn. App. at 506 (citing RESTATEMENT (SECOND) OF TORTS § 773 (1977)). There is no evidence in the record of an improper purpose for PCM's actions or of improper means being used. When Mr. Leingang refused to sign the subrogation agreement, PCM paid his medical bills and sought reimbursement in court. PCM was merely asserting an arguable interpretation of existing law. The trial court correctly dismissed the claims for tortious interference with a contract.

131 Wn.2d at 157. It logically follows that if a garnishment cannot be a business expectancy, Smith could never have been aware of it.

TES incorrectly claims that the anticipated collectability of a judgment against Eagle Electric following receipt of the bank's initial Answer on December 6, 2005, was a "business expectancy" with which IBEW could interfere. Washington case law does not support this conclusion. Security interests such as TES's judgment lien are not

business expectancies. “A lien is not a contract, but an encumbrance on property as security for payment of a debt.” *Schmerer v. Darcy, supra.*, 80 Wn. App. at 509. Likewise there is no authority for the position that garnished funds are a business expectancy. “The existence of a due process property claim depends upon claimant’s having a legitimate claim of entitlement based on either mutually explicit understanding or on an express or implied contract.” *Meyer v. University of Washington*, 105 Wn.2d 847, 853, 719 P.2d 98 (1986).

In general, the policy and effect of extending the tort to protect business expectancies, as well as consummated contracts, was to protect the opportunity to obtain and maintain business relationships, and the future consummation of business transactions. In this case that policy negates element four of the tort. Washington courts have allowed recovery where a defendant’s acts destroyed a plaintiff’s opportunity to obtain prospective business customers, and the plaintiff can show that future business opportunities are a reasonable expectation and not mere wishful thinking. *Caruso v. Local Union 690 of International Brotherhood of Teamsters*, 33 Wn. App. 201, 653 P.2d 638 (1982), *reversed on other grounds*, 100 Wn.2d 343, 670 P.2d 240 (1983), *appeal after remand*, 107 Wn.2d 524, 730 P.2d 1299 (1987), *cert. denied*, 484 U.S. 815, 108 S.Ct. 67, 98 L.Ed.2d 31 (1987).

TES's anticipated satisfaction of its judgment following receipt of the bank's initial Answer of December 6, 2005, cannot be characterized as a "business expectancy." There was no expectation of any future mutually consensual transaction with any other party to the proceedings. The relationship between the bank and the plaintiff was that of legal adversaries. The money was the property of the bank, the bank owed Eagle Electric money, but the bank's security interest proved to be superior and senior to any claim by TES or IBEW.

TES cannot satisfy element three of the tort, because it cannot show the defendant induced or caused a breach or termination of the expectancy. If there was any doubt of the precarious and transient nature of the plaintiff's expectancy that was fully resolved when the bank filed its Amended Answer on January 6, 2006. That Answer, while acknowledging the account as originally stated, further affirmatively stated that the bank had a prior, senior security interest in the funds. This claim was validated by subsequent court action and acknowledged by TES. CP 121-125.

We have already discussed the issue of damages, element five, and will not further repeat those arguments.

7. Immunity.

WG Platts, Inc. v. CW Platts, 73 Wn.2d 434, 430 P.2d 867 (1968)

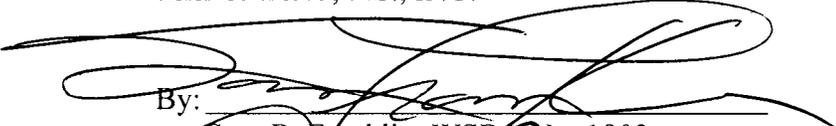
held that a conspiracy to give or secure false testimony is a public offense only, and does not constitute grounds for a civil action. In *Platts*, one party to protracted its civil litigation sought to assert a claim against some of the opposing parties in the concluded litigation by claiming that the parties had suborned perjury in the preceding action. The Supreme Court held that even assuming the facts to be true, this did not state a cause of action since the misdeeds alleged, though heinous, constituted a public offense only and did not give rise to a cause of action. In this case, even if the facts of intentional misrepresentation were true it would not give rise to a cause of action.

E. CONCLUSION

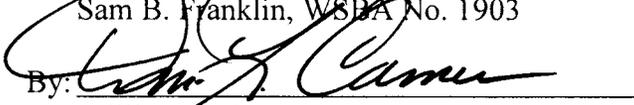
This Court should reverse the trial court with instructions to grant summary judgment of Dismissal to Mark Smith and McKenzie Rothwell Barlow & Korpl, P.S. or in the alternative to remand for trial on the disputed factual issues necessary for TES to make out any cause of action.

RESPECTFULLY SUBMITTED this 26 day of January, 2009.

LEE SMART, P.S., INC.

By: 

Sam B. Franklin, WSBA No. 1903

By: 

William L. Cameron, WSBA No. 5108
Attorneys for Appellants

DECLARATION OF SERVICE

The undersigned certifies under penalty of perjury under the laws of the State of Washington, that on January 26, 2009, I caused service of the foregoing pleading on each and every attorney of record herein:

VIA HAND DELIVERY TO SEATTLE OFFICE

Mr. John Guadnola
Gordon Thomas Honeywell
1201 Pacific Avenue, Suite 2200
Tacoma, WA 98401


William L. Cameron

FILED
COURT OF APPEALS
DIVISION II
09 JAN 27 AM 8:46
STATE OF WASHINGTON
BY 
DEPUTY

APPENDIX

RESTATEMENT (SECOND) OF TORTS, § 682 General Principle

One who uses a legal process, whether criminal or civil, against another primarily to accomplish a purpose for which it is not designed, is subject to liability to the other for harm caused by the abuse of process.

RESTATEMENT (SECOND) OF TORTS, § 903 Compensatory Damages -- Definition

“Compensatory damages” are the damages awarded to a person as compensation, indemnity or restitution for harm sustained by him.

COMMENTS & ILLUSTRATIONS: Comment:

a. When there has been harm only to the pecuniary interests of a person, compensatory damages are designed to place him in a position substantially equivalent in a pecuniary way to that which he would have occupied had no tort been committed. When however, the tort causes bodily harm or emotional distress, the law cannot restore the injured person to his previous position. The sensations caused by harm to the body or by pain or humiliation are not in any way analogous to a pecuniary loss, and a sum of money is not the equivalent of peace of mind. Nevertheless, damages given for pain and humiliation are called compensatory. They give to the injured person some pecuniary return for what he has suffered or is likely to suffer. There is no scale by which the detriment caused by suffering can be measured and hence there can be only a very rough correspondence between the amount awarded as damages and the extent of the suffering. However, these damages, although frequently not segregated in a verdict, differ from punitive damages, both in the reasons for their existence and in the method of their computation.

RCW 6.27.160. Claiming exemptions -- Form -- Hearing -- Attorney's fees -- Costs -- Release of funds or property

(1) A defendant may claim exemptions from garnishment in the manner specified by the statute that creates the exemption or by delivering to or mailing by first-class mail to the clerk of the court out of which the writ was issued a declaration in substantially the following form or in the form set forth in RCW 6.27.140 and mailing a copy of the form by first-class mail to the plaintiff or plaintiff's attorney at the address shown on the writ of garnishment, all not later than twenty-eight days after the date stated on the writ except that the time shall be extended to allow a declaration mailed or delivered to the clerk within twenty-one days after service of the writ on the garnishee if service on the garnishee is delayed more than seven days after the date of the writ.

[NAME OF COURT]

No.

.....No.

...

Plaintiff,

vs. RELEASE OF WRIT OF

GARNISHMENT

.....,

Defendant

.....,

Garnishee.

