

NO. 77708-0

SUPREME COURT
OF THE STATE OF WASHINGTON

Court of Appeals No. 22764-2-III

Court of Appeals No. 23239-5-III

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Cashmere Valley Bank, a Washington corporation,

Respondent

v.

Terry B. Brender, a single man,

Petitioner

ANSWER TO PETITION FOR REVIEW

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I. ASSIGNMENT OF ERROR

Whether the Court of Appeals correctly affirmed Chelan County Superior Court's dismissal of Terry B. Brender's ("Brender") Truth in Lending Act ("TILA") counterclaim and affirmative defense.

II. STATEMENT OF CASE

Brender's Petition for Review omits critical undisputed facts. Contrary to Brender's claim, these omitted facts establish that Brender and Cashmere Valley Bank ("CVB") did not enter into their May 1993 loan (the "1993 Loan") exclusively so Brender would have \$150,000 to fund his divorce. The following facts show that the 1993 Loan was primarily for the business purpose of resolving Brender's defaults on four pre-1993 business loans and resolving CVB's lawsuit against Brender on those pre-existing business debts:

1. At the making of the 1993 Loan, Brender was in default on four (4) business loans CVB had made to him totaling about \$200,000 (the "Defaulted Business Loans")(CP 83-105 and 293-335).

2. Prior to the making of the 1993 Loan, CVB started a lawsuit against Brender to collect on the Defaulted Business Loans (CP 83-105 and 380-482).

3. The 1993 Loan consolidated the Defaulted Business Loans with \$150,000 Brender used to acquire Brenda Brender's (Brender's soon-

to-be ex-wife) interests the couple's mobile home, orchards, and shake mill. CVB conditioned the 1993 Loan and the dismissal of its lawsuit on Brender's pledge of these properties as collateral free and clear of Brenda's interests (CP 83-105).

4. Upon the execution of the 1993 Loan, CVB dismissed its lawsuit against Brender on the Defaulted Business Loans (CP 83-105 and 293-335).

5. The February 9, 1993 Memorandum to Credit File (cited by Brender on page 3 of his Petition) specifically states that the purpose of the 1993 Loan is for the consolidation of the (i) Defaulted Business Loans and (ii) the funds Brender used to acquire and pledge Brenda's interests in the mobile home, orchards, and shake mill. The Memorandum states: "Loan Purpose: Divorce Settlement and Consolidation." It also states: "These new funds and the restructuring of our present debt would put the bank in a fully secured and amortizing position." (CP 65). A copy of the Memorandum to Credit File is attached hereto as Appendix A.

6. At the execution of the 1993 Loan, Brender signed a Disbursement Agreement and Authorization representing and warranting to CVB that the 1993 Loan was primarily for business purposes. (CP 336-357).

III. ARGUMENT

A. The Court of Appeals correctly used quantitative approach for Brender's hybrid loan

Contrary to Brender's assertions, the Court of Appeals' decision in Cashmere Valley Bank v. Brender, 128 Wn. App. 497, 116 P.3d 421 (Div. III 2005) clarifies the applicability of the TILA to hybrid loan cases and correctly applies the quantitative approach.

The TILA's use of the word "primarily" provides that a loan made primarily for business purposes is excluded from the TILA. The pertinent portion of the TILA reads:

This subchapter does not apply to the following:

(1) Credit transactions involving extensions of credit **primarily** for business, commercial, or agricultural purposes, or to government or governmental agencies or instrumentalities, or to organizations.

15 U.S.C. § 1603(1)(emphasis added).

The TILA's use of the word "primarily" anticipated that a loan could have both a consumer and business purpose:

By using the word "primarily" the [TILA] recognizes that a single loan may have more than one purpose. The courts have accordingly found that loans to be 'primarily' for an exempt purpose, and therefore totally exempt from the requirements of the [TILA], where more than half of the proceeds were devoted to the exempt purpose.

Federal Land Bank of Jackson v. Kennedy, 662 F. Supp. 787, 790 (N.D. Miss. 1987).

In Brender, the Court of Appeals explained that the 1993 Loan was a hybrid loan. The 1993 Loan had an undisputed business purpose (the refinancing of the Defaulted Business Loans and the resolution of CVB's lawsuit) and an arguably consumer purpose (the \$150,000 Brender claims he used to fund his divorce). The Court of Appeals stated:

The loan in question here is a hybrid loan because it was made for both consumer and business purposes.

