

63331-7

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No. 63331-7-I

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION I

GMAC, a Delaware corporation,

Appellant,

v.

EVERETT CHEVROLET, INC., a Delaware corporation,
JOHN REGGANS, AND JANE DOE REGGANS,

Respondents.

APPELLANT'S OPENING BRIEF

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I. ASSIGNMENTS OF ERROR

1. The trial court erred by applying the duty of good faith to a demand promise, contrary to *Allied Sheet Metal Fabricators, Inc. v. Peoples National Bank of Washington*, 10 Wn. App. 530, 536, 518 P.2d 734, *review denied*, 83 Wn.2d 1013, *cert. denied*, 419 U.S. 967 (1974).

2. The trial court erred by using the duty of good faith to retroactively inject new terms into the written contract, and by finding “bad faith” when GMAC acted upon its contract rights, contrary to *Badgett v. Security State Bank*, 116 Wn.2d 563, 570, 807 P.2d 356 (1991).

3. The trial court erred by entering “findings” of bad faith without any legal substance, based upon speculation, and not supported by substantial evidence.¹

4. The trial court erred by failing to grant GMAC’s motion for replevin of its collateral because (1) GMAC held a security interest in the collateral; (2) GMAC properly made demand for payment; (3) Everett

¹ The trial court’s findings are contained in its oral opinion and no separate pleading designating conclusions of law and findings of fact was entered. The oral opinion is contained in RP Vol. XVI and a copy is attached in the Appendix (App.) hereto. (The page references used herein are based upon the page number at the bottom of each page.) RAP 10.4(c). GMAC’s appeal challenges the findings on the grounds that there was no legal basis to make any findings of bad faith, that the trial court used speculation and disregarded GMAC’s contract rights, and that the findings were not supported by substantial evidence, as more fully addressed in the argument section of this brief.

Chevrolet (“EC”) was in default because EC failed to pay after GMAC made demand; and (4) GMAC was entitled to possession of its collateral.

5. The trial court erred in dissolving the trial court injunction because the injunction compelled EC to comply with its contractual obligations and therefore was not wrongfully issued.

6. The trial court erred in failing to grant GMAC’s motion to amend its complaint because EC showed no prejudice.

7. The trial court erred by awarding attorneys’ fees to EC for obtaining a dissolution of the preliminary injunction because the injunction was not wrongfully issued.

8. The trial court erred by awarding attorneys’ fees to EC because the fees awarded by the trial court were not solely related to EC’s efforts to dissolve the injunction.

9. The trial court erred by awarding attorneys’ fees to EC prior to a final ruling on the merits.

10. The trial court erred by failing to grant GMAC’s motion to enforce the injunction.

11. The trial court erred by concluding that GMAC breached the parties’ contract by violating the duty of good faith.

II. ISSUES PRESENTED FOR REVIEW

1. Does the Uniform Commercial Code (“UCC”) and controlling Washington precedent bar the application of the duty of good faith as a limitation upon GMAC’s contractual right to make demand for payment? (Assignment of Error Nos. 1, 11.)

2. Was GMAC’s demand proper where the duty of good faith does not apply to a demand promise and a “demand promise” permits demand for payment to be made “at any time” “with or without reason”? (Assignment of Error No. 1.)

3. Was EC in default in mid-December 2008 because it did not pay when GMAC made demand, and was GMAC therefore entitled to a writ of replevin and possession of its collateral? (Assignment of Error Nos. 1, 4.)

4. Did the trial court fail to follow the UCC and the controlling Washington precedent of *Badgett* by using the duty of good faith to retroactively inject new terms into the written contract? (Assignment of Error Nos. 2, 11.)

5. Did the trial court fail to follow the UCC and the controlling Washington precedent of *Badgett* by finding that GMAC’s exercise of its contractual rights were violations of the duty of good faith? (Assignment of Error Nos. 2, 11.)

6. Is a demand promise, as defined in Articles 1 and 3 of the UCC, not subject to any duty of “good faith” found in Article 9? (Assignment of Error Nos. 1, 11.)

7. Were the trial court’s “findings” of bad faith not based upon a recognized legal theory, and were the findings based upon speculation and not supported by substantial evidence? (Assignment of Error No. 3.)

8. Is the definition of good faith contained in Article 9 limited in application to creation of a security interest or the manner of the disposal of collateral by the secured creditor, neither of which was at issue before the trial court? (Assignment of Error Nos. 1, 4.)

9. Was the preliminary injunction not “wrongfully issued” when the injunction only compelled EC to do what it was contractually required to do and prevented EC and Mr. Reggans from converting GMAC’s collateral? (Assignment of Error No. 5.)

10. Was the trial court’s denial of GMAC’s motion to amend its complaint an abuse of discretion because EC showed no prejudice due to the filing of an amended complaint within four months of the original filing and no trial date was scheduled? (Assignment of Error No. 6.)

11. Was the award of attorneys' fees unwarranted because EC did not incur any fees solely to the dissolution of the injunction as required by the applicable Washington rule? (Assignment of Error No. 7.)

12. Was the trial court's award of fees for a wrongfully issued injunction premature, even if the injunction were properly dissolved, because final judgment after trial has not been entered in favor of the party that has been enjoined? (Assignment of Error No. 9.)

13. Was EC violating the preliminary injunction by selling vehicles and not paying any sales proceeds to GMAC? (Assignment of Error No. 10.)

III. STATEMENT OF THE CASE

A. Relevant Facts

1. GMAC² and EC Had "Demand" Financing

Everett Chevrolet is a Chevrolet dealer located in Everett, Washington. In December 1996, EC and GMAC entered into what is commonly known in the auto dealership industry as a wholesale floor plan financing arrangement. R Ex. 3.³

² GMAC's name was changed from "GMAC LLC" to "GMAC Inc." on June 30, 2009, when GMAC converted from a limited liability company to a corporation after discretionary review was accepted. Under Delaware law, the effect of a conversion amounts to little more than a name change. *See* Del. Code tit. 8, § 265(a), (f).

³ Replevin hearing exhibits are identified herein as "R Ex."

GMAC's floor plan financing with EC contained a UCC "promise to pay on demand." *Id.* Both the "Wholesale Security Agreement" and the "Amendment to Wholesale Security Agreement," dated December 10, 1996, signed by John Reggans, EC's principal,⁴ provided that EC agrees "upon demand to pay to GMAC the amount it advances or is obligated to advance." R Exs. 3, 6 (emphasis added).⁵

Wholesale floor plan financing provides a financing mechanism for auto dealers who are continually buying vehicles from the manufacturer and selling to retail consumers. Verbatim Report of Proceedings (RP) Vol. I 169:22 – 170:18 (Cady). In the ordinary course, the amount GMAC advanced for each vehicle purchased wholesale by EC, the "floor plan" amount for that vehicle, was added to the GMAC financing balance. *Id.* When EC sold that vehicle to a retail customer, EC was obligated to pay GMAC the "floor plan" amount for that vehicle. *Id.*

[A]s each vehicle is sold, or leased, we [*i.e.*, EC] will, faithfully and promptly remit to you [*i.e.*, GMAC] the amount you advanced or have become obligated to advance on our behalf to the manufacturer, distributor or seller . . ."

⁴ John Reggans owned 100% of the stock of EC. RP Vol. X 105:4-5.

⁵ The Amendment also provided that "[a]ny and all credit lines provided by GMAC to Dealer are expressly subject to the written terms of the Wholesale Security Agreement, including this amendment, and are discretionary in that they may be modified, suspended or terminated at GMAC's election." R Ex. 6.

R Ex. 3, ¶ 7.⁶

Since 1999, GMAC had also provided additional financing to EC through a revolving line of credit agreement (“RLCA”). R Ex. 8. In late 2007, Mr. Reggans sought and obtained from GMAC a \$300,000 increase (from \$500,000 to \$800,000) in the credit limit on the RLCA. RP Vol. I 18:17 – 20:16 (Vick). R Exs. 1, 8, 54. By May 2008, EC had used virtually all of those additional funds to pay bills, increasing EC’s outstanding balance on the RLCA to \$786,000. *Id.*

2. GMAC Has a Security Interest in the Vehicle Collateral, Floored and Non-Floored, and Other Assets of EC

GMAC’s security interest covered all of EC’s vehicles, floored and non-floored,⁷ and virtually all of its other assets.⁸ In the Wholesale Security Agreement, EC granted GMAC “a security interest in the vehicles and the proceeds of sale thereof.” R Ex. 3, ¶ 3. In the Security Agreement EC granted GMAC a security interest in “all of Debtor’s

⁶ EC’s office manager, Terry Cady, testified that EC had a three- business-day release privilege under which EC paid GMAC the wholesale amount due for each car sold within three business days after it was sold. R Ex. 70; RP Vol. I 166:12 – 167:15.

⁷ Wholesale flooring financing arrangements distinguish between “floored” and “non-floored” vehicles. A “floored” vehicle is a vehicle purchased with GMAC financing. RP Vol. I 169:22 – 170:17. A “non-floored” vehicle is a vehicle owned by EC and subject to GMAC’s security interest in all EC’s vehicles, but that was not purchased with GMAC financing.

⁸ GMAC’s replevin motion sought possession of all GMAC’s collateral, which included other assets of EC subject to GMAC’s security interest including parts, equipment, etc. CP 382.

inventory, including vehicles, new and used . . . and all products thereof and proceeds thereof.” R Ex. 2.

Before GMAC made demand in December 2008, GMAC was entitled to be paid sales proceeds equal to the “floor plan” amount within three business days when EC sold a floored vehicle. R Ex. 3, ¶ 7. After EC’s default by failing to pay after GMAC made demand, GMAC was entitled to be fully paid, and therefore was entitled to receive all sales proceeds of all of its collateral, which included all vehicles, floored and non-floored. R Ex. 3, ¶ 9.