TO THE ABOVE-NAMED GARNISHEE

You are hereby directed by the attorney for plaintiff, under the authority of chapter 6.27 of the Revised Code of Washington, to release the writ of garnishment issued in this cause on, as follows:[indicate full or partial release, and if partial the extent to which the garnishment is released]

You are relieved of your obligation to withhold funds or property of the defendant to the extent indicated in this release. Any funds or property covered by this release which have been withheld, should be returned to the defendant.

Date: Date:

Attorney for Plaintiff

RCW 6.27.210. Answer of garnishee may be controverted by plaintiff or defendant

If the garnishee files an answer, either the plaintiff or the defendant, if not satisfied with the answer of the garnishee, may controvert within twenty days after the filing of the answer, by filing an affidavit in writing signed by the controverting party or attorney or agent, stating that the affiant has good reason to believe and does believe that the answer of the garnishee is incorrect, stating in what particulars the affiant believes the same is incorrect. Copies of the affidavit shall be served on or mailed by first-class mail to the garnishee at the address indicated on the answer or, if no address is indicated, at the address to or at which the writ was mailed or served, and to the other party, at the address shown on the writ if the defendant controverts, or at the address to or at which the copy of the writ of garnishment was mailed or served on the defendant if the plaintiff controverts, unless otherwise directed in writing by the defendant or defendant's attorney.

RCW 62A.9A-322. Priorities among conflicting security interests in and agricultural liens on same collateral

(a) General priority rules. Except as otherwise provided in this section, priority among conflicting security interests and agricultural liens in the same collateral is determined according to the following rules:

(1) Conflicting perfected security interests and agricultural liens rank according to priority in time of filing or perfection. Priority dates from the earlier of the time a filing covering the collateral is first made or the security interest or agricultural lien is first perfected, if there is no period thereafter when there is neither filing nor perfection.

(2) A perfected security interest or agricultural lien has priority over a conflicting unperfected security interest or agricultural lien.

(3) The first security interest or agricultural lien to attach or become effective has priority if conflicting security interests and agricultural liens are unperfected.

(b) Time of perfection: Proceeds and supporting obligations. For the purposes of subsection (a)(1) of this section:

(1) The time of filing or perfection as to a security interest in collateral is also the time of filing or perfection as to a security interest in proceeds; and

(2) The time of filing or perfection as to a security interest in collateral supported by a supporting obligation is also the time of filing or perfection as to a security interest in the supporting obligation.

(c) Special priority rules: Proceeds and supporting obligations. Except as otherwise provided in subsection (f) of this section, a security interest in collateral which qualifies for priority over a conflicting security interest under RCW 62A.9A-327, 62A.9A-328, 62A.9A-329, 62A.9A-330, or 62A.9A-331 also has priority over a conflicting security interest in:

(1) Any supporting obligation for the collateral; and

(2) Proceeds of the collateral if:

(A) The security interest in proceeds is perfected;

(B) The proceeds are cash proceeds or of the same type as the collateral; and

(C) In the case of proceeds that are proceeds of proceeds, all intervening proceeds are cash proceeds, proceeds of the same type as the collateral, or an account relating to the collateral.

(d) First-to-file priority rule for certain collateral. Subject to subsection (e) of this section and except as otherwise provided in subsection (f) of this section, if a security interest in chattel paper, deposit accounts, negotiable documents, instruments, investment property, or letter-of-credit rights is perfected by a method other than filing, conflicting perfected security interests in proceeds of the collateral rank according to priority in time of filing.

(e) Applicability of subsection (d) of this section. Subsection (d) of this section applies only if the proceeds of the collateral are not cash proceeds, chattel paper, negotiable documents, instruments, investment property, or letter-of-credit rights.

(f) Limitations on subsections (a) through (e) of this section. Subsections (a) through (e) of this section are subject to:

(1) Subsection (g) of this section and the other provisions of this part;

(2) RCW 62A.4-210 with respect to a security interest of a collecting bank;

(3) RCW 62A.5-118 with respect to a security interest of an issuer or nominated person; and

(4) RCW 62A.9A-110 with respect to a security interest arising under Article 2 or 2A.

(g) Priority under agricultural lien statute. A perfected agricultural lien on collateral has priority over a conflicting security interest in or agricultural lien on the same collateral if the statute creating the agricultural lien so provides. Conflicts as to priority between and among security interests in crops and agricultural liens subject to chapter 60.11 RCW are governed by the provisions of that chapter

**R.M. JOHNSON and LINDSEY A. JOHNSON, Plaintiffs, v. STAR
BREWING INCORPORATED, an Oregon corporation; GENE
SCOTT WENZEL; VICKI S. WENZEL; ROLLING
COMPONENTS, LTD., an Oregon corporation; and KIM OLSEN,
Trustee of Bison Investors' Trust, Defendants.**

CV 97-177-JE

**UNITED STATES DISTRICT COURT FOR THE DISTRICT OF
OREGON**

1997 U.S. Dist. LEXIS 24185

**September 30, 1997, Decided
September 30, 1997, Filed**

COUNSEL: [*1] David A. Foraker, Greene & Markley, P.C., Portland, OR, Attorneys for Plaintiffs.

Johnston A. Mitchell, Bullivant, Houser, Bailey, Pendergrass & Hoffman, Portland, OR, Attorneys for Defendant Bison Investors' Trust.

JUDGES: John Jelderks, United States Magistrate Judge.

OPINION BY: John Jelderks

OPINION

JELDERKS, Magistrate Judge:

This is a dispute between secured creditors concerning priority to certain collateral owned by defendant Star Brewing Incorporated. The contestants are plaintiffs R.M. Johnson and Lindsey A. Johnson (hereafter, "Johnson") and defendant Kim Olsen as Trustee of Bison Investors' Trust (hereafter, "Bison"). The parties have filed cross-motions for summary judgment seeking a determination as to the validity, priority, and extent of the parties' respective interests in the collateral.

FACTS

On September 6, 1994, West One Bank duly filed a UCC-1 financing statement naming Star Brewing as debtor and West One Bank as secured party. The collateral described in the statement was:

All Inventory, Chattel Paper, Accounts, Contract Rights, Equipment and General Intangibles, whether any of the foregoing is owned now or acquired later; all accessions, additions, [*2] replacements, and substitutions relating to any of the foregoing; all records of any kind relating to any of the foregoing; all proceeds relating to any of the foregoing (including Insurance, general intangibles and accounts process), together with the following specifically described property: All furniture and fixtures whether now owned or hereafter acquired.

It is unclear what prompted the filing of this financing statement. The record does not reflect that any loans were made to Star Brewing by West One Bank around that time period or the existence of any contemporaneous security agreement.

On or about July 12, 1995, West One Bank loaned Star Brewing the sum of \$ 100,243.13 at a variable interest rate. The loan was to be repaid in 49 monthly installments of \$ 2,430, and a final balloon payment of approximately \$ 5,801 which was due on August 25, 1999. The promissory note was secured by a Commercial Security Agreement. The description of the collateral in that Agreement was substantially similar to the description set forth in the earlier financing statement. However, under the terms of the fine print of that Security Agreement, the collateral was declared to be security [*3] for more than just the loan in question:

The word "indebtedness" means the indebtedness evidenced by the Note, including all principal and interest, together with all other indebtedness and costs and expenses for which Grantor or Borrower is responsible under this Agreement or under any of the Related Documents. In addition, the word "Indebtedness" includes all other obligations, debts and liabilities, plus interest thereon, of Borrower, or any one or more of them, to Lender, as well as all claims by Lender against Borrower, or any one or more of them, whether existing now or later; whether they are voluntary or involuntary, due or not due, direct or indirect, absolute or contingent, liquidated or unliquidated; whether Borrower may be liable individually or jointly with others; whether Borrower may be obligated as guarantor, surety,

accommodation party or otherwise; whether recovery upon such indebtedness may be or hereafter may become barred by any statute of limitations; and whether such indebtedness may be or hereafter may become otherwise unenforceable.