...

[T]he undisputed facts demonstrate that prior to the 1993 Loan, Mr. Brender was in default on unsecured business debts owed to CVB. To receive the 1993 Loan, Mr. Brender had to pledge his orchard, shake mill, and mobile home. Mr. Brender was involved in a divorce and Ms. Brender owned a one-half interest in these properties. Mr. Brender used approximately \$200,000 of the 1993 Loan to pay off the pre-1993 business loans, and approximately \$150,000 of the 1993 Loan to buy out Ms. Brender's interests. Mr. Brender was then able to use these properties to secure the loan.

Brender, 116 P.3d at 424-425.

The Court of Appeals' decision is consistent with numerous other cases applying the quantitative approach to hybrid loans. These cases all find that the TILA does not apply to hybrid loans when the majority of loan proceeds were used (as in Brender's case) for a business purpose.

See Stillman v. First Nat. Bank of North Idaho, 791 P.2d 23 (Idaho App. 1990)(debtor borrowed \$32,000 and used \$16,411 for business purposes and \$15,559 for personal reasons); Toy Nat. Bank v. McGarr, 286 N.W.2d 376 (Iowa 1975)(borrower consolidated \$1,000 pleasure boat loan with \$12,000 business loan); Bokros v. Associates Finance Inc., 607 F. Supp. 869 (N.D. Ill. 1984)(borrower used \$8,000 to retire home mortgage and \$9,000 to finance purchase of business tractor trailer); In Re Klutzaritz, 46 B.R. 368 (E.D. Pa. 1985)(borrower consolidated \$33,000 in business debts and \$21,000 in personal debts).

The Court of Appeals correctly applied the quantitative approach to Brender's hybrid loan. The Court stated, "Applying the quantitative analysis to the facts here, more than one-half of the proceeds of the 1993 Loan were used for business purposes and the 1993 Loan was exempt from the TLA." Brender, 116 P.3d at 425.

The Court of Appeals' rationale for adopting the quantitative approach is consistent with the reasoning of numerous other courts that use the quantitative approach. See e.g. Stillman, 791 P.2d at 25 (courts have adopted a quantitative approach where more than half the money loaned is for an exempt purpose, such as to fund a business). The quantitative approach is the easiest test to apply and promotes the most

certainty in commercial lending, as opposed to the all circumstances test

Brender champions:

The quantitative approach is the easiest to apply and it will promote certainty in the commercial marketplace. Conversely, a test for hybrid loans that examines all relevant circumstances will promote uncertainty and litigation. As already noted, the majority of the loan proceeds here were used for commercial purposes and, consequently, the loan is exempt from the application of the TLA for a business loan.

Brender, 116 P.3d at 426.

Contrary to Brender's assertion, the quantitative approach will lessen future litigation. It is a simple two step analysis. A lender, borrower, or court first determines if the loan is for mixed business and consumer purposes (i.e. a hybrid loan). In Brender's case, this is easily done. Brender was in default on \$200,000 in business loans, and consolidated these loans with the \$150,000 Brender used to acquire Brenda Brender's interest in the properties CVB required Brender pledge as collateral to secure the 1993 Loan.

If a hybrid loan exists, the second step is to determine where the majority of the loan proceeds were applied. If the majority were applied for business purposes, as in Brender's case, the TILA does not apply.

The all circumstances test championed by Brender invites future litigation. That test requires an analysis of countless facts, including the

subjective intent of the borrower. As the Iowa Supreme Court stated, if a borrower's subjective motivations are a factor, it would "create uncertainty in the application of the [TILA] and could completely swallow the [TILA's] business purpose exception." Toy Nat. Bank v. McGarr, 286 N.W.2d 376, 378 (Iowa 1975). As the Federal District Court reasoned in Bokros v. Associates Finance Inc.:

If "primarily" is to have any substantive content (as it must), in the context of a loan like Bokros' – taken out of the two discrete purposes – it must refer to the use of **more than half the funds**. That use, for purpose of the tractor-trailer, was concededly for "business [or] commercial ... purposes." Because the loan thus involved an "extension of credit primarily for business [or] commercial ... purposes," TILA was inapplicable to the loan under TILA § 1603(1) as a matter of law.