3. EC’s Financial Problems Began in 2007 and Grew Worse Throughout 2008 As Shown by EC’s Own Financial Records and the Testimony of Mr. Reggans and EC’s Long-Time Controller.

EC’s financial records and the testimony of Mr. Reggans established that EC’s financial woes started in 2007, well before GMAC’s letter requests (R Ex. 1, July 31, 2008), and were the result of the general nationwide contraction of the automobile sales industry.

EC’s annual profit shrank from \$700,000 in 2006 to \$28,000 in 2007. RP Vol. X 100:1-7. Mr. Reggans admitted that he had observed the auto market declining in 2006 and had begun “proactively” trying to address EC’s financial distress in July 2007 *even before* GMAC raised the issue with EC in early 2008. RP Vol. X 103:17-23; RP Vol. XIII 100:1-

25, 118:5-16.⁹ Mr. Reggans admitted that the U.S. auto sales industry suffered a substantial downturn in 2007 and “went off a cliff” in 2008. RP Vol. X 103:19-21; 99:7 – 100:13.

Rebecca Iverson, EC’s long-time controller (1996 – Sept. 2008), testified to EC’s severe financial problems starting in 2007 and its problems paying numerous bills in 2008. RP Vol. III 4:23-25; 7:19-8:2; 10:2-12; 12:4 – 13:3; 18:1-15. Ms. Iverson eventually resigned in September 2008 because of her concern over potential personal liability for EC’s unpaid state sales tax. RP Vol. III 15:18 – 17:10.

EC’s financial reports showed that, through July 2008, EC had five straight months of substantial operating losses. R Ex. 79 (March (\$111,899); April (\$104,010); May (\$78,218); June (\$87,405); July (\$87,040)).¹⁰

Like any ordinary prudent lender, by early spring 2008, GMAC was seriously concerned with its borrower’s financial problems. RP Vol. I

⁹ In mid- 2007, Mr. Reggans embarked on a campaign to obtain more working capital for EC through a purchase of the property EC was then renting for the dealership. RP Vol. X 104:3-9. Mr. Reggans wanted GMAC to provide 100% financing (RP Vol. XIII 100:18-101:3), which GMAC declined to do. RP Vol. I 20:20 – 23:9. GMAC had no obligation to make a real estate loan to EC. RP Vol. XIV 45:4 – 46:6.

¹⁰ EC submitted monthly financial statements to GM that were made available to both GM and GMAC. RP Vol. I 25:16 - 26:9; *see, e.g.*, R Exs. 60, 64, 79. A year-to-date monthly profit or loss summary is contained on the lower center portion of the front page of each of these reports.

24:13 – 32:25; 140:7 – 141:10. Although GMAC's financing contract gave GMAC the right to demand payment at any time, Jerry Vick, GMAC's branch manager, first discussed GMAC's concerns with Mr. Reggans in telephone calls and then in a meeting in early June 2008. *Id.* On July 31, 2008, GMAC put its concerns and requests in a letter to Mr. Reggans. R Ex. 1.

Based on an analysis of the Dealership's operating trends, repayment capacity, and available security, GMAC is unable to increase the limit of the Dealership's Revolving Line of Credit or extend a working capital loan to the Dealership.

Further, the deteriorating operating trends and credit base of the Dealership and its poor wholesale performance increase GMAC's credit risk associated with the Dealership's account. In order to continue the financing arrangement between the Dealership and GMAC and to help mitigate GMAC's credit risk, GMAC requires, at a minimum, the following: [the letter lists requests for an \$800,000 unencumbered capital injection, a personal guaranty from Mr. Reggans, and faithful and prompt payment for vehicles upon sale, (and sets a deadline of October 31, 2008)].

R Ex. 1 (emphasis added).¹¹ GMAC's letter expressly advised EC that, if it could not meet GMAC's requests,

GMAC may suspend or terminate the Dealership's wholesale credit lines.

¹¹ This letter contained GMAC's first request to EC to pay \$10,000/month on the RLCA and to pay audit costs of \$500 per inventory audit. GMAC's audits were relatively limited until December 2008. R Ex. 97.

Id. It is undisputed that EC never met any of GMAC's requests stated in the July 31 letter. EC never injected \$800,000 of unencumbered capital into the corporation and Mr. Reggans never provided a personal guaranty.

Meanwhile, after the July 31st letter, EC continued to lose more and more money. R Ex. 79.¹² As noted, Ms. Iverson quit in September 2008 over concerns for personal liability for EC's state excise taxes. GMAC's audits of EC's payments in the fall of 2008 showed that EC was making many late payments to GMAC.¹³ In October 2008 EC received \$500,000 of additional funds from Motors Holdings, but it's already substantial losses forced EC to use those funds to pay amounts in arrears to GMAC and other debt.¹⁴ RP Vol. X 125:1-7; Vol. XIV 46:21 – 47:7.

By October 2008, GMAC was faced with a borrower that was suffering substantial operating losses, that was repeatedly "out of trust,"¹⁵

¹² EC's loss in August, 2008 was \$73,095; in September, 2008, \$78,413; and in October 2008, \$96,291.

¹³ GMAC's audits of the dealership had shown numerous late payments by EC to GMAC in August, September, October, and November 2008. *See* R Exs. 66, 140-142; R Ex. 88 (last page, letter dated Sept. 22, 2008) (81% payment delays); R Ex. 89 (last page, letter dated Oct. 16, 2008) (60% payment delays); R Ex. 90 (last page, letter dated Sept. 22, 2008) (44% payment delays); R Ex. 91 (letter dated Nov. 19, 2008) (38% payment delays).

¹⁴ Mr. Reggans' testimony on the nature of these funds was less than clear. RP Vol. XI 56:1-22; RP Vol. XIV 46:21 – 51:25. Nevertheless, the funds appeared to be a loan to EC, not unencumbered capital, and were immediately spent instead of being available as working capital.

¹⁵ Selling "out of trust" is an industry term referring to an auto dealer's failure to pay timely its wholesale lender the "floor plan" amount after a retail

that had not been able to increase its working capital, and whose principal refused to provide a personal guaranty as additional security.¹⁶ Nevertheless, when EC failed to meet GMAC's original deadline of October 31, 2008, GMAC extended EC's wholesale credit line until November 30, 2008, and again asked EC to address its financial problems. RP Vol. VII 29:2 – 35:7; R Ex. 9. EC, despite the additional \$700,000-\$800,000 funds it had received from Motors Holdings and on the RLCA, was unable to do so. By the end of November 2008, EC's total year-to-date operating losses had worsened to \$717,552. R Ex. 79.

In December 2008, EC's severe cash shortage caused it to go "out of trust" on three occasions in the span of approximately two weeks. A December 5th audit revealed that EC was "out of trust" on seven vehicle sales totaling approximately \$132,000. RP Vol. VII 38:4 – 42:8. R Ex. 76. On December 8, 2008, GMAC suspended EC's wholesale credit line.¹⁷ R Ex. 76.¹⁸

sale of a vehicle. RP Vol. I 44:3-17 (Vick). R Ex. 3. EC had been "out of trust" a number of times earlier in 2008, which had prompted additional audits by GMAC. RP Vol. I 51:23 – 52:11 (Vick).

¹⁶ It was very disconcerting to GMAC that EC had received a \$500,000 cash injection but still had a negative cash position. RP Vol. VII 24:8 – 25:7.

¹⁷ As noted above, GMAC and EC's contract provides that GMAC could modify or suspend the credit lines. R Ex. 6. On December 4, 2008, GMAC also gave notice to GM on its "open account" with EC. R Ex. 56.

As a stop-gap measure to help EC cure its immediate “out of trust” position, GMAC on two occasions in early December agreed to “floor” additional vehicles for EC, thereby, in effect, loaning additional funds to EC to permit it to pay the delinquent amount due GMAC. *See* RP Vol. I 39:23 – 47:21; 119:2 – 120:14; Vol. VII 52:18 – 53:15. R Exs. 10, 23, 32.

EC’s failure to meet GMAC’s extended deadline and the repeated substantial “out of trust” situations only confirmed the validity of GMAC’s then long-standing and unaddressed concerns about EC’s serious financial problems. In mid-December 2008, GMAC terminated its financing arrangements with EC and made demand for payment of \$5,629,294.89 owing on the floor plan financing and \$738,000 owing on the RLCA (total \$6,367,294.89). R Ex. 77. After GMAC’s initial demand on December 15, 2008, EC again sold a number of vehicles “out of trust.” On December 18 approximately \$206,000 came due to GMAC for the sale of cars by EC. RP Vol. VII 60:19 – 67:24; R Ex. 14. When EC made no

¹⁸ The letter also references EC’s failure to make a principal reduction payment (also called a “curtailment” payment), the request for which is a common industry practice. RP Vol. II 13:16 – 14:23 (Cady); R Ex. 115. But EC never paid the approximately \$172,000 curtailment request. Therefore, it had no effect upon EC’s working capital. Mr. Reggans claimed that both a GMAC and a GM employee told him not to pay the curtailment. RP Vol. XII 51:21 – 53:13; RP Vol. XIII 41:1 – 42:5.

arrangements to pay this amount on December 18 or 19, GMAC demanded full payment immediately from EC. *Id.* R Ex. 83.¹⁹

EC was in default when it did not pay the full amount due after GMAC's demand was made. Under its security agreement with EC, GMAC was entitled to have EC assemble the collateral and make it available for GMAC's immediate possession. R Ex. 3, ¶ 9.

EC's response to GMAC's demand was to convert proceeds of \$778,774.80 from the sale of 33 vehicles in December and early January 2009 instead of paying the floor plan amount due to GMAC as the parties' contract required. RP Vol. VI 27:14 – 30:22; Vol. VIII 9:2-16. R Ex. 52.