This is often referred to as a "dragnet clause."

On or about April 11, 1996, Bison loaned Star Brewing \$ 200,000. [*4] The Loan Agreement recites that:

Borrower shall grant to Lender a security interest in the equipment listed on Exhibit B (the "Collateral"), which security interest shall be inferior in priority only to that security interest of West One Bank Oregon, securing a loan with a current balance of approximately \$ 80,000.00 (the "Senior Debt"). The Senior Debt is secured by all or substantially all of the assets of Borrower. Borrower shall be permitted to substitute other collateral of greater or equal value, upon Lender's written consent, which shall not be unreasonably withheld. In connection with the security interest granted herein, Borrower agrees to execute, as part of this Agreement, a Uniform Commercial Code Financing Statement to enable Lender to perfect the security interest granted by Borrower.

Star Brewing also represented that:

4.3 No financing statement covering the Collateral is prior in

interest to that of Lender, except that financing statement securing the Senior Debt. Borrower shall repay such Senior Debt in a timely manner.

4.4 The Borrower will not sell, exchange, or otherwise transfer the Collateral, and will not suffer or permit any lien, levy, [*5] or attachment thereon or security interest therein or financing statement to be filed with reference thereto other than that of Lender and the Senior Debt.

4.5 The Borrower will join with the Lender in executing, filing and doing whatever necessary under applicable law to perfect and continue Lender's security interest in the Collateral.

On or about April 11, 1996, Bison and Star Brewing also signed a Security Agreement covering specific pieces of equipment that were to be the collateral for that loan. Among the obligations which the agreement imposed upon Star Brewing was the duty to "keep the Collateral free and clear of all Liens, except Permitted Liens . . ." The term "Permitted Liens" included "(e) the security interest granted by Debtor in favor of West One Bank, Oregon covering all, or substantially all of the assets of Debtor."

Star Brewing also pledged that it would "not enter into any transaction that may reasonably be expected to have a Material Adverse Effect. . ." A "Material Adverse Effect means a material adverse effect on (a) Debtor's financial condition, business, assets or ability to pay the Obligation, or (b) Secured Party's rights in the Collateral or [*6] the priority of such rights." Star Brewing also pledged that, "except for Permitted Liens, [it would] not permit any Lien to exist on any of the

Collateral, nor encumber, pledge, mortgage, grant a security interest in, assign, sell, lease, or otherwise dispose of or transfer . . . any of the Collateral . . ."

On May 14, 1996, Bison duly filed a UCC-1 financing statement naming Star Brewing as Debtor and Bison as the Secured Party. That statement listed the specific pieces of equipment that had been designated as collateral.

On or about June 1, 1996, Pacific One Bank became the successor in interest to West One Bank.¹ On August 15, 1996, Pacific One Bank duly filed a UCC-3 statement indicating that the September 6, 1994, financing statement filed by West One Bank had now been assigned to Pacific One Bank. For simplicity, unless the context otherwise requires, I will refer to both West One Bank and Pacific One Bank as "the Bank."

1 It is unclear from the record whether Pacific One Bank acquired West One Bank, or simply acquired a portion of the latter's loan portfolio. The distinction is not significant to the issues in this case.

[*7] By August 1996, the Bank had identified the Star Brewing loan as a problem loan. Star Brewing had missed its July 1996 loan payment, and (at least in the Bank's view) otherwise failed to comply with its obligations under the loan agreement. On or about August 1, 1996, the Bank sent Star Brewing a letter declaring the loan to be in default. At the time, the balance owed on the loan was \$ 81,307.96. The Bank simultaneously seized \$ 54,573.91 in funds on account at the Bank as a setoff against the loan, which left a net balance owing of \$ 26,734.05. The letter also mentioned several incidents in which some of the collateral allegedly had been sold without the Bank's permission.

On August 5, 1996, representatives of Star and the Bank negotiated a forbearance

agreement. The Bank would not foreclose on the note, providing that Star Brewing paid off the loan, in full, by October 4, 1996. Star Brewing also would sell certain collateral, the proceeds of which were to be divided between Star and the Bank. The forbearance agreement was reduced to writing on or about August 14, 1996.

Sometime during August or September of 1996, Star Brewing and Johnson discussed terms under which the latter [*8] would invest \$ 150,000 in the company. However, Johnson did not want the risk associated with a traditional stock investment. They therefore agreed to a convertible loan, which carried an interest rate of 10 percent. The loan was to be amortized over 36 months, with monthly payments commencing on November 1, 1996. However, notwithstanding the amortization period, a balloon payment for the balance was due on June 30, 1997. Johnson was to receive 25,000 shares of common stock upon making the loan, and an additional 25,000 shares unless the note was pre-paid prior to June 30, 1997. Johnson also had the option, at any time, to convert all or any portion of the balance owed to common stock at the price of one dollar per share.

Approximately \$ 50,000 of the funds furnished by Johnson was to be used to pay off the outstanding loan from the Bank. The balance would be used to pay "expenses related to the proposed [public stock] offering and general working capital." Although not expressly stated on the Loan Term Sheet, Johnson and Star Brewing also anticipated spending a good deal of the loan proceeds to relocate the company from Oregon to Arizona.

Finally, Star Brewing and Johnson agreed [*9] that Johnson would "have a perfected first security position on the assets of Star. The primary asset is production equipment valued at approximately \$ 450,000." Had the equipment actually been worth that amount, there would have been enough collateral to

satisfy all of the secured parties. In hindsight, it appears that the equipment actually was worth no more than one-third of that figure.

The agreement between Johnson and Star Brewing was formalized on or about October 2, 1996, just two days before the deadline for Star Brewing to repay the Bank loan. Johnson and Star Brewing did not file a new financing statement, or sign a new security agreement. Nor did they notify Bison of their plans, though both were aware of Bison's, security interest in certain collateral of Star Brewing. Johnson deposited the \$ 150,000 in an account at Pacific One Bank. On October 4, 1996, \$ 54,293.60 was debited against that account and used to pay the Bank the balance owing on the 1995 loan.² Internal bank documents repeatedly use the term "paid off," though bank officials have offered various explanations for why that term does not accurately reflect the form of their agreement with Johnson. Officially, [*10] the Bank assigned the loan to Johnson, along with the loan documents, security agreements, and financing statement. However, Johnson admits that the terms of the original Bank loan to Star Brewing have largely been superseded by the terms of the Johnson loan to Star Brewing.³

2 It appears that about \$ 20,000 of the funds that previously had been seized by the Bank as a setoff against the loan had been released, which accounts for why the remaining balance was not \$ 26,734.05 as stated in the August 1, 1996 letter from the Bank.

3 Johnson hedges a bit by asserting that the loan still is governed by the original West One documents "to the extent that the terms thereof are not inconsistent with those set forth in the Term Sheet" (*i.e.*, the terms of the loan from Johnson to Star Brewing). That is a meaningless equivocation. Either the loan is governed by the terms of the original loan agreement, or it is not. The terms of the Johnson loan (*e.g.*, monthly payment,

maturity date, balloon payments, interest rate, option to convert to stock, penalty for pre-payment, etc.) are substantially different than the terms of the Bank loan. Johnson does not deny that those terms prevail over the contrary terms in the Bank loan.

