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COURT OF APPEALS
DIVISION III
STATE OF WASHINGTON

Court of Appeals Case No. 359263
Spokane County Superior Court Case No. 17-2-01864-8

STATE OF WASHINGTON, COURT OF APPEALS
DIVISION III

In re: BATES DRUG STORES, INC., dba BATES PHARMACY &
MEDICAL SUPPLY

CARDINAL HEALTH,

Appellant/Petitioner/Creditor

vs.

BANNER BANK, a Washington corporation,

Respondent/Secured Creditor

REPLY BRIEF OF APPELLANT CARDINAL HEALTH 110, LLC

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I. STANDARD OF REVIEW IS DE NOVO

Respondent, Banner Bank, would have this Court apply a substantial evidence standard to the entirety of this review. This displays a fundamental misunderstanding both of the proper use of the substantial evidence standard, and also about the issues before the Court on this appeal.

The substantial evidence standard is applied most often in the review of administrative agency actions. See e.g. *Hensel v. Dept. of Fisheries*, 82 Wash. App. 521, 919 P.2d 102 (Div. 2 1996); *Motley-Motley, Inc. v. State*, 127 Wash. App. 62, 110 P.3d 812 (Div. 3 2005). Even then, the standard only applies to a review of findings of fact. See e.g. *Fox v. State, Dept. of Retirement Systems*, 154 Wash. App. 517, 225 P.3d 1018 (Div. 1, 2009).

Banner Bank would have this Court view this case as one which only involves an issue of fact. Appellant, Cardinal Health, submits that this case involves a review of both findings of fact and conclusions of law. The issues of law include whether Banner Bank had a perfected security interest in general intangibles, and whether a subordination agreement can

be used to create new security interests in collateral for a party that are not mentioned in that party's UCC Financing Statement.

While issues of fact can be reviewed based on a substantial evidence standard, conclusions of law should be reviewed de novo. *MH 2 Co. v. Wang*, 104 Wash. App. 680, 16 P.3d 1272 (Div. 3 2001). But this case is not a review of agency action, and truly is more like a review of a summary judgment motion. As Cardinal Health has argued previously, where a trial court's action resembles that of a summary judgment, the Court of Appeals reviews the trial court decision de novo. *Brinkerhoff v. Campbell*, 99 Wn. App. 692, 994 P.2d 911 (Div. 1 2000).

II. THE "UCC FILING" MYSTERY EXPLAINED

Banner Bank goes on at length about the term "UCC Filing" in the subordination agreement, and how that actually refers to Cardinal Health's Financing Statement and not to Banner Bank's Financing Statement. Banner Bank's response brief displays near apoplexy in addressing this issue, going so far as to accuse Cardinal Health of intentionally misleading the Court. This completely misses, and fails to address, the point of Cardinal Health's argument.

Security interests are typically manifested by two separate documents: a security agreement and a financing statement. Initially, the security interest is created in a security agreement between the creditor and debtor. RCW 62A.9A.102(a)(74). In addition, a financing statement is prepared and publicly filed, which has the effect of putting other creditors (current and future) on notice of the security interest and therefore perfects that security interest, making it enforceable as against the interest of other creditors. RCW 62A.9A.310; 62A.9A.322. With some exceptions (none of which apply here) creditors are only held to be on notice of those security interests which have been properly perfected through filing. *Id.*

The subordination agreement does in fact reference security interests reflected in UCC financing statements. Both Cardinal Health and Banner Bank made UCC filings in the form of financing statements. Pursuant to the statutory law cited above, Cardinal Health was deemed to be on notice of the perfected security interests in the Banner Bank UCC Filing. There is nothing in the subordination agreement which incorporates Banner Bank's security agreement with the debtor, Bates Drug Stores. In fact, there is no evidence in the agreement or in the entire record that at the time of entering the subordination agreement Cardinal Health had any

time of entering the subordination agreement Cardinal Health had any knowledge of the terms of the security agreement between Banner Bank and Bates Drug Stores; the only security interests of which Cardinal Health had knowledge were those publicly filed in Banner Bank's financing statement.

Cardinal Health's emphasis on Banner Bank's financing statement is because that is the only notice it had of Banner Bank's claimed security interests at the time the subordination agreement was entered. Therefore, if we must look at the intent of the parties as Banner Bank vehemently argues, it is clear that Cardinal Health only thought it was subordinating to those perfected security interests in Banner Bank's UCC Filing.

It is now argued by Banner Bank that the security interests identified in its security agreement with Bates Drug Store are in fact much broader and inclusive than those listed in its publicly filed financing statement. Banner Bank argues that when the subordination agreement says that Cardinal Health subordinated its agreement to Banner Bank's security interests, it includes not only those in the Financing Statement but also those in its security agreement. This becomes a classic case of bait and switch; Banner Bank shows Cardinal Health its financing statement,

which reflects that Banner Bank only claims a perfected security interest in inventory, equipment and accounts, and induces Cardinal Health to enter an agreement subordinating its interests to those of Banner Bank. Cardinal Health does so, believing that the only security interests in question are those in inventory, equipment and accounts. Then Banner Bank flourishes its security agreement and says, in essence, “Ha ha, we fooled you, we have a security interest in EVERYTHING!”