In March and April 2009, while the replevin hearing was proceeding and despite the outstanding injunction requiring EC to pay GMAC when it sold vehicles, EC sold another 18 vehicles without paying any proceeds to GMAC. CP 52-86.²⁰

¹⁹ EC has claimed that it could not pay this amount by cashier's check, as GMAC had previously required, because the big snowstorm of December 2008 had caused its bank to close early on December 18. RP Vol. VII 64:9-10. (The bank did close early that day. R Ex. 105.) But EC had known since it received the results of the audit of December 16 that payment for a number of cars would come due on the 18th. R Ex. 14; RP Vol. II 33:24 – 38:15. Despite knowing for two days that \$206,000 would come due on the 18th, EC made no arrangements of any kind on either the 18th or 19th (or any day thereafter) to pay GMAC. RP Vol. VII 64:1 – 65:12; Vol. VIII 5:10 – 9:1.

²⁰ Ms. Smith's declaration identifying the vehicles was inadvertently in correctly titled. CP 45-48.

As a result of these actions by EC and Mr. Reggans, GMAC expects a substantial deficiency in payment from EC. At the replevin hearing GMAC estimated it would suffer a deficiency of \$1,163,834.80 even after liquidating all of EC's collateral. R Ex. 54; RP Vol. VI 50:3-11.

After the trial court's April 10 ruling and before this Court's June 5 order requiring EC to deposit sales proceeds in the court registry, EC sold yet more vehicles without paying any proceeds to GMAC. CP 33-36.

B. Procedural History

Because EC and Mr. Reggans began converting the proceeds of vehicle sales in response to GMAC's demand instead of paying GMAC as required by its contract (R Ex. 52), GMAC filed this lawsuit on December 31, 2008 to replevy its vehicle collateral. CP 382-388. GMAC obtained a temporary restraining order ("TRO") to halt EC and Mr. Reggans' conversion of the proceeds of GMAC's vehicle collateral. CP 351-353. The TRO was modified on January 14, 2009 to a preliminary injunction that permitted EC to sell cars so long as EC remitted the proceeds to GMAC (less certain enumerated items). CP 333-337.

An extended replevin hearing was conducted between March 16 and April 10, 2009, before the Honorable Eric Z. Lucas of the Snohomish

County Superior Court.²¹ On April 10, the trial court denied the motion for replevin, dissolved the injunction, and denied GMAC's motion to amend its complaint and its motion to enforce the injunction. CP 49-51. The trial court concluded that GMAC breached the contract by violating the duty of good faith and fair dealing. App. at 21.

This Court granted discretionary review on June 5, 2009.

On July 18, 2009, the trial court awarded EC \$215,442.50 in attorneys' fees, including a "lodestar" multiplier increase of Mr. William Wheeler's fees by 50% in the amount of \$46,310, based upon the trial court's dissolution of the injunction. Supplemental CP 392-393.

IV. LEGAL ARGUMENT

A. Summary of the Argument

The trial court's order denying replevin, dissolving the injunction, denying enforcement of the injunction, and denying amendment of the complaint, and its order awarding fees should be reversed. The trial court's "findings" of bad faith should be reversed because they lack any legal basis, ignore GMAC's contract rights, contradict applicable law, and are based upon speculation rather than substantial evidence. The evidence showed that GMAC was responding to EC's financial problems, not

²¹ In response to GMAC's motion to exclude evidence of damages in the hearing, the trial court expressly noted that the replevin hearing was not a damages hearing. RP Vol. I 9:1-2.

causing them. GMAC was entitled to replevy its vehicle collateral because it was a secured creditor that properly made demand in mid-December 2008, and EC failed to pay. The trial court erroneously dissolved the injunction and erroneously failed to enforce the injunction because the injunction only required EC to comply with EC's contractual obligations and halted EC's and Mr. Reggans' conversion of GMAC's security interest in the proceeds of vehicle sales. EC is not entitled to any award of attorneys' fees because the injunction was not "wrongly issued" and none of EC's attorneys' fees were incurred "solely" to dissolve the injunction. The trial court abused its discretion by denying GMAC's motion to amend its complaint because it relied upon its erroneous findings of bad faith and EC showed no prejudice in allowing an amendment approximately four months after the case was filed and when no trial date was set.

The trial court erred on all of these issues largely because it ignored the well-established UCC rules and Washington case law that the duty of good faith does not apply to demand promises and cannot be used to retroactively insert new duties into a contract. *Allied*, 10 Wn. App. at 530; *Badgett*, 116 Wn.2d at 563.

The trial court's findings lack a legal basis and are not supported by substantial evidence. The trial court's "bad faith" findings were based

upon the trial court's retroactive creation of numerous duties not found in the parties' contract. To the contrary, the evidence in the record showed that GMAC acted in accordance with its contractual rights, and took the normal steps an ordinarily prudent lender takes when faced with a borrower in financial trouble. Substantial evidence – EC's own financial reports, and the testimony of Mr. Reggans and his long-time controller – showed that EC was in financial trouble in 2007, long before GMAC requested EC to obtain more working capital.

B. GMAC's Demand for Payment and Right to Replevin Cannot Be Barred by the Duty of Good Faith; the Trial Court's Findings of Bad Faith Were Based upon an Erroneous Legal Theory

GMAC's floor plan financing agreement with EC provided that EC agrees "upon demand to pay to GMAC the amount it advances or is obligated to advance." R Exs. 3, 6. Under the UCC, this contract language creates a "demand" promise:

A promise or order is "payable on demand" if it (i) states that it is payable on demand or at sight, or otherwise indicates that it is payable at the will of the holder, or (ii) does not state any time of payment.^[22]

RCW 62A.3-108(a) (emphasis added). A lender making demand is entitled to be paid upon demand. But the trial court here ruled that GMAC

²² A promise is also payable upon demand if it does not state a time of payment. RCW 62A.3-108(a). The Wholesale Security Agreement does not state a time for payment.

was not entitled to be paid upon demand because the trial court used the duty of good faith to find that GMAC had “manufactured” a default in “bad faith.”

This is error. A demand promise is not subject to the duty of good faith because, as Washington courts and virtually all courts hold,²³ applying the UCC’s Official Comments to UCC § 1-208 (RCW 62A.1-208), the “very nature” of “demand instruments or obligations” “permits call at any time with or without reason.”²⁴ *See Allied*, 10 Wn. App. at 536.²⁵ The trial court’s ruling ignores the central legal premise of a

²³ Because one of the primary purposes of the UCC is to create a uniform national body of commercial law, the decisions of other courts on UCC issues are relevant precedent in Washington. *See* RCW 62A.1-102(2)(c); *Larson v. Vermillion State Bank*, 567 N.W.2d 721, 724 (Minn. App. 1997).

²⁴ Revised Article 1 of the UCC was approved by the National Conference of Commissioners on Uniform State Laws and The American Law Institute in 2001, but has not been adopted in Washington. Former Section 1-208 is now designated as Section 1-309 in revised Article 1, and this specific sentence in the comment has been relocated to the comments to Section 1-309 to revised Article 1. Washington has retained this sentence in its comments to RCW 62A.1-208.

²⁵ *Zeno Buick-GMC Inc. v. GMC Truck & Coach*, 844 F. Supp. 1340, 1350 (E.D. Ark. 1992); *Coffee v. GMAC*, 5 F. Supp. 2d 1365 (S.D. Ga. 1998); *Solar Motors, Inc. v. First Nat’l Bank of Chadron*, 545 N.W.2d 714 (Neb. 1996); *Taggart & Taggart Seed, Inc. v. First Tenn. Bank Nat’l Ass’n*, 684 F. Supp. 230, 235-36 (E.D. Ark. 1988), *aff’d*, 881 F.2d 1080 (8th Cir. 1989); *Kham & Nate’s Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1357-58 (7th Cir. 1990); *Dominion Bank, N.A. v. Moore*, 688 F. Supp. 1084, 1086-87 (W.D. Va. 1988); *Spencer Cos. v. Chase Manhattan Bank, N.A.*, 81 B.R. 194, 199 (D. Mass. 1987); *Pavco Indus., Inc. v. First Nat’l Bank of Mobile*, 534 So. 2d 572, 576-77 (Ala. 1988); *Flagship Nat’l Bank v. Gray Distribution Sys., Inc.*, 485 So. 2d 1336, 1340 (Fla. Dist. Ct. App.), *review denied*, 497 So. 2d 1217 (Fla. 1986); *Fulton Nat’l Bank v. Willis Denney Ford, Inc.*, 269 S.E.2d 916, 918-19 (Ga. Ct. App. 1980); *Centerre Bank of Kansas City, N.A. v. Distribs., Inc.*, 705 S.W.2d

demand promise: GMAC could make demand “at any time” “with or without a reason.”²⁶ GMAC had no need to manufacture a default in order for GMAC to make demand.

Nevertheless, starting from its erroneous legal assumption, the trial court took what was, in truth, GMAC’s ordinary and prudent lender conduct in response to a borrower with severe financial problems, and speculated that GMAC had a “hidden agenda” and “undisclosed targets”²⁷

42, 46-48 (Mo. Ct. App. 1985); *Simon v. N.H. Savs. Bank*, 296 A.2d 913, 915 (N.H. 1972); *Mirax Chem. Prods. Corp. v. First Interstate Commercial Corp.*, 950 F.2d 566, 570 (8th Cir. 1991) (good-faith obligation arising under UCC does not apply to demand instruments); *Henning Constr., Inc. v. First E. Bank & Trust Co.*, 635 So. 2d 273 (La. Ct. App.), writ denied, 642 So. 2d 870 (La. 1994); *Waller v. Md. Nat’l Bank*, 620 A.2d 381 (Md. Ct. Spec. App.), cert. granted, judgment vacated on other grounds and remanded, 631 A.2d 447, and cert. granted, 631 A.2d 451 (table) (Md. 1993).