[*11] On October 10, 1996, a UCC-3 form was duly filed indicating that the September 6, 1994, financing statement had now been assigned to Johnson. On October 16, 1996, Johnson paid \$ 30,000 to Star Brewing from the \$ 150,000 account that had been established at Pacific One Bank. On October 17, 1996, Johnson paid Star Brewing the \$ 65,686.41 that remained in that account. By December 1996, Star Brewing was in default on the Bison loan. The following month, Star Brewing defaulted on the Johnson loan. The liabilities of Star Brewing far exceed its assets. Bison and Johnson each assert a first priority to the collateral described in Bison's financing statement.

STANDARDS FOR EVALUATING MOTIONS FOR SUMMARY JUDGMENT

Federal Rule of Civil Procedure 56(c) authorizes summary judgment if no genuine issue exists regarding any material fact and the moving party is entitled to judgment as a matter of law. The moving party must show the absence of an issue of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 325, 91 L. Ed. 2d 265, 106 S. Ct. 2548 (1986). The moving party may discharge this burden by showing that there is an absence of evidence to support the nonmoving party's case. [*12] *Id.* When the moving party shows the absence of an issue of material fact, the nonmoving party must go beyond the pleadings and show that there is a genuine issue for trial. *Id.* at 324.

The substantive law governing a claim or defense determines whether a fact is material. *T.W. Elec. Serv., Inc. v. Pacific Elec. Contractors Ass'n*, 809 F.2d 626, 630 (9th Cir

1987). Reasonable doubts concerning the existence of a factual issue should be resolved against the moving party. *Id.* at 630-31. The evidence is to be viewed in the light most favorable to the nonmoving party, and all justifiable inferences are to be drawn in the nonmoving party's favor. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255, 91 L. Ed. 2d 202, 106 S. Ct. 2505 (1985). No genuine issue for trial exists, however, where the record as a whole could not lead the trier of fact to find for the nonmoving party. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587, 89 L. Ed. 2d 538, 106 S. Ct. 1348 (1986).

DISCUSSION

The instant case brings into sharp focus an inherent contradiction in the Uniform Commercial Code. Under certain circumstances, the [*13] same set of rules that is designed to provide stability and predictability in commercial transactions, and to protect settled expectations, may --if applied literally-- also be invoked to the opposite effect, disrupting settled expectations and introducing an element of instability and unpredictability in commercial transactions.

As a general rule, under Article 9 of the UCC, priority to collateral is determined by the order in which the claimants file a financing statement or otherwise perfect a security interest in the specified collateral, whichever occurs earlier. ORS 79.3120(5); D. Newell, *Security Interests in Personal Property* at 133 and 349 (1987). A financing statement may be filed before a security agreement is made or any credit is extended. ORS 79.4020(1). A subsequent security agreement and security interest will relate back to the existing financing statement, providing that statement was continuously maintained and encompasses the same collateral. ORS 79.3120(5)(a). That is true even if, in the interim, other creditors have filed their own financing statements and extended credit in reliance thereupon.

The rationale for this rule appears to be three-fold. [*14] First, it may take days or even weeks to complete the paperwork and consummate a loan or other commercial transaction. Measuring priorities from the date that the financing statement was filed provides some breathing room to complete the transaction. The prospective creditor --having checked the public records and found no prior financing statements-- may file his own financing statement and preserve his place in line. He now can extend credit without fear that another secured party will sneak into line ahead of him while the paperwork is being completed.

A second purpose for the rule is to provide a measure of certainty. A financing statement is a public record. Fixing priorities by the order of filing of a financing statement eliminates most of the potential debate as to when a particular security interest was perfected, or whether other parties had knowledge of that interest.

A third rationale for the relation-back rule is to allow for financing arrangements that involve future advances or floating liens. There are circumstances where it is desirable to secure a debt that has not yet been incurred, or to encumber collateral that the debtor does not yet possess, and to grant priority [*15] in that security to the party that has agreed to extend credit. A future advances clause can be very useful in facilitating commercial relationships that involve "frequent or continuing advancement of funds and extension of credits." *Emporia State Bank & Trust Co.*, 214 Kan. 178, 519 P.2d 618, 620 (Kan 1974). A classic example is a construction loan, where the borrower draws upon the loan amount as the project progresses. This enables the borrower to minimize interest costs by not having to borrow the entire sum in advance, and it enables the lender to better police the use of the loan proceeds.

A future advance clause also is appropriate when the lender is financing inventory or lending against receivables. It would be

unreasonable to require the lender to file a new financing statement each day. A future advances clause may also be used to secure a line of revolving credit. In addition, as a general rule, a loan that is refinanced should retain its priority since the junior creditor is unlikely to be prejudiced thereby. *See, e.g., Shutze v. Credithrift of America, Inc.*, 607 So. 2d 55, 60 (Miss 1992) (it would be anomalous to hold that a secured [*16] creditor loses his priority position when he refinances a debt).

Problems have arisen, however, because the drafters of Article 9 did not define a "future advance" or expressly limit the scope of such advances. That in turn has encouraged the proliferation of "dragnet" clauses in security agreements.⁴ A typical dragnet clause declares that the collateral that is the subject of the security agreement will secure not just the obligation contemplated by the present loan, but also any other obligation that the debtor presently has, or ever will have, towards the secured party. Typically the clause is included in the boilerplate text of the security agreement, where it may attract little attention from the "unsuspecting debtor." *Berger v. Fuller*, 180 Ark. 372, 21 S.W.2d 419, 421. Only later does its full significance become apparent.

4 Dragnet clauses predate the enactment of Article 9. Their propriety has been debated for at least a century. *See Western Farm Credit Bank v. Auza* (In re Auza), 181 BR 63, 66-67 (Bkrcty App 9th Cir 1995); H. Flechtner, *Inflatable Liens and Like Phenomena: Converting Unsecured Obligations into Secured Debt under U.C.C. Article 9 and the Bankruptcy Code*, 72 Cornell L. Rev. 696, 707-10 (1987). Historically, the courts have viewed such clauses with suspicion because of the great potential for abuse. *Id.*; *Emporia*, 519 P.2d at 621; *First National Bank v. First Interstate Bank*, 774 P.2d 645, 651-52 (Wyo 1989) (Urbigkit, J., dissenting and collecting

authorities); *Berger v. Fuller*, 180 Ark. 372, 21 S.W.2d 419, 421 (Ark 1929) (labeling mortgages containing dragnet clause as “anaconda mortgages” because “they enwrap the unsuspecting debtor in the folds of indebtedness embraced and secured in the mortgage which [the debtor] did not contemplate. . .”)

[*17] In one common scenario, the debtor enters into a security agreement with respect to a particular transaction, such as a car loan or mortgage. The debtor later incurs an unrelated (and on its face, unsecured) obligation to the same creditor, such as an overdraft on a checking account. The creditor deems the unrelated obligation to be a “future advance” subject to the dragnet clause in the original security agreement, with the same priority date as the original debt, and repossesses the collateral.⁵

5 *Cf* *Community Bank v. Jones*, 278 Ore. 647, 566 P.2d 470 (1977) (holding that overdraft was not a “future advance”); *Security National Bank v. Dentsply Professional Plan*, 1980 OK 136, 617 P.2d 1340 (Okla 1980) (opposite result); *Emporia*, 214 Kan. 178, 519 P.2d 618 (asserting right to foreclose on home to satisfy unrelated debt incurred eight years after original debt that had been secured by home); *In re Eshelman*, 1972 U.S. Dist. LEXIS 15739, 10 UCC Rep. Serv 750, 972 WL 20838 (Bkrcty ED Penn 1972) (asserting right to automobile, which was security for car loan, to satisfy unrelated debt); *Hulsart v. Hooper*, 274 F.2d 403 (5th Cir 1960) (asserting right to real property securing mortgage to satisfy unsecured debt for goods sold on open account); *In re Prichar*, 170 BR 41 (Bkrcty NDNY 1994).