This is the basis of Cardinal Health’s argument in its Appellate Brief concerning priority and perfection and references to the UCC Filing. Cardinal Health could not have subordinated its perfected security interests to Banner Bank’s unperfected security interests without specifying this intent in the subordination agreement. Cardinal Health believed it was subordinating its interests to those of Banner Bank that were publicly filed and perfected.

III. CUSTOMER LISTS, LICENSES, AND GOODWILL ARE GENERAL INTANGIBLES

Banner Bank gleefully attempts to discredit the cases Cardinal Health cited in support of its contention that customer lists, licenses, and goodwill are general intangibles. However, after mocking Cardinal Health for its choice in cases, Banner Bank is unable to present a single case that

supports its position that customer lists, licenses, and goodwill are accounts.

There are in fact multiple cases, mostly from Bankruptcy District Courts, that classify customer lists as general intangibles, though there is little to no discussion of this classification. See e.g. *In re SEE Intern Group*, 198 B.R. 667 (Bankr. W.D. Pa. 1996). Similarly, courts have found that general intangibles can include licenses. See e.g. *In re Ciprian Ltd.*, 473 B.R. 669 (Bankr. W.D. Pa. 2012). Washington courts have recognized that goodwill is an intangible asset that can be included in the category of general intangibles. See *Bank of Washington v. Burgraff*, 38 Wash. App. 492, 687 P.2d 386 (Div. 1 1984).

IV. GENERAL INTANGIBLES ARE NOT “DERIVED FROM BATES DRUG’S ACCOUNTS AND INVENTORY”

Banner Bank makes the completely unsupported and illogical claim that all of the items which would typically be categorized as general intangibles (customer lists, customer records, contact information, telephone numbers, website addresses, software, files, charts, scripts, provider lists, patients, referral sources and referral relationships) are actually “directly relating to and derived from Bates Drug’s accounts and inventory....” As with many of its argumentative assertions, Banner Bank

fails to provide any case, statute, article, or treatise that would lend credence to this idea.

The reality is that accounts and inventory are entirely separate categories of collateral under the Uniform Commercial Code. RCW 62A.9A-102. To say that because something is related to another category of collateral it is therefore part of that category is a novel and somewhat silly notion that is not supported by any commentary on the law whatsoever. One could draw connections and relations between all manner of a company's collateral; for example, one could say that because a computer is used to do the books of a company, it is related to that company's accounts, but no reasonable person would classify a computer as an account rather than equipment. This argument of Banner Bank is dead on arrival.

V. CARDINAL HEALTH'S CORPORATE STATUS HAS NOT BEEN APPEALED

There is much consternation displayed in Banner Bank's response brief over the corporate identity of Cardinal Health. In the midst of its abject confusion, Banner Bank raises for the first time an allegation that Cardinal Health never had a properly perfected security interest. While this

claim is ludicrous on its face, it is, more importantly, terribly out of place in a response brief on appeal.

There is no order of the trial court which addresses the validity of Cardinal Health's security interest, and this issue was never addressed. The trial court decisions which are currently on appeal treat Cardinal Health as having a validly perfected security interest. No motion was made to invalidate that security interest; the entire dispute at the lower court was about the effect of the subordination agreement. In any case, Banner Bank never appealed any decision of the trial court, and it makes clear in its response brief that it "assigns no error to any decision made by the Trial Court."

Banner Bank's concern over the corporate identity of Cardinal Health is much ado about nothing and the Court should disregard it entirely.

VI. CONCLUSION

At the time the subordination agreement was entered, Cardinal Health believed it was subordinating its security interest in inventory, equipment, and accounts, because that is all it could have known Banner Bank was claiming an interest in; those were Banner Bank's only

perfected security interests, the only ones available on the public record. To say now that Cardinal Health subordinated all of its perfected security interests belies the clear intent of the language of the subordination agreement and defies logic.

The items that were sold for \$202,500 were general intangibles. They were not inventory, accounts, or equipment. If the proceeds from the sale of Bates Drugs Store assets were distributed correctly according to priority under Washington's Uniform Commercial Code, those funds would have gone to Cardinal Health. The trial court erred when it determined that all of Cardinal Health's perfected security interests were subordinated to Banner Bank's security interests, both perfected and unperfected. As such, Cardinal Health respectfully requests that this Court reverse and remand the decision of the trial court for a ruling requiring Banner Bank to turn over \$202,500 to Cardinal Health.

DATED this 10 day of December 2018.

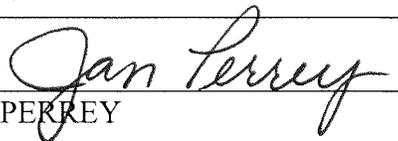
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CERTIFICATE OF SERVICE

I hereby certify that on this 10 day of December 2018, a true and correct copy of the foregoing document was served on the following in the manner set forth herein:

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Arnold M. Willig Elizabeth H. Shea Charles L. Butler, III Hacker & Willig, Inc. PS 520 Pike Street, Suite 2500 Seattle, WA 98101	<input checked="" type="checkbox"/> U.S. Mail <input type="checkbox"/> Certified Mail <input type="checkbox"/> Hand Delivery/Messenger <input type="checkbox"/> Overnight Courier <input type="checkbox"/> Fax: <input type="checkbox"/> Email:
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