²⁶ Because EC’s own financial statements had shown substantial operating losses since early 2008, and EC was repeatedly “out of trust” in the fall of 2008, and had not met GMAC’s requests, GMAC had good reason to be concerned about EC’s financial problems and to make demand.

Even if it were applicable, Mirax has not met its burden of establishing lack of good faith. It is undisputed that Mirax was suffering considerable losses which were revealed to FICC in the financial statements. If FICC needed a reason to feel insecure, it surely had one.

Mirax, 950 F.2d at 570 (emphasis added). But a demand promise does not require that EC must first default before GMAC can make demand, as the trial court incorrectly concluded.

²⁷ There were no “undisclosed targets.” GMAC’s requests to EC were contained in the July 31 letter, and were not changed. Despite aggressive cross-examination by the trial judge himself, Michele Smith repeatedly testified that GMAC would have honored the July 31 letter had EC met its requests, even

for a “working capital assault” on EC designed to “manufacture” a “default” by EC that then allowed GMAC to demand payment. App.²⁸ The trial court’s speculation that GMAC had various motives to put EC out of business²⁹ was based upon its misapprehension of the duty of good faith and demand obligations. The trial court’s ruling is therefore legally meritless because the fact that making demand may make matters more difficult for a borrower does not render the lender’s conduct “bad faith.”

Demand notes with the security agreements here executed indeed put the bank in a position where if it takes action, as a practical matter, the company is in trouble because it has lost its financing, but that is the agreement that the parties made by appropriate written instruments.

Allied, 10 Wn. App. at 534. *Allied*, and the applicable UCC case law, repeatedly reject “bad faith” defenses to demand promises as a matter of law.

Although these facts might raise questions as to the bank’s business judgment, they create no factual issue as to the bank’s right to do what it did, and so are not material facts. This is particularly so under our interpretation of what constituted the agreement between the parties, namely, the terms of the demand notes.

though EC’s financial condition had worsened throughout 2008. RP Vol. IX 134:19 – 136:16. Notably, EC never meet GMAC’s stated requests.

²⁸ These assertions appear repeatedly throughout the oral opinion.

²⁹ App. at 19-20.

Id. at 536 n.5 (emphasis added).³⁰

This court cannot limit the bank's ability to enforce its rights under the demand note without interposing new terms into the parties' agreement. The note unambiguously conferred on the bank the right to demand payment from the Larsons at any time it deemed necessary or desirable. The bank did not breach the agreement simply by taking action expressly permitted by the agreement's terms. To impose an additional requirement of good faith would force the bank to surrender its entitlement to payment on demand, in exchange for the right to payment on a demand supported by good faith judgment. *Cf. Solar Motors, Inc. v. First Nat'l Bank*, 249 Neb. 758, 545 N.W.2d 714, 720 (1996) (recognizing addition of good faith requirement would impose on parties terms never agreed upon). The parties did not bargain for such a term, and we decline to read one into the contract.

Larson, 567 N.W.2d at 723 (citation omitted).³¹

There is no reason why the obligor on an "immediately" due and payable instrument should be entitled to contest the holder's decision to enforce payment anytime within the statute of limitation as being in "bad faith." The obligor, by his signature, has agreed that his obligation is on its face "immediately" due and payable and is subject to no other contingencies.

Fulton Nat'l Bank 269 S.E.2d at 918.³²

The imposition of a good faith defense to the call for payment of a demand note transcends the performance or enforcement of a contract and in fact adds a term to the

³⁰ The *Badgett* opinion twice favorably cited *Allied*, thereby firmly establishing the continuing authority of *Allied*.

³¹ The court dismissed the case for failure to state a claim.

³² The trial court denied the bank's summary judgment motion. The Court of Appeals accepted interlocutory review and reversed.

agreement which the parties had not included. The additional term would be that the note is not payable at any time demand is made but only payable when demand is made if such demand is made in good faith. The parties by the demand note did not agree that payment would be made only when demand was made in good faith but agreed that payment would be made whenever demand was made. Thus, § 400.1-203 has no application because it does not relate to the performance or enforcement of any right under the demand note but in fact would add an additional term which the parties did not agree to.

Centerre Bank 705 S.W.2d at 47-48.³³

However, the defendant bank maintains that the U.C.C. good faith requirement is not applicable to a demand note and, therefore, the question of good faith is immaterial to the resolution of this case. The court agrees and finds that allegations of bad faith do not create a genuine issue of material fact to preclude summary judgment. The Official Comment to U.C.C. § 1-208 states that “obviously this section has no application to demand instruments or obligations whose very nature permits call at any time with or without reason, [but rather], this section applies only to an agreement or to paper which in the first instance is payable at a future date.” And courts have held that the lack of good faith defense is unavailable in a suit to collect on a demand note, which by its very nature can become due and payable at any time after its execution.

Taggart & Taggart 684 F. Supp. at 235-36 (brackets in original);³⁴ *Mirax*, 950 F.2d at 570 (same).³⁵ The trial court’s use of findings of “bad faith” to deny replevin was error.

³³ Jury verdict in favor of defendant borrowers/guarantors vacated.

³⁴ Summary judgment in favor of bank.

Considered under the correct legal standard, the facts relevant to GMAC's replevin motion were undisputed and required that the trial court grant the motion. When GMAC properly made demand in December 2008, EC's entire debt was then due and payable to GMAC. EC did not pay, and GMAC was entitled, under the Wholesale Security Agreement, to have EC assemble the collateral and make it available to GMAC. R Ex. 3.³⁶ GMAC was entitled to replevin, instead of being subjected to a 3½-week-long hearing upon GMAC's legally non-existent "bad faith."

C. The *Coffee* Case Upheld GMAC's Right to Make Demand

EC has vaguely suggested in its pleadings to this Court in opposition to GMAC's motion for discretionary review that EC's demand obligation was subject to "default contingencies." But EC never actually identifies the "default contingencies" that EC alleges modified its promise to pay on demand. There are none. Instead, in a unapologetic sleight-of-hand, EC refers to *Coffee v. GMAC*, 5 F. Supp. 2d 1365 (S.D. Ga. 1998), as if the GMAC Wholesale Security Agreement at issue in that case was the same as the GMAC Wholesale Security Agreement at issue here. *Coffee*, in

³⁵ See also *Dominion Bank*, 688 F. Supp. at 1086-87 (same); *Pavco*, 534 So. 2d at 576-77 (same); *Waller*, 620 A.2d at 392(same).

³⁶ In fact, the duty of good faith obligated EC to cooperate to give GMAC the benefit of its bargain, including paying upon demand and assembling the collateral for GMAC. *Badgett*, 116 Wn.2d at 570.

fact, expressly noted that the default contingencies there applied only to termination of the line of credit, and stands as authority upholding the “demand” feature of GMAC’s Wholesale Security Agreement.

Thus, while GMAC was entitled to demand payment of the advances it had made pursuant to the line of credit at any time, it could not terminate the line of credit in the absence of one of the specific events of default enumerated in paragraph 3 of the Loan Agreement.

Id. at 1377 (emphasis added). The *Coffee* court addressed an earlier version of GMAC’s Wholesale Security Agreement that expressly conditioned termination of a line of credit upon the occurrence of certain enumerated events of default. *Id.* at 1368, 1372-73:

It is understood and agreed that [GMAC] may, at its option, terminate the line of credit and refuse to advance funds hereunder upon the occurrence of any of the following: [1] a default by [LMC] in the payment or performance of any obligation hereunder or under any other agreement entered into with [GMAC]; [listing other events of default]

Id. at 1372 (first, second, third, and fourth brackets in original). The Wholesale Security Agreement in the present case *did not contain* the language quoted above. Instead of providing for “events of default,” the Wholesale Security Agreement *in this case*, in fact, provided exactly the opposite:

Any and all credit lines provided by GMAC to Dealer are expressly subject to the written terms of the Wholesale Security Agreement, including this amendment, and are

discretionary in that may be modified, suspended or terminated at GMAC's election.

R Ex. 6 (emphasis added). The contractual language in *Coffee* is materially different from – and in fact, directly opposite to – the contractual language in this case.

D. The Trial Court Erred by Retroactively Injecting New Terms into the Parties' Agreement in Violation of *Badgett*

Not only did the trial court err by applying the duty of good faith to a demand promise, contrary to *Allied*, the trial court erred under *Badgett* by using the duty of good faith to retroactively impose new contract duties upon GMAC.³⁷ Unlike *Allied*, the *Badgett* court ruling did not address only demand promises. *Badgett* states the rules governing the limits of the duty of good will as applied to contracts generally.

Badgett rejected attempts “to expand the existing duty of good faith to create obligations on the parties in addition to those contained in the contract.” *Badgett*, 116 Wn.2d at 570.³⁸ The duty of good faith cannot

³⁷ As discussed *infra*, GMAC submits that the evidence submitted at the replevin hearing, considered under the proper law, establishes there was no bad-faith conduct as a matter of fact.