[*18] A variation of this scenario is illustrated by the case of *State Bank of Sleepy*

Eye v. Krueger, 405 N.W.2d 491 (Minn App 1987). The debtor borrowed money from A to buy a combine, and signed a **security agreement** covering all equipment. The debtor repaid most of that loan. The debtor then borrowed money from B, secured by specific equipment. Before making that loan, B first checked with A to verify the outstanding balance on the prior loan. B promptly perfected its security interest. The debtor later borrowed money from A to finance crop operations. When the debtor subsequently filed for bankruptcy, A successfully asserted that the entire sum owing, including the subsequent loans that A made to the debtor with knowledge of B’s perfected interest, were entitled to the same priority date as the original **financing statement** and thus had priority over B’s intervening security interest. *See also* *First National Bank v. First Interstate Bank*, 774 P.2d 645 (Wyo 1989) (similar transaction involving an airplane as collateral.) The practice of making new loans, which for priority purposes are deemed to **relate back** to the date of the original **financing statement**, [*19] is sometimes referred to as “feeding the priority.” *See* *Newell, Security Interests in Personal Property* at 133.

The dragnet clause may also be invoked to secure an antecedent unsecured debt. For instance, in *Lundgren v. National Bank of Alaska*, 756 P.2d 270 (Ak 1987), the debtor borrowed money from a bank. The debtor later obtained a second (unrelated) loan from the bank, secured by different collateral. The security agreement for the second loan contained a dragnet clause, but did not mention the first loan. Nonetheless, when the debtor defaulted, the bank foreclosed on the collateral given to secure the second loan, and asserted that under the terms of the dragnet clause it became security for both loans.

The use (and abuse) of dragnet clauses has not been limited to obligations between the same parties. Secured parties sometimes

purchase unsecured obligations that the debtor owes to a third party, and then assert that the “after-acquired debt” is within the scope of the dragnet clause and therefore is a secured debt.⁶ If successful, this ploy effectively defeats the rights of intervening secured creditors with a duly perfected security interest in the [*20] collateral.⁷

6 *Cf* *Pongetti v. Bankers Trust*, 368 So. 2d 819 (Miss 1979) (secured creditor purchased unrelated judgment against debtor owned by third party so creditor could use his dragnet clause in attempt to collect that judgment); *Ex parte Chandler*, 477 So. 2d 360 (Ala 1985) (bank with security agreement purchased unsecured note so it could collect the note by foreclosing on the security); *Gillet v. Bank of America*, 160 N.Y. 549, 55 N.E. 292 (NY 1899).

7 *Cf* *In re Goodman Ind.*, 21 BR 512 (Bkrcty D Mass 1982) (rejecting contention that unsecured debt can be transformed into secured debt by conveyance to secured creditor holding security agreement containing dragnet clause); *Thorp Sales Corp. v. Dolese Brothers Co.*, 453 F. Supp. 196, 199 (WD Okla 1978) (warning that there “is a great deal of danger inherent in reading agreements in a manner which allows a party to buy up claims of third persons and bring such claims within a security agreement or mortgage held by that party.”)

[*21] Dragnet clauses also have figured prominently in attempts to create “after-secured debt” or “floating secured parties.” Typically, the debtor borrows money from A, and signs a security agreement containing a dragnet clause. The debtor also owes money to B, which is unsecured debt. B purchases the security agreement from A, and transforms the unsecured debt into a secured debt with a priority date of the original security agreement.

B then uses that priority to defeat the rights of other secured creditors. *See* G. Gilmore, *Security Interests in Personal Property* § 35.2, at 917-18 (1965) (categorizing such arrangements as an abuse of the future advances clause, if not an “outright fraud”); B. Campbell, *Contracts Jurisprudence and Article Nine of the Uniform Commercial Code*, 37 Hastings LJ 1007, 1071 (1986) (denouncing such conduct as “overreaching” and “bad faith”).

An alternative variation is “cutting into the line.” The debtor borrows money from A, and signs a security agreement containing a dragnet clause. The debtor also borrows money from B, and signs a security agreement covering the same collateral. Both are duly perfected. C wants to lend money to Debtor, [*22] but doesn’t want to be third in line. C therefore purchases the security agreement from A, and then lends additional sums to Debtor, which C contends are entitled to the same priority as the original note to A (and therefore defeat the claims of B.) *Cf* *Rutledge v. Verdigris Valley Economic Dev. Corp.*, 186 BR 517 (Bkrcty ND Okla 1995). That is the scenario in the case *sub judice*.

If the concept of “future advances” is broadly defined, then many of these practices would be permissible under the UCC. Once a prospective creditor has filed a financing statement, that person would have priority as to the full value of that collateral not just for any existing obligations, but also for all obligations of any sort that might exist in the future even though none were contemplated at the time. For instance, a creditor could lend the debtor one thousand dollars and file a financing statement covering all equipment owned by the debtor. Years pass, during which time other creditors lend money and perfect security interests on various pieces of equipment, in the belief that there is only one thousand dollars in senior debt ahead of them. The original secured party then [*23] decides to loan the debtor an additional

one million dollars. That new loan would be entitled to priority over all intervening creditors, even though the loan was made with full knowledge of the prior creditors.

Alternatively, the security documents could be sold to a new prospective lender, who would then leapfrog ahead of all existing secured creditors. Indeed, as Johnson candidly conceded during oral argument, so long as the deal was “structured” correctly, the original security documents could even be sold (or “assigned”) to ten prospective new lenders, each of whom would be entitled to priority over the existing secured creditors for any and all new loans that those lenders were willing to make. Transactions such as this bear little relation to traditional “future advances” such as construction loans, flooring agreements, and the financing of receivables and inventory.

Over the years, courts have strived to curb what they considered to be abuses of dragnet and future advances clauses. Much of the case law to date has focused upon the rights of the debtor in such situations, *i.e.*, whether the collateral may be taken in satisfaction of what had been an unsecured debt. Of equal [*24] importance is the rights of other creditors. Secured creditors and lienholders unexpectedly may find themselves transformed into undersecured or (effectively) unsecured creditors. General creditors may discover that one of their own has leapfrogged to the head of the line by transforming unsecured debt into secured debt.⁸

8 *Cf* In re Eshelman, 1972 U.S. Dist. LEXIS 15739, 10 UCC Rep Serv 750, 1972 WL 20838 (“It seems wholly unjust . . . for a court of equity . . . to permit the bank to couple to a small remaining balance on an earlier loan a wholly unrelated indebtedness over six times its size and defeat what appears to be a source of funds for general creditors. In our view this would be an impermissible

extension of a future advances clause authorized by § 9-204(5) of the [UCC].”)

The classic statement of the majority rule is that “no matter how the clause is drafted, the future advances, to be covered, must be of the same class as the primary obligation and so related to it that the consent of the debtor [*25] to its inclusion may be inferred.” *Community Bank v. Jones*, 278 Ore. 647, 666, 566 P.2d 470 (1977) (internal punctuation omitted). Oregon follows that rule.⁹ *Id.* That standard originally was devised to resolve conflicts between the debtor and creditor, hence the emphasis upon the implied consent of the debtor. However, the consent of the debtor cannot be the sole factor that determines the rights of third parties, or else the debtor could align itself with one creditor and thereby defeat the rights of all other creditors.