Bokros, 607 F. Supp. at 872 (emphasis added).

B. No conflict between Conrad and Brender decisions.

In Brender, the Court of Appeals properly distinguished Conrad v. Smith, 42 Wn. App. 559, 712 P.2d 866 (Div. III 1986) as a non-hybrid loan case. The Court stated:

In Conrad, the court considered a transaction that was not a hybrid loan. The borrower obtained a loan to refinance a prior commercial loan with additional funds necessary to pay off liens on the borrower's house, which was to be used as security for the refinanced loan. The loan statement and the promissory note contained a statement that the loan was made for commercial purposes, but the proceeds of the loan were used to discharge all encumbrances against the house, except the first mortgage. When the borrowers defaulted on

the loan, the lenders initiated foreclosure proceedings and the borrowers initiated an action alleging a violation of the TLA.

...

[A]s the trial court correctly noted here, *Conrad* did not involve a hybrid loan because the loan was obtained to refinance a prior commercial loan with additional funds to clear liens.

Brender, 116 P.3d at 425-426.

Conrad did not involve a hybrid loan, like the 1993 Loan in Brender's case. Unlike the situation in Conrad, Brender claims he used \$150,000 for the consumer purpose of settling his divorce, a claim the Trial Court and the Court of Appeals found to be true for the purposes of summary judgment. However, unlike Brender, these courts did not ignore the Defaulted Business Loans and lawsuit. The Conrads, in contrast, used all of the proceeds from the Smith Loan to satisfy a pre-existing business debt.

To the extent Conrad may relate to Brender's case, Conrad supports that the 1993 Loan was primarily for business purposes. In Conrad, Mrs. Conrad alleged her motive to borrow money from the Smiths was to avoid foreclosure on her home. 42 Wn. App. at 564. The Smith Loan allowed Mr. and Mrs. Conrad to pay off a lien on their home securing a business loan made by Pacific Security Companies, along with

past due property tax liens, a judgment lien, an IRS lien, and a tax warrant. Id. at 561. The Smiths required these liens be released before they would make a loan to the Conrads. Like Brender, at the time of making the Smith Loan, the Conrads signed a statement admitting the Smith Loan was for business purposes. Id. at 564-65. Finding the loan excluded from the TILA, the Court of Appeals in Conrad ruled the purpose of the Smith Loan was to pay off the debt owed Pacific Security Companies. In support of its decision, the Conrad Court cited First National Bank v. Skidis, 403 N.E.2d 56 (Ill. App. 1980) for the proposition that a personal benefit (such as the retirement of liens) only facilitated the Smith Loan and did not change the loan's business purpose. Conrad, 42 Wn. App. at 565-566.

Like the Conrads, Brender needed funds to pay off existing business debts, and signed a document admitting the 1993 Loan was for primarily business purposes. To obtain the needed funds, Brender had to pledge encumbered assets. CVB (like the Smiths) was willing to provide the money necessary to pay off the business debts and remove the encumbrances on the assets to be pledged as collateral. While the release of these encumbrances benefited Brender (as the released encumbrances also benefited Mrs. Conrad), this personal benefit did not change the 1993 Loan's business purpose. See Skidis, supra.

C. The Court of Appeals' ruling does not conflict with prior summary judgment decisions

The Court of Appeals correctly affirmed the Chelan County Superior Court's grant of summary judgment, after viewing all the facts and reasonable inferences in a light most favorable to Brender. A court may decide, as a matter of law, a loan was for primarily business purposes, and excluded from the TILA. Conrad v. Smith, 42 Wn. App. 559, 564 (Div. III 1986).

As with Conrad, Brender's case does not involve disputed material facts and can be decided as a matter of law. Despite Brender's efforts to ignore key facts in his Petition for Review, it is undisputed that the 1993 Loan was the consolidation of the Defaulted Business Loans, and the \$150,000 Brender characterizes as having the consumer purpose of funding his divorce. It is also undisputed the 1993 Loan resolved CVB's lawsuit against Brender, and that Brender represented and warranted to CVB that the 1993 Loan was primarily for business purposes.

To avoid summary judgment, Brender has consistently cited a single portion of Jim Geary's deposition testimony taken about ten (10) years after the making of the 1993 Loan. However, Brender's argument ignores the complete testimony of