³⁸ Stated somewhat differently, most courts addressing the issue have held that the duty of good faith is not an independent source of duties for parties to a contract. *See, e.g., Baxter Healthcare Corp. v. O.R. Concepts, Inc.*, 69 F.3d 785, 792 (7th Cir. 1995) (“[T]he covenant of good faith and fair dealing is not an independent source of duties for the parties to a contract. Instead, the covenant merely ‘guides the construction of the explicit terms in the agreement.’” (citations omitted)); *Metro Commc'ns Co. v. Ameritech Mobile Commc'ns, Inc.*,

be used to “inject substantive terms into the parties’ contract.” *Id.* at 569.³⁹ Unlike the trial court’s approach, Washington has “consistently held there is no ‘free-floating’ duty of good faith and fair dealing that is unattached to an existing contract.” *Keystone Land & Development Co. v. Xerox Corp.*, 152 Wn.2d 171, 177, 94 P.3d 945 (2004) (quoting *Badgett*, 116 Wn.2d at 570). The trial court’s numerous “findings” of “bad faith” in this case provide compelling evidence for *Badgett*’s wisdom of limiting the duty of good faith to existing contract terms. Without such a limit, it is

984 F.2d 739, 743 (6th Cir. 1993) (“[T]he implied covenant of good faith is a construction aid that helps a court determine the intent of the parties; it cannot be used to add terms to the contract when there is no evidence that the parties intended that those terms be included.”); *Medtronic, Inc. v. ConvaCare, Inc.*, 17 F.3d 252, 256 (8th Cir. 1994) (“Minnesota law does not recognize a cause of action for breach of the implied covenant of good faith and fair dealing separate from the underlying breach of contract claim.”); *Swedish Civil Aviation Admin. v. Project Mgmt. Enters., Inc.*, 190 F. Supp. 2d 785, 794 (D. Md. 2002) (“The implied duty of good faith . . . is merely part of an action for breach of contract.”); *Designers N. Carpet, Inc. v. Mohawk Indus., Inc.*, 153 F. Supp. 2d 193, 197 (E.D.N.Y. 2001) (“A claim for breach of an implied covenant of good faith and fair dealing does not provide a cause of action that is separate and different from a breach of contract claim. Rather, breach of that duty is merely a breach of the underlying contract.” (citation omitted)); *Clark Bros. Sales Co. v. Dana Corp.*, 77 F. Supp. 2d 837, 852 (E.D. Mich. 1999) (“Under Michigan law, this implied covenant does not override the express terms of the parties’ contract, and cannot form the basis for a claim independent of that contract.”).

³⁹ *Badgett* held that “[t]he duty to cooperate exists only in relation to performance of a specific contract term.” 116 Wn.2d at 570. As Court Commissioner Ellis correctly observed, “There is nothing in any of the financing contracts that obligates GMAC to make other loans, to consider alternate business structures, or to explain its reasons for asking for changes to Everett’s capitalization (footnote omitted).” Commissioner’s Ruling Granting Motion for Discretionary Review at 11.

clear that there is virtually no end to the “duties” a trial court can retroactively impose upon a party.⁴⁰

Despite the clear precedent of *Badgett*, the trial court erroneously used the duty of good faith to retroactively impose numerous new duties upon GMAC outside the parties’ contract, stretching back to GMAC’s initial decision not to make a real estate loan to EC. App. at 4-5.⁴¹ These alleged breaches were not for violations of *existing* contract terms but for GMAC’s “non-performance” of the new contract terms the trial court imposed, *i.e.*, the trial court found GMAC had acted in “bad faith” because GMAC had failed to comply with new duties that the trial court had newly created at the time of its ruling. Of course, since these duties were not in the contract, and in many instances contradict the actual contract terms, GMAC had no way of knowing these new duties existed, much less of performing them.

⁴⁰ In prior pleadings to this Court, EC has at different times submitted lists with differing numbers of trial court findings of bad faith. GMAC submits that, regardless how counted or listed, the trial court proceeded on an erroneous legal theory, and consequently there is no basis for any findings of bad faith in the trial court’s Oral Ruling as a matter of law.

⁴¹ In mid-2007, Mr. Reggans embarked on a campaign to obtain more working capital for EC through a purchase of the property EC was then renting. RP Vol. X 104:3-9. Mr. Reggans wanted GMAC to provide 100% financing (RP Vol. XIII 100:18 – 101:3), which GMAC declined to do. RP Vol. I 20:20 – 23:9. GMAC had no obligation to make a real estate loan to EC. RP Vol. XIV 45:4 – 46:6.

For example, the trial court found, as “bad faith,” that GMAC (1) did not provide a timely response to EC’s request for a real estate loan, App. at 4-5; (2) did not send the July 31 letter soon enough, *id.* at 6-7; (3) did not inform Mr. Reggans that GMAC was undertaking a sophisticated financial analysis of the dealership’s debt-to-equity ratio, *id.* at 8-9;⁴² (4) did not discuss, in detail, various elements of GMAC’s financial analysis of EC’s operations and financial condition with Mr. Reggans, *id.* at 9;⁴³ (5) GMAC set targets without justification, *id.* at 9;⁴⁴ and (5) refused to floor unencumbered new and used vehicles in November at the dealership’s request, *id.* at 13.⁴⁵ The trial court then

⁴² The trial court asserted that GMAC gave EC “false targets,” *id.* at 11, but this confuses GMAC’s written requests in its letter with GMAC’s financial analysis. Michele Smith repeatedly testified that GMAC would have honored the July 31 letter had EC met its requests. RP Vol. IX 134:19 – 136:16. And equally to the point, no question of “false targets” arises when EC did not meet GMAC’s *stated* targets. EC never provided \$800,000 of additional working capital and Mr. Reggans refused to provide a personal guaranty.

⁴³ The trial court found that the July 31 letter both was an attempt to mask GMAC’s intentions and a “drop dead” letter in which “the author is communicating to the reader that the relationship is over and it is just a matter of time before the end.” App. at 8. The trial court’s view of the letter was not only internally contradictory, the “duty” the trial court found also simply did not exist.

⁴⁴ Again, this confuses GMAC’s written requests with its financial analysis. GMAC requested \$800,000 additional capital infusion and a guaranty, and stuck to those requests, even though EC’s financial condition did continue to worsen.

⁴⁵ The trial court also found GMAC’s demand for a “curtailment” payment of approximately \$172,000 in November 2008 was arbitrary because it was not based upon depreciation of a vehicle. *Id.* at 12-13. A “curtailment” request is a common industry practice. RP Vol. II 13:16 – 14:23 (Cady); R Ex. 115. But EC never paid the \$172,000, so it had no actual effect upon EC. And, in fact,

speculated on what EC might have done if GMAC had complied with these non-existent duties. *Id.* at 7.

None of these “duties”⁴⁶ are found in the parties’ contract. They were created, retroactively, by the trial court on the day the trial court ruled on the replevin motion. The trial court’s use of the duty of good faith to create new duties for GMAC is error. *Badgett*, 116 Wn.2d at 563.

E. The Trial Court Erred by Finding Bad Faith When GMAC Exercised Contract Rights

The trial court also erred under *Badgett* in finding instances of “bad faith” when GMAC exercised its contractual rights. *Badgett* held that “[a]s a matter of law, there cannot be a breach of the duty of good faith when a party simply stands on its rights to require performance of a contract according to its terms.” *Id.* at 570. For example, it was not “bad faith” to require EC to perform according to the loan’s terms, *i.e.*, for

depreciation of a dealer’s inventory is based, not upon mileage and wear and tear, but on the fact that older cars are not eligible for rebates, and other sales incentives, that make such cars less valuable to dealers because they are not as profitable to sell. RP Vol. IX 104:9-106:18. Moreover, since GMAC had the right to demand full payment, a request for a partial payment cannot be an instance of bad faith.

⁴⁶ The trial court’s oral opinion may contain other duties not found in the parties’ contract not specifically discussed in this brief. GMAC’s listing of these specific findings does not exclude its objection to all such retroactively created duties.

GMAC to require EC to pay “upon demand.”⁴⁷ To the contrary, EC had a good-faith duty to cooperate with GMAC’s demand for payment to give GMAC the benefit of its bargain. *Badgett*, 116 Wn.2d at 570.

Accordingly, GMAC did not violate the duty of good faith by standing on its contractual right to make a demand for payment⁴⁸ in December 2008,⁴⁹ its right to inspect the vehicles and EC’s books,⁵⁰ its

⁴⁷ As another court put it: “Firms that have negotiated contracts are entitled to enforce them to the letter, even to the great discomfort of their trading partners, without being mulcted for lack of ‘good faith.’” *Kham*, 908 F.2d at 1357.

⁴⁸ EC agrees “upon demand to pay to GMAC the amount it advances or is obligated to advance.” R Ex. 3.

⁴⁹ Ignoring EC’s substantial financial problems, its repeated and large “out of trust” sales in December, GMAC’s right to make demand at any time, and the extended deadlines GMAC gave EC, the trial court speculated that GMAC made demand in December to stop EC from selling itself to Motors Holdings. *Id.* at 15-16. The Motor’s Holdings letter referenced several reasons it did not proceed, including the GMAC replevin lawsuit. R Exs. 109, 114. But EC and Mr. Reggans triggered GMAC’s filing of this lawsuit on December 31, 2008 by wrongfully converting proceeds of sales throughout December. In addition, GMAC had a legal right to make demand and terminate its financing with EC. Therefore, EC cannot base a claim upon GMAC’s legally proper exercise of a contract right. Moreover, GMAC had set its deadlines for EC in its July 31, 2008 letter – long before the Motors Holdings proposal was presented to EC in October 2008. GMAC could not have set its deadlines in July to interfere with a proposed transaction that did not come into existence until October. GMAC followed through on its letter of July 31, 2008, when EC was unable to meet GMAC’s requests. The trial court’s findings are speculation that contradicts GM’s letter. GM advised EC that it was discontinuing its discussions regarding a proposed investment in EC for several reasons, and noted that “GM had no obligation to invest in the Company unless GM determines, in its sole discretion, that such an investment is a commercially reasonable business investment. GM has determined it will not proceed with this transaction.” R Ex. 114.

⁵⁰ The Wholesale Security Agreement expressly provided GMAC with a right of access and inspection of the vehicles and related records. R Ex. 3, ¶ 5.

right to receive payment when EC sold cars,⁵¹ and its right to demand principal payments under the RLCA.⁵²

F. *Badgett* Rejected *Liebergesell* and Defined the Scope of Both a Common Law and the UCC Duty of Good Faith

The trial court relied upon *Liebergesell v. Evans*, 93 Wn.2d 881, 613 P.2d 1170 (1980), to justify its imposition of an extraordinarily broad obligation to provide information upon GMAC contrary to *Badgett*. App. at 17.⁵³ But the Supreme Court in *Badgett* expressly rejected *Liebergesell* as inapplicable to expand a lender's duties to a borrower.