9 In a few jurisdictions, such “future advances” have been held to be subordinate to an intervening lien of which the first creditor had actual knowledge, unless the first creditor was contractually obliged to extend the future advance. *See, e.g.*, *In re Johnson*, 124 BR 648 (Bkrtcy ED Penn 1991) (following Pennsylvania law); *La Cholla Group v. Timm*, 173 Ariz. 490, 844 P.2d 657 (Ariz App 1992) (explaining the rationale for the rule).

In the instant [*26] case, a prospective third party creditor, Johnson, and the debtor, Star Brewing, joined together to obtain for Johnson a first priority to the collateral ahead of a prior secured creditor, Bison Trust. The “consent of the debtor” is not only inferred, it is express. That begs the question, though, of whether the debtor and Johnson could agree, amongst themselves, to allow Johnson to leapfrog to the head of the line and obtain priority over the claims of Bison Trust. The “consent of the debtor” rule is not in itself determinative because it ignores the vested

rights and reasonable expectations of other existing creditors such as Bison Trust. See Flechtner, *Inflatable Liens*, 72 Cornell L. Rev. at 713.

In *Community Bank*, the Oregon Supreme Court applied an extension of the “same class” rule to a priority dispute between secured creditors. The bank had a flooring agreement with the debtor, an auto dealer. Subsequently, other creditors perfected security interests. The bank clearly was first in line to the collateral covered by the security agreement, at least to the extent of the loans that the bank had made to the debtor pursuant to the flooring agreement. However, the debtor [*27] also had overdrawn its checking account at the bank. The bank, invoking the dragnet clause in the security agreement, asserted that the overdrafts constituted a future advance. Accordingly, the bank contended, the overdrafts were covered by the security agreement with a priority date retroactive to the filing of the original financing statement, and thus had priority over the perfected security interests of intervening creditors.

The Oregon Supreme Court disagreed. The court first determined that, under Oregon law, a priority contest between creditors is governed by equitable principles. *Id.*, 278 Ore. at 651. The court then decided that, notwithstanding the dragnet clause in the security agreement, the overdrafts were not covered by the security agreement and were not entitled to priority over intervening secured creditors. *Id.* at 666-67. The court reasoned that:

Although this transaction appears in form to conform to the security agreement, we find its substance to be different in kind and not related to the purpose intended by the parties when they entered into the . . . security agreement. *To hold otherwise would be to allow a creditor [*28] secured as to one*

line of financing to retroactively secure a second separate indebtedness (not included in the loan section of the security agreement), and to step ahead of others holding perfected security interests in the same property. To permit such a belated reordering of priorities would do little to lend stability to commercial transactions. Consistency and predictability in commercial transactions is one of the purposes of the [UCC]. We find the [second] transaction not to be covered by plaintiff’s security agreement with Jones.

Id. at 666-67 (emphasis added). The court did not reject entirely the idea that future advances may be secured by a single financing statement and security agreement, and be given priority retroactive to the filing of the original financing statement. Indeed, the security agreement in *Community Bank* specifically contemplated a flooring agreement by which new funds were regularly advanced to the debtor, and the court gave effect to that flooring agreement. However, the overdrafts were in no way related to the course of financing contemplated by the parties at the time they entered into the original security agreement. [*29] No additional collateral was provided, as would be the case if the funds had been used to acquire additional inventory. Nor would giving the bank a first priority with respect to the overdrafts further the objectives that the future advances clause originally was intended to serve. Rather, it was a windfall for the bank, at the expense of other secured creditors.

Arguably, the Oregon Supreme Court’s decision in *Community Bank* may be contrary to the literal language of the UCC. Once a creditor files its financing statement, Article 9 purports to give that creditor priority not only as to any credit that it extends to the debtor

before junior creditors file their financing statements and extend credit, but also as to any credit that the senior creditor *subsequently* extends to the debtor so long as the financing statement remains continuously in effect and is timely renewed. See UCC §§ 9-204(3), 9-312(5) and (7), 9-402(1). In theory, once a creditor has its foot in the door, it may “feed that priority” by lending additional funds to the debtor with impunity, even if the effect of those additional loans is to render other security interests worthless. See UCC [*30] § 9-204(3) and Official Comment 5; UCC § 9-312(5) and (7) and Official Comments 5, 6, and 7; UCC § 9-402(1) and Official Comment 2; 1972 Amendments to Article 9, Official Comments E-39 through E-42. Article 9 does not define the term “future advances” nor does it expressly require that the “future advance” be related in any way to the purpose or form of the original loan.

On the other hand, one of the principal drafters of Article 9, Professor Grant Gilmore, has stated that Article 9 was “certainly not” intended to overrule the pre-Code cases limiting the application of “dragnet” clauses. G. Gilmore, *Security Interests in Personal Property* § 35.5 at 932. Professor Gilmore also observed that:

Legitimate future advance arrangements are validated under the Code, as indeed they generally were under pre-Code law. This useful device can, however, be abused; it is abused when a lender, relying on a broadly drafted clause, seeks to bring within the shelter of his security arrangement claims against the debtor which are unrelated to the course of financing that was contemplated by the parties. In the dragnet cases, the courts have regularly curbed such abuses: no matter [*31] how the clause is drafted, the future

advances, to be covered, must “be of the same class as the primary obligation . . . and so related to it that the consent of the debtor to its inclusion may be inferred.” The same tests of “similarity” and “relatedness,” vague but useful, should be applied to [future advances under Article 9.]

Id. Thus the views expressed by the Oregon Supreme Court in *Community Bank* may in fact be consistent with Article 9.

The *Community Bank* decision does introduce an element of uncertainty by effectively affording retroactivity only to legitimate future advances, even though neither the UCC nor *Community Bank* establishes a bright line standard for determining what is a legitimate future advance.¹⁰ The Oregon Supreme Court implicitly decided that any uncertainty created by its decision was more than offset by the reduction in abuse of future advance and dragnet clauses.

10 Technically, the *Community Bank* court reached its result by deciding that, notwithstanding the dragnet clause, the particular transaction was not subject to the existing **security agreement**. However, the debtor and the Bank could simply have entered into a new **security agreement** expressly covering the overdrafts, which would have **related back** to the filing of the original **financing statement**. The debtor’s consent, but not that of other creditors, would have done nothing to prevent the “belated reordering of priorities” that troubled the court. Consequently, the real issue in *Community Bank* was whether the unrelated overdrafts should be regarded as a “future advance” that **relates back** to the original **financing statement**.

[*32] The decision in Community Bank thus reflects a policy decision by the Oregon Supreme Court to use that court's equitable powers to curb what it perceived to be an abuse of the dragnet clause. That decision has never been overruled or even called into question by the courts of Oregon. A federal court sitting in diversity is bound by the decisions of the state's highest court on matters of state law. This court therefore must give effect to the public, policy articulated in Community Bank.

In the case *sub judice*, had Johnson simply extended credit to Star Brewing, secured by the existing collateral (*i.e.*, not a purchase money security interest), at best Johnson would have been third in line behind the Bank and Bison. Johnson and Star Brewing therefore devised a plan to let Johnson leapfrog in front of other secured creditors. Notwithstanding the legal fiction that the Bank loan was merely "assigned" to Johnson, as a practical matter Johnson bought out the Bank's position so that he could acquire the Bank's financing statement and security documents and take the Bank's place in line ahead of Bison.

With full knowledge of Bison's position, Johnson then extended an additional [*33] \$ 100,000 in loans to Star Brewing. There was little or no infusion of additional collateral; rather, the money was used to move the company to Phoenix, and to finance an (apparently abortive attempt at an) initial public offering of the company's stock. The net effect of Johnson's actions was to render Bison's security agreement worthless by tripling the amount of senior debt secured by the same collateral.

The \$ 100,000 in new funds provided by Johnson was entirely unrelated to the course of financing originally contemplated by the Bank and Star Brewing. This was not part of a flooring agreement or other arrangement for financing inventory or receivables. Nor was this related to an existing line of revolving credit. Rather, the loan from the Bank to Star

Brewing had been a single isolated transaction. The Johnson loan to Star Brewing thus implicates the very "belated reordering of priorities" to "retroactively secure a second separate indebtedness" that the Community Bank court condemned. 278 Ore. at 666-67.

Johnson argues that Bison Trust has not been harmed. Bison accepted a junior security interest in the first place, knowing (or charged with the knowledge) [*34] that there was a "future advances" clause in the security agreement between the Bank and Star Brewing. In theory, the Bank might have used that clause to secure additional loans that it would make to Star Brewing. Consequently, the argument goes, Bison has no cause to complain if additional debts are now secured through the future advances clause, albeit those debts were to a third party instead of to the Bank.

At the outset, the decision in Community Bank indicates that, at least in Oregon, the future advances clause will be narrowly construed. Thus it is doubtful whether the Bank, having once loaned money to Star Brewing, would forever after be entitled to priority over all other creditors for any and all future loans that the Bank might make to Star Brewing, including loans not contemplated at the time of the original loan or related thereto.

In addition, the "assume the worst" philosophy advocated by Johnson --and by some commentators¹¹ -- prejudices debtors and inflates the cost of borrowing. If a one thousand dollar senior debt may be transformed into a one million dollar senior debt at some later date, with a retroactive priority, it would be foolish for a junior creditor [*35] to extend additional credit against that collateral, regardless of its value. Consequently, the first person to file a financing statement against the collateral would effectively have a monopoly on that collateral, regardless of how much equity the debtor has in that collateral. *Cf* Shutze, 607 So. 2d at 72 (debtor who naively executes mortgage containing dragnet clause

may “find himself locked to that particular lender for the rest of his life”) (Lee, dissenting, quoting S. Nelson and D. Whitman, *Real Estate Finance Law* 885-86 (2d ed 1985)); La Cholla Group, 844 P.2d at 659 (dragnet clause limits debtor’s ability to obtain financing from anyone other than original debtor). That possibility also encourages the secured party to oversecure the original debt, e.g., by taking a security interest in “all equipment, accounts, and proceeds thereof.” The prospect that the secured party can sell the security documents to other creditors also creates an incentive to oversecure the original obligation.

11 See, e.g., Walt, *The Case for Laundered Security Interests*, 63 Tenn L Rev 369 (1996)(junior creditor should assume the worst and price its loan to the debtor accordingly).

[*36] Allowing the security documents to be sold to third parties, who may themselves “feed the priority,” creates a further set of problems. In deciding to lend money to Star Brewing, Bison reasonably could have assumed that a professional lender such as the Bank, with its conservative lending practices, was unlikely to do anything rash such as extending additional credit to an insolvent debtor without obtaining additional collateral. At the time Bison decided to extend credit to Star Brewing, Johnson was not even in the picture. If a hypothetical assignee can also “feed the priority,” then other creditors must always assume a worst-case scenario. The more hypothetical risks the prospective lender must anticipate, the higher the cost of borrowing. It is difficult to identify any offsetting social benefits that are gained by allowing a new lender such as Johnson to cut into the line and be entitled to retroactive priority.¹²

12 This court is reluctant to place too much weight upon factors such as the identity of the senior creditor. Arguably such considerations are foreign to an

Article 9 that is premised upon objectively verifiable criteria such as public filings as opposed to actual knowledge or other less verifiable criteria. Consequently, the focus of any attempt to curb perceived abuses of dragnet and future advance clauses probably should be upon defining permissible future advances in a manner that allows any interested person to determine what additional loans, if any, will be entitled to the same priority as the original advance, without regard to whether the person extending that additional credit is the original lender or an assignee.

[*37] The incantation that prospective lenders “are charged at their peril to inquire of the debtor and prior secured parties,” Shutze, 607 So. 2d at 63, is no answer when there is little that the prospective lender could discover if it inquired of prior secured parties:

“Q: Do you have a dragnet clause in your security agreement?”

“A” Sure do.”

“Q: Do you intend to extend additional loans to Debtor in the future?”

“A: Don’t really know. Maybe I will someday. Maybe I won’t. Or I might assign the security agreement to someone else who will extend credit to Debtor, or who holds some presently unsecured notes from Debtor. Or maybe I’ll purchase some unsecured notes of Debtor’s myself and cloak them with my security interest. Or maybe I won’t have any business dealings with the Debtor ever again.”

At that point, the prospective lender has four options: (1) refuse to lend money to the debtor, which effectively makes the debtor a captive of the original lender as to all collateral covered by the original security agreement, (2) attempt to obtain a subrogation agreement from the prior secured party, and then pass along any cost incurred to the [*38] debtor, (3) purchase or pay off the prior obligation, and pass along the added costs to the debtor, or (4) proceed with the loan in the absence of a subrogation agreement, and charge a higher rate of interest to compensate for the increased risk.¹³ In the long run, it is the debtor who will suffer, while there is little concomitant societal benefit outside the context of true “future advance” arrangements.

13 In theory, the prospective lender could obtain a commitment from the debtor not to borrow additional funds from the senior lender. Indeed, as part of the agreement by which Bison agreed to lend funds to Star Brewing, the latter apparently promised not to further encumber the collateral. The problem is how to enforce such a promise. Star Brewing arguably breached its contract by entering into the agreement with Johnson. However, as a practical matter, any judgment that Bison might obtain against Star Brewing for breach of contract is likely to be uncollectible.

This court has found a handful of cases [*39] involving “future advances” made by an assignee of the original secured party. In *re Cycle Products Distributing Co.*, 118 BR 643 (Bkrcty SD Ill 1990), concerned a floating lien arrangement in which the creditor advanced inventory to the debtor and took a floating lien on that inventory and the proceeds therefrom. The creditor, Dunlop Tire and Rubber Corporation, later transferred substantially all of its assets to Dunlop Tire Corporation. The debtor subsequently filed for Chapter 11

protection. The court held that Dunlop Tire Corporation had a security interest in the debtor’s inventory and proceeds, with a priority date as of when the original security agreement was perfected.

The decision in *Cycle Products* is not inconsistent with *Community Bank*. In *Cycle Products*, there was no abuse of the future advances clause. On the contrary, the clause is specifically intended to cover circumstances just such as this. The subsequent advances were not unrelated transactions, but a continuation of the existing pattern of business. *Cf Credit Alliance Corp. v. Amhoist Credit Corp.*, 74 Ore. App. 257, 702 P.2d 1121 (1985) (secured creditor was entitled to priority [*40] for future advances that were part of ongoing pattern of lending that included dozens of advances). Any putative creditor who was aware of that ongoing arrangement would expect it to continue and would anticipate that such advances would have the original priority date. All of the debts subject to the security agreement were incurred in good faith reliance upon the existence of that security agreement. The assignment of the security agreement was pursuant to a bulk transfer of the creditor’s assets to a related or successor company.¹⁴ It was not part of a scheme to transform unsecured debt into secured debt, or to obtain an unfair advantage over other creditors by obtaining a higher priority. The facts of the case *sub judice* stand in stark contrast to those of *Cycle Products*.

14 *Cf Georgia Railroad Bank & Trust Co. v. McCullough*, 241 Ga. 456, 246 SE2d 313 (Ga 1978) (although state law ordinarily forbids application of dragnet clauses to obligations other than those arising between the original contracting parties, exception exists when bank’s assets, including security agreement, were acquired by merger with second bank.)