The Court of Appeals relied on *Liebergesell v. Evans*, 93 Wash.2d 881, 613 P.2d 1170 (1980), to assert that “the

GMAC started conducting daily audits after December 5, only after GMAC learned that EC was “out of trust” on eight vehicles totaling over \$132,000. R. Ex. 97. RP Vol. I 37:13 – 38:17, 39:24 – 40:11.

⁵¹ R Ex. 3, ¶ 7.

⁵² GMAC requested a \$10,000 monthly principal reduction on the RLCA. R Ex. 1. The RLCA provided that the “mandatory payment of credit line advances” included “the amount, if any, at a minimum indicated on a Billing Statement as may be sent to Borrower by GMAC, payable by the due date shown on such statement.” R Ex. 8. The trial court also deemed it “commercially unreasonable” that GMAC increased the interest rate on the RLCA based upon “market conditions” without indicating any metric or specific market term or contract term. App at 12. But Mr. Reggans expressly agreed to the increase in writing. R Ex. 69.

⁵³ In *Liebergesell*, a widowed school teacher with no expertise in business, investments, or lending practices relied on the superior knowledge of a person knowledgeable and skilled in accounting. *Liebergesell*, 93 Wn.2d at 884-85. In contrast, Mr. Reggans is an experienced auto dealer with 19 years of experience in the industry, including 12 years at EC. R Ex. 100; RP Vol. X 63:2 – 64:6. *Liebergesell* dealt with a pre-contract factual setting, unlike this case and *Badgett*, where the parties have defined their duties in a contract.

scope of the good faith obligation can be expanded by the conduct of a contracting party which gives rise to reasonable expectations on the part of the other party.” *Badgett*, 56 Wash. App. at 877, 786 P.2d 302. *Liebergessell* is not on point, and more importantly, does not support the broad conclusion stated by the Court of Appeals.

Badgett, 116 Wn.2d at 570 n.2.⁵⁴

In its appellate briefing in this case, EC has argued that *Badgett* does not apply because it only addressed an implied duty of good faith, without ruling on the statutory duty of good faith under the UCC. But the Supreme Court in *Badgett* made no exception for a statutory as opposed to a common law duty of good faith. The Supreme Court in *Badgett* rejected the Court of Appeals’ approach,⁵⁵ including its reliance upon a UCC definition of good faith under RCW 62A.1.201(19). Thus, regardless of the source of the definition of good faith, the duty of good faith cannot be used to inject new terms into the contract or limit a party from standing on its contract rights. *Badgett*, 116 Wn.2d at 569.

⁵⁴ Notably there was no evidence that GMAC had ever provided its credit analysis information to EC or that EC had any expectation of receiving such information.

⁵⁵ *Badgett v. Security State Bank*, 56 Wn. App. 872, 878-79, 786 P.2d 302 (1990).

G. *By Definition, Making Demand Under a Demand Obligation Is Commercially Reasonable; the Amendment of RCW 62A.9A-102(43) Under Article 9 Does Not Change the Nature of a Demand Obligation Under Articles 1 and 3*

The trial court also relied upon the recent amendment of RCW 62A.9A-102(43)⁵⁶ expanding the definition of “good faith” under Article 9 to incorporate the concept of “commercial” reasonableness.

First, “demand” obligations are created, defined, and sanctioned under Articles 1 and 3. RCW 62A.3-108(a); UCC’s Official Comments to UCC § 1-208 (RCW 62A.1-208). Therefore, *by definition*, making demand under a demand promise, “at any time” “with or without reason,” is commercially reasonable under the UCC.

Second, the trial court provided no explanation how the changed definition of “good faith” under Article 9 could affect the definition or operation of a “demand” obligation under Articles 1 and 3 of the UCC. The relationship between demand instruments and the duty of good faith is addressed by specific provisions in Articles 1 and 3, not Article 9.

It is nonsense to argue that the UCC created, sanctioned, and authorized demand obligations with the salient characteristic of not being subject to a duty of good faith – but then, *sub silencio*, the UCC committee

⁵⁶ RCW 62A.1.9A-102(43) is simply a definitional section. As such, it does not require or direct that the duty of good faith be applied to any conduct.

amending Article 9, not Articles 1 or 3, fundamentally changed demand obligations by subjecting them to a “good faith” requirement under Section 9-102(43).

Moreover, the trial court erred by extending an Article 9 definition of “good faith” beyond Article 9 subject matters. Article 9 deals with security interests: their formation, attachment, perfection, priority, rights of third parties, filing, and default. Article 9 does not purport to deal with performance of demand promises or general contract issues or rights, particularly when those issues are addressed in other articles of the UCC.

This case has not raised any issues regarding any Article 9 subject matter because GMAC has yet to obtain possession of its collateral, much less take any steps to sell it, precisely because the trial court denied GMAC’s replevin motion. When GMAC is permitted to replevy the collateral as it should have been, then RCW 62A.9A-102(43) will apply to GMAC’s conduct in disposing of the collateral.

H. The Trial Court’s Findings Contradicted the Parties’ Contract and GMAC’s Legal Rights, Are Based upon Retroactively Imposed Contract Terms and Speculation, and Are Not Supported by Substantial Evidence

The trial court’s colorful rhetoric aside, no evidence was submitted at the replevin hearing to show that GMAC had a “hidden intention” to shut down the dealership, or had the intent to drive the dealership out of

business, make an assault on EC's "working capital," or to manipulate the financial capacity of EC to eliminate EC from the marketplace. App. at 17-19. The trial court's speculation contradicted the contract terms and GMAC's legal rights; GMAC had a right to make demand at any time, with or without reason. GMAC's conduct in acting on its legal and contractual rights cannot support a finding that GMAC had an intent to put EC out of business, even if, as *Allied* recognized, "as a practical matter, the company is in trouble because it has lost its financing." *Allied*, 10 Wn. App. at 534.

The trial court's "bad faith" findings were the product of the trial court's erroneous legal theory of good faith and the trial court's speculation that ignored GMAC's actual contract rights and EC's own financial information and the testimony of its owner and long-time controller, all of which showed that EC's financial problems started in 2007. The fact that EC was in financial trouble due to the auto industry downturn, and the fact that GMAC acted upon its demand financing, cannot logically result in imputation of bad motives to GMAC.

Findings of fact cannot rest upon guess, speculation, or conjecture and must be supported by substantial evidence. *State v. Hutton*, 7 Wn. App. 726, 728, 502 P.2d 1037 (1972); *Rogers Potato Serv., LLC v. Countrywide Potato, LLC*, 119 Wn. App. 815, 79 P.3d 1163 (2003);

Bering v. SHARE, 106 Wn.2d 212, 220, 721 P.2d 918 (1986), *cert. dismissed*, 479 U.S. 1050 (1987). Substantial evidence is evidence of sufficient quantity to “persuade a fair-minded, rational person of the truth of a declared premise.” *In re Snyder*, 85 Wn.2d 182, 185-86, 532 P.2d 278 (1975) (internal quotation marks and citation omitted).

None of the trial court’s findings of bad faith are supported by substantial evidence. Substantial evidence showed that GMAC acted upon its contract rights in good faith like any ordinary commercial lender with demand financing in response to EC’s financial problems.

The trial court’s broad conclusion that GMAC’s conduct somehow made EC unable to meet its obligations to GMAC contradicts the financial evidence in the record. GMAC first spoke to Mr. Reggans in early June about EC’s financial problems, and first made its written requests of EC on July 31, 2008. R Ex. 1. The evidence showed that GMAC was responding to EC’s financial problems, not causing them.

EC’s own financial records showed that by early 2008, *before any* of GMAC’s actions that the trial court found were bad faith, EC’s financial condition was seriously deteriorating. EC’s annual profit shrank from \$700,000 in 2006 to \$28,000 in 2007. RP Vol. X 100:1-7. Mr. Reggans admitted that he had begun “proactively” trying to address EC’s financial distress in July 2007 *even before* GMAC raised the issue

with EC in early 2008. RP Vol. X 103:17-23; RP Vol. XIII 100:1-25, 118:5-16.⁵⁷ Mr. Reggans admitted that the U.S. auto sales industry suffered a substantial downturn in 2007 and “went off a cliff” in 2008. RP Vol. X 103:19-21; 99:7 – 100:13. EC’s records showed that EC had suffered five straight months of substantial operating losses through July 2008, when GMAC sent its July 31 letter making its first financial demands upon EC. R Ex. 64. Ms. Iverson also testified to EC’s severe financial problems starting in 2007, including its inability to pay numerous bills. RP Vol. III 4:23-25; 7:19-8:2; 10:2-12; 12:4 – 13:3; 18:1-15.

Therefore, the actual financial records and testimony submitted – contrary to the trial judge’s erroneous legal theories and speculation – provided substantial evidence that EC’s financial predicament preceded GMAC’s July 31 letter, and was not the result of anything GMAC did. R Exs. 77, 83.⁵⁸ Accordingly, GMAC’s July 31, 2008 letter plainly stated GMAC’s concerns, its requests, its deadline, and the consequences of not

⁵⁷ In mid-2007, Mr. Reggans embarked on a campaign to obtain more working capital for EC through a purchase of the property EC was then renting. RP Vol. X 104:3-9. Mr. Reggans wanted GMAC to provide 100% financing (RP Vol. XIII 100:18-101:3), which GMAC declined to do. RP Vol. I 20:20 – 23:9. GMAC had no obligation to make a real estate loan to EC. RP Vol. XIV 45:4 – 46:6.