[*41] In re Robert E. Lee Enterprises, Inc., 980 F.2d 606 (9th Cir (Or) 1992), likewise concerned a *bona fide* future advances arrangement. The debtor was a mobile home dealer. The creditor, a finance company, entered into a flooring arrangement by which the creditor routinely advanced the funds required to purchase additional mobile homes, and in turn obtained a floating security interest in all of the debtor's inventory and the proceeds thereof. The finance company later assigned its security agreement to a second finance company, who continued to finance the dealer's inventory. The dealer later filed for bankruptcy. The Ninth Circuit concluded that the second finance company had a security interest in the remaining inventory with a priority as of the date that the original security agreement had been perfected.

Again, there was no abuse of the future advances clause. Flooring arrangements such as this are squarely within the purpose of that clause. The creditor did not attempt to transform an unrelated debt into secured debt, or to obtain an unfair advantage over other creditors. All of the debts subject to the security agreement were incurred in good faith reliance [*42] upon the existence of that security agreement. The assignment of the security agreement was made in the regular course of business, to a second finance company that continued the existing flooring arrangement. The assignment was not a scheme to capture the financing statement so the first lender's priority could be stuffed with unrelated debts.

Although the specific holding in Robert E Lee is readily distinguishable, that opinion also contains sweeping dictum that purports to extend the holding to all cases in which a security agreement containing a future advances clause is assigned. That dictum, while meriting consideration by this court, is not controlling since it purports to decide questions that were not before the Robert E Lee court and that would not have altered the rights of the

parties to that particular case. This court is particularly reluctant to ascribe controlling status to dictum in a diversity case, where the circuit is merely interpreting state law or projecting how the state courts would rule if presented with the same question.

The Robert E Lee court categorically declared that Oregon law "allows an assignee to make future advances and retain the [*43] priority of his assignor." Id. at 608. In the context of the facts present in Robert E. Lee, that was true. However, the Robert E. Lee court did not discuss whether Community Bank might require a different result in other circumstances. That is understandable, since Robert E Lee did not concern an attempt to procure a "belated reordering of priorities." Community Bank, 278 Or at 667. By contrast, Community Bank is directly applicable to the case *sub judice*. Moreover, Robert E. Lee concerned legitimate advances. A continuation of the existing financing arrangement was a development that other creditors reasonably could have anticipated, and which did not prejudice the other creditors.

To the extent the dicta in Robert E. Lee is inconsistent with the views expressed by the Oregon Supreme Court in Community Bank, and with this court's forecast of how the Oregon Supreme Court would rule if confronted with the specific questions presented in this case, this court declines to follow that dicta.

A final consideration is the extent to which Bison Trust has been prejudiced by the transaction with Johnson. If Johnson had [*44] furnished new tangible collateral to secure the loan -- as with a purchase money security interest -- then Bison Trust would be in no worse position than it was prior to the transaction with Johnson, at least up to the value of the new collateral. Alternatively, if -- by providing "new value" to Star Brewing -- Johnson also had increased the total value of the collateral securing the note from Star

Brewing to Bison Trust, then the latter would not be injured by the transaction. However, little if any of the funds provided by Johnson were used for that purpose. Bison's security interest covered certain brewery equipment. The funds provided by Johnson were used to finance an attempted stock offering and to relocate the company from Oregon to Arizona. Some of the funds may also have been used for general operating expenses. Since the "new value" did not substantially increase the value of the collateral securing Bison's note, while purporting to triple the senior debt being secured by the collateral, Bison clearly has been prejudiced by this transaction.

The one exception is the balance that was outstanding on the note from Star Brewing to the Bank. Since Star Brewing would have been [*45] obliged to pay that sum anyway, and the Bank had priority over Bison Trust, the latter is not unfairly prejudiced if Johnson assumes the Bank's priority status with respect to those sums. In that regard, it is no different than if the loan had been assigned to another bank. Although the terms of the loan have been altered somewhat -- which in some instances may give a junior creditor grounds to object -- Star Brewing was in default on the loan anyway, hence the risk to Bison Trust will not be increased substantially by the change in terms.

This court concludes that Johnson has priority over Bison Trust as to the amount outstanding on the Bank loan that was either "assumed" or paid off by Johnson, which was approximately \$ 54,253.60. That amount may be subject to adjustment for accrued interest less the proportionate amount of any loan payments that Star Brewing made to Johnson before defaulting. Next, Bison Trust has priority over Johnson with regard to the particular collateral securing the Bison Trust note.

In its moving papers, Bison also asked the court to invoke the equitable doctrine of

"marshaling." It is a basic principle of equity that where a senior creditor has recourse [*46] to two funds and a junior creditor has recourse to but one of them, the senior creditor must seek to satisfy itself first out of the fund in which the junior creditor has no interest providing the senior creditor can do so without prejudice to its claims. *Community Bank*, 278 Or at 679.

Johnson is a senior creditor with regard to the balance of the original Bank loan, and -- at least on paper -- has recourse to a broader range of collateral than does Bison Trust, the latter being limited to recourse against certain equipment. This is a classic circumstance for invocation of the marshaling rule, assuming that there is other collateral. What makes this case somewhat unusual is that Johnson also is a creditor with regard to the additional \$ 100,000 (approximately) that he loaned to Star Brewing. The question is whether Johnson must first attempt to satisfy his senior claim from the collateral not available to Bison, even at the expense of Johnson's second claim which also is secured by all of Star Brewing's Assets.

The parties did not brief this particular scenario, and the point may be moot if it turns out that there is no separate fund of collateral apart from that [*47] to which Bison has access. I will defer this issue for the moment, and ask the parties to promptly advise the court whether there is a separate fund of collateral, the estimated value of that collateral, and whether the parties have been able to reach agreement regarding the division of the collateral. If there is a dispute, then I will give the parties an opportunity to submit supplemental briefs on this issue.

CONCLUSION

The cross-motions for summary judgment (# 50-1 and # 64-1) are each GRANTED IN PART AND DENIED IN PART. Johnson has priority over Bison Trust with regard to the amount outstanding on the Bank loan that was

assumed or paid off by Johnson, which is approximately \$ 54,253.60 (subject to adjustment for accrued interest less the proportionate amount of any loan payments that Star Brewing made to Johnson before defaulting.) Next, Bison Trust has priority over Johnson with regard to the particular collateral securing the Bison Trust note.

The court will defer a ruling on Bison's request to invoke the doctrine of marshalling. The parties shall promptly advise the court whether there is a separate fund of collateral, the estimated value of that collateral, [*48] and whether the parties have been able to reach agreement regarding the division of the collateral. Upon resolution of that issue, counsel for Johnson shall prepare a form of judgment consistent with this opinion that resolves all remaining issues in this case.

DATED this 30 day of September, 1997.

John Jelderks

United States Magistrate Judge

ORDER

JELDERKS, Magistrate Judge:

The cross-motions for summary judgment (# 50-1 and # 64-1) are each GRANTED IN PART and DENIED IN PART. Johnson has priority over Bison Trust with regard to the amount outstanding on the Bank loan that was assumed or paid off by Johnson, which is approximately \$ 54,253.60 (subject to adjustment for accrued interest less the proportionate amount of any loan payments that Star Brewing made to Johnson before defaulting). Next, Bison Trust has priority over Johnson with regard to the particular collateral securing the Bison Trust note.

The court will defer a ruling on Bison's request to invoke the doctrine of marshalling. The parties shall promptly advise the court whether there is a separate fund of collateral, the estimated value of that collateral, and

whether the parties have been able to reach [*49] agreement regarding the division of the collateral. Upon resolution of that issue, counsel for Johnson shall prepare a form of judgment consistent with this opinion that resolves all remaining issues in this case.

DATED this 30th day of September, 1997.

John Jelderks

United States Magistrate Judge