⁵⁸ “Even if it were applicable, Mirax has not met its burden of establishing lack of good faith. It is undisputed that Mirax was suffering considerable losses which were revealed to FICC in the financial statements. If FICC needed a reason to feel insecure, it surely had one.” *Mirax*, 950 F.2d at 570.

addressing those concerns. R Ex 1. That is not a “working capital assault” or an attempt to put EC out of business. That was GMAC acting as a prudent lender responding to EC’s financial records showing that EC was in serious financial trouble.

The trial court found it to be “bad faith” that GMAC did not tell Mr. Reggans all the details of its credit analysis, and speculated that EC might have acted differently if GMAC had done so. GMAC had no contractual duty to discuss in detail its financial analysis of EC. And the actual evidence showed that Mr. Reggans *already knew* EC was in trouble. *See* pp. 8-10, *supra*. GMAC did repeatedly discuss with Mr. Reggans, in the July 31 letter and in conversations and letters between Mr. Reggans and various GMAC employees, the financial problems facing EC. RP Vol. VII 9:12-10:3; 23:12-30:25; *see, e.g.*, R Exs. 69, 70, 76. To an auto dealer with 19 years of experience like Mr. Reggans, who had already recognized his company’s financial problems, the July 31 letter clearly notified EC of the financial issues that concerned GMAC.

The trial court’s conclusion that by requesting that EC obtain \$800,000 of working capital, or asking for payments, GMAC was

conducting a “working capital assault” against EC⁵⁹ ignores GMAC’s contract rights⁶⁰ to demand full payment of its approximately \$6,300,000 debt at any time. And instead of immediately making demand for payment of \$6,300,000 in July 2008, GMAC gave EC more than half a year to meet its requests that EC increase its working capital by \$800,000 and provide a personal guaranty as additional security.⁶¹ Only after affording EC an ample opportunity to address its financial problems did GMAC make demand.

As noted, the trial court confused some of the common financial criteria that GMAC uses to measure a borrower’s financial condition with GMAC’s actual requests to EC. This approach improperly imposed bad-faith liability on GMAC for a purely hypothetical situation that never, in fact, occurred. EC did not meet GMAC’s *actual* requests for an \$800,000 increase in working capital and a personal guaranty from Mr. Reggans. So

⁵⁹ EC obtained approximately \$500,000 of additional funds in or about October 2008, but those funds appeared to be a loan, not unencumbered capital. Tellingly, EC used those funds largely to pay amounts in arrears to GMAC; thus, these funds did not increase EC’s available working capital as GMAC requested. RP Vol. X 125:1-7.

⁶⁰ As noted above, the trial court’s “working capital assault” ignored the substantial evidence that EC’s “working capital” problems had started in 2007, pre-dating GMAC’s requests that Mr. Reggans address what Mr. Reggans had already realized needed to be addressed. *See pp. 8-10 supra.*

⁶¹ Plainly, it was far easier for EC to meet GMAC’s requests for \$800,000 of working capital, and pay curtailments, than to pay the approximate \$6,200,000 it owed GMAC on demand.

what might have happened if EC had in fact met the requests in GMAC's July 31 letter is pure speculation. Bad faith cannot be based upon hypothetical events.

In short, the trial court ignored EC's own financial records and the testimony of EC's owner and long-time controller, ignored GMAC's contract rights, ignored the applicable law, and constructed out of speculation its findings of bad faith. The trial court's findings lack a legal basis and are not supported by substantial evidence.

I. The Injunction Was Not Wrongfully Issued and Should Not Have Been Dissolved

The trial court provided no explanation for its dissolution of the injunction and failure to grant GMAC's motion to enforce the injunction against EC's and Mr. Reggans' continued conversion of proceeds, presumably relying on its erroneous findings of bad faith. But EC's conversion of approximately \$778,623 of vehicle sales proceeds in which GMAC had a security interest⁶² in December 2008 and early January 2009 – instead of paying in response to GMAC's demand – and EC and

⁶² “[A] security interest is property which is protected by the Takings Clause of the Fifth Amendment to the United States Constitution . . . *United States v. Security Industrial Bank*, 459 U.S. 70, 103 S.Ct. 407, 74 L.Ed.2d 235 (1982); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 55 S.Ct. 854, 79 L.Ed. 1593 (1935).” *In re Heldor Industries., Inc.*, 131 B.R. 578, 586 (Bankr. D.N.J. 1991) (emphasis added).

Mr. Reggans' continued conversion of vehicle proceeds, supported the trial court's preliminary injunction issued in January 2009.⁶³

GMAC met the standard for an injunction when the trial court entered the preliminary injunction on January 14. GMAC established that

⁶³ It is well established that sales of vehicles "out of trust" by an auto dealer are conversion:

In the automobile sales business, a dealer's sale of automobile inventory without paying the secured lender is known as "selling out of trust". *In re Moody*, 277 B.R. 865 (Bankr.S.D.Ga.2001). In other words, a sale out of trust is a conversion of the collateral.

In re Penton, 299 B.R. 701, 706 (Bankr. S.D. Ga. 2003); see *In re Speers*, 244 B.R. 142, 146 (E.D. Ark. 2000); *In re Baietti*, 189 B.R. 549 (Bankr. D. Me. 1995) (by selling floor plan financier's collateral out of trust, debtor wrongfully obtained financier's property, creating non-dischargeable obligation for value of collateral); *In re Howard*, 261 B.R. 513 (Bankr. M.D. Fla. 2001) (debtor fraudulently obtained lender's property by failing to remit proceeds from sale of its collateral). "Where property is subject to a security interest, an exercise of dominion or control over the property which is inconsistent with the rights of the secured party, constitutes, as to him or her, a conversion of the property . . ." 79 C.J.S. *Secured Transactions* § 157 (2009).

Washington recognizes that a security interest in proceeds can be converted. *Meyers Way Dev. Ltd. P'ship v. Univ. Sav. Bank*, 80 Wn. App. 655, 675, 910 P.2d 1308 (1996) ("By virtue of the security interest, the Bank had 'some property interest' in the proceeds from the sale of sand sufficient to maintain a conversion action." (Citation omitted.)).

We conclude that the Bank nevertheless had the right to immediate possession of the proceeds from the sales of sand. The security stated in the security agreement is the proceeds from sand sales. Thus, the moment the borrowers or Meyers Way received any money in exchange for sand, that money was subject to a security interest.

Id. at 675 n.17.

(1) it had a clear legal or equitable right;⁶⁴ (2) it had a well-grounded fear of immediate invasion of that right by EC;⁶⁵ and (3) the acts about which GMAC complained were resulting in actual and substantial injury to GMAC.⁶⁶ *Tyler Pipe Indus, Inc. v. Dep't of Rev.*, 96 Wn.2d 785, 792, 638 P.2d 1213 (1982). The trial court's preliminary injunction found that "GMAC is in danger of losing their [sic] property and their [sic] remedies under the security agreement signed by both parties" CP 333-337.

The injunction preserved the "status quo"⁶⁷ of GMAC's lending contract with EC, under which, for the 12 preceding years, EC paid GMAC the "floor plan" amount for each vehicle it sold. Moreover, GMAC had a clear legal right not to have its security interest in proceeds converted. *Meyers Way*, 80 Wn. App. 655. Yet, after the January 14 preliminary injunction was entered, and while the replevin hearing was

⁶⁴ GMAC had property interest in the vehicle collateral and its proceeds, and EC had a contract obligation to pay proceeds over to GMAC. GMAC had a legal right not to have its property converted. *Meyers Way*, 80 Wn. App. 655.

⁶⁵ EC had converted the proceeds of the sale of 33 vehicles totaling \$778,000 immediately before GMAC obtained a TRO. RP Vol. VI 27:14 – 30:22; Vol. VIII 9:2-16;. R Exs. 3, 52.

⁶⁶ The proceeds converted by EC and Mr. Reggans will never be available to apply to EC's debt to GMAC. At the replevin hearing, GMAC estimated it will suffer a deficiency of \$1,163,834.80 even after liquidating all of EC's collateral (R Ex. 54). RP Vol. VI 50:3-11.

⁶⁷ The purpose of a preliminary injunction is to preserve the status quo of the subject matter of a suit until a trial can be had on the merits. *Ameriquest Mortg. Co. v. State Atty. Gen.*, 148 Wn. App. 145, 199 P.3d 468 (2009).

proceeding, EC converted additional vehicle collateral proceeds. CP 52-86. None of the relevant facts supporting the injunction had changed by April 10 when the trial court dissolved the injunction.⁶⁸ To the contrary, on April 10, at the conclusion of Judge Lucas' ruling from the bench, EC's attorneys acknowledged that EC was obligated to pay the floor plan amount to GMAC as it sold vehicles⁶⁹ (but after April 10, EC sold yet more vehicles and *still* did not pay GMAC, CP 33-36).

It was not until this Court's June 5 order requiring proceeds to be placed in the superior court registry that EC and Mr. Reggans' conversion of proceeds was finally halted.

Because the trial court's bad-faith findings were legally and factually groundless, they provided no basis to dissolve the injunction. Because EC continued to sell vehicles without paying GMAC even when the injunction was in place, GMAC had a well-grounded fear that EC would continue converting its vehicle collateral, further damaging GMAC.

⁶⁸ On June 5, in conjunction with granting discretionary review, this Court ordered EC to deposit all proceeds of all vehicle sales into the court registry, thereby preventing further conversion of proceeds.

⁶⁹ Mr. Glowney: So when they [EC] sell cars what do they do?

Mr. Hausmann: They are still contractually bound.

Mr. Wheeler: We will pay the floor plan amount.

App. at 25. Because EC was in default in meeting GMAC's mid-December demand for full payment, GMAC was entitled to all proceeds from "non-floored" vehicles as well.

EC never moved to have the injunction dissolved and did not challenge the findings in the preliminary injunction order, and nothing submitted by EC in the replevin hearing changed the findings contained in the January 14 order. The trial court's dissolution of the injunction was error.

J. Because the Injunction Was Not Wrongfully Issued, EC Was Not Entitled to an Award of Attorneys' Fees

On July 28, 2009, Judge Lucas awarded fees of \$215,442.50 to EC for the “wrongfully issued” injunction applying a 1.5 lodestar multiplier to the fees of Mr. Wheeler.⁷⁰ An attorneys’ fee award may be made only if an injunction is dissolved for being “wrongfully issued.” *See, e.g., All Star Gas, Inc., of Wash. v. Bechard*, 100 Wn. App. 732, 739, 998 P.2d 367 (2000).⁷¹ An injunction is “wrongfully issued” if the party enjoined had the right all along to do what it was enjoined from doing. *See, e.g., Nintendo of Am., Inc. v. Lewis Galoob Toys, Inc.*, 16 F.3d 1032, 1036 (9th Cir. 1994).

The injunction against EC was not “wrongfully issued.” EC and Mr. Reggans had no right to convert proceeds of GMAC’s vehicle

⁷⁰ Supplemental CP 392-393. A portion of the fees claimed and awarded were based upon the work of Karl Hausmann, EC’s local counsel.

⁷¹ “Washington courts traditionally follow the American Rule in not awarding attorneys’ fees as costs absent a contract, statute, or recognized equitable exception. *City of Seattle v. McCready*, 131 Wn.2d 266, 273-74, 931 P.2d 156 (1997). One exception to this rule is the dissolution of an injunction when wrongfully issued. *Id.* at 274.” *All Star Gas*, 100 Wn. App. at 739.

collateral.⁷² The injunction only compelled EC to perform its contract obligations to pay GMAC its “floor plan” amount when it sold a vehicle and prevented EC and Mr. Reggans from converting proceeds due and payable to GMAC. Therefore, the trial court had no basis to dissolve the injunction or award attorneys’ fees to EC.

K. EC Did Not Meet the Standards for a Fee Award Under Washington Law

EC failed to show that *any* of its claimed fees were recoverable. Attorneys’ fee awards are limited to fees incurred “solely” to obtaining dissolution of the injunction.

“[A]ttorney fees are recoverable in an action [when] a trial on the merits has for its sole purpose the determination of whether an injunction should be dissolved, the injunction is dissolved, and a trial was the sole procedure available to the party attempting to dissolve the temporary injunction.” *Id.* at 277, 931 P.2d 156 (citing *Cecil v. Dominy*, 69 Wash.2d 289, 293, 418 P.2d 233 (1966)). “If dissolving the injunction is not the sole purpose of the trial, then attorney fees are available only for services performed in dissolving the temporary injunction.” *Id.* The rationale supporting this exception is that the party enjoined may have no choice but to litigate. *Id.* at 277-78, 931 P.2d 156. Although *McCready* addressed attorney fees for dissolving a temporary injunction, the rule should apply as well to this action based on a final injunction because the rationale supporting the exception remains the same.

All Star Gas, 100 Wn. App. at 739 (emphasis added).

⁷² Under the parties’ contract EC had no right to keep the “floor plan” portion of proceeds of vehicle sales whether or not GMAC had made demand.

No trial on the merits has been conducted in this case. The only motion before the court for the extended evidentiary hearing conducted in this case was GMAC's pretrial motion for replevin under RCW 7.64. EC did not file a motion to dissolve the injunction. The pretrial replevin hearing was *not* a final trial in this case⁷³ and was in any case *not* "a trial on the merits" that had "for its sole purpose, the determination of whether an injunction should be dissolved." *All Star Gas*, 100 Wn. App. at 739 (internal quotation marks and citation omitted).

Injunctive relief was not the sole purpose of GMAC's lawsuit. GMAC sought replevin of its vehicle collateral; the injunctive relief GMAC obtained was, as the preliminary injunction stated, to protect GMAC's property and its remedies under the security agreement against EC. CP 333-337.

As noted above, EC never filed a motion to dissolve the injunction and defended GMAC's motion for replevin by asserting GMAC acted with "bad faith." All of the proof offered by EC at the replevin hearing, and all of EC's legal arguments, were raised to defend against GMAC's motion for replevin. In other words, had no injunction been entered, EC would have presented the same defense and the same evidence.

⁷³ The trial court expressly noted that the replevin motion hearing was not a damages hearing. RP Vol. I 9:1-2.

Accordingly, where EC did not file a motion to dissolve the injunction, GMAC did not solely seek injunctive relief, and the pretrial replevin hearing conducted in this case did not have as its sole purpose the dissolution of the injunction, EC's legal fees were not incurred solely for the purpose of seeking to dissolve the injunction, and the trial court had no basis whatsoever to award EC any fees.

Washington law also requires EC to segregate and justify its fee request.⁷⁴ EC did not do so. EC simply sought all the fees EC incurred in connection with EC's defense of GMAC's replevin action. But because EC would have had to expend all the same fees to present its defenses to the motion for replevin, even if there had been no injunction, none of its fees were incurred solely to dissolve the injunction. Therefore, the trial court's award of fees to EC is erroneous and should be reversed.

The trial court's award of attorneys' fees was also premature. An award of attorneys' fees as damages or a claim on an injunction bond for a

⁷⁴ If attorneys' fees are allowed for only some claims, time spent on issues for which attorneys' fees are authorized and time spent on other issues must be segregated. *Gaglidari v. Denny's Rests., Inc.*, 117 Wn.2d 426, 450, 815 P.2d 1362 (1991). An attorneys' fee award "must properly reflect a segregation of the time spent on issues for which attorney fees are authorized from time spent on other issues." *Dash Point Village Assocs. v. Exxon Corp.*, 86 Wn. App. 596, 611, 937 P.2d 1148 (1997) (quoting *Hume v. Am. Disposal Co.*, 124 Wn.2d 656, 672, 880 P.2d 988 (1994), cert. denied, 513 U.S. 1112 (1995)). A party must establish entitlement to attorneys' fees and must also establish that they are reasonable. *Absher Constr. Co. v. Kent Sch. Dist., No. 415* 79 Wn. App. 841, 847, 917 P.2d 1086 (1995).

“wrongfully” issued injunction cannot be made against a bond until final judgment on the merits of the case is entered.

As to damages on the injunction bond, it is well established that there can be no recovery of damages caused by a preliminary injunction, even if the injunction is set aside, unless final judgment after trial is in favor of the party that has been enjoined.

Meeker v. Stuart, 188 F. Supp. 272, 276 (D.C.D.C. 1960), *aff'd*, 289 F.2d 902 (1961).⁷⁵ Washington law is in accord. *All Star Gas*, 100 Wn. App. at 739 (“But because we reverse the summary judgment order that he was not bound by the injunction, he has yet to prevail on this issue and the award of fees was premature.”). EC has not finally prevailed here.

L. The Trial Court Erred in Denying GMAC’s Motion to Amend Its Complaint

The trial court abused its discretion by denying GMAC’s motion to amend its complaint, apparently relying upon its bad faith findings. CR 15(a) provides that “leave [to amend] shall be freely given when justice so requires.” The purposes of CR 15 are to “facilitate a proper decision on the merits,” and to provide each party with adequate notice of the basis of the claims or defenses asserted against it. *Pierce County Sheriff v. Civil*

⁷⁵ See *Clark v. K-Mart Corp.*, 979 F.2d 965, 969 (3d Cir. 1992); *Am. Bible Soc’y v. Blount*, 446 F.2d 588, 594-95 & n.12 (3d Cir. 1971); *Madison Shipping Corp. v. Nat’l Mar. Union*, 204 F. Supp. 22, 23 (E.D. Pa. 1962); *Janssen v. Shown*, 53 F.2d 608, 609 (9th Cir. 1931); *Ala. Mills v. Mitchell*, 159 F. Supp. 637, 639 (D.D.C. 1958); *Nuclear Elec. Labs., Inc. v. William C. Cornell Co.*, 239 Cal. App. 2d 8, 12-13, 48 Cal. Rptr. 416 (1965).

Serv. Comm'n, 98 Wn.2d 690, 695, 658 P.2d 648 (1983). The touchstone is prejudice to the opposing party. *Herron v. Tribune Pub. Co.*, 108 Wn.2d 162, 165-67, 736 P.2d 249 (1987). The fact that the material in the amended pleading could have been included in the original pleading does not preclude amendment without a showing of prejudice. *Id.*

There was no prejudice to EC in allowing an amendment four months after the case was filed when no trial date had been set. Instead, GMAC's early amendment of its complaint gave notice to EC of the claims in the case and provided ample time to prepare its defenses. CP 106-117. The trial court abused its discretion by denying the motion to amend.

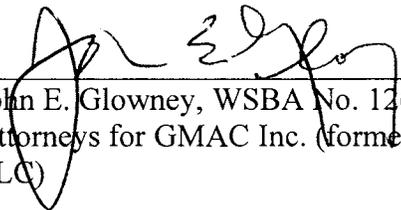
V. CONCLUSION

The trial court's two orders should be entirely reversed and its "findings" of bad faith discarded as lacking legal substance and unsupported by substantial evidence. Under a proper application of *Allied*, *Badgett*, and the UCC, GMAC was entitled to replevy its collateral. The trial court erred by applying the duty of good faith to a demand promise and by retroactively injecting new duties into a contract in violation of *Allied*, *Badgett*, and the UCC. The injunction was necessary to prevent conversion of the proceeds of GMAC's vehicle collateral and was not "wrongfully issued," because it only required EC to perform its

contractual duty. No fees should have been awarded, because the injunction should not have been dissolved and because EC failed to show that its fees were incurred “solely” to obtain dissolution of the injunction. The motion to amend should have been granted because EC failed to show any prejudice.

Dated this 5th day of November, 2009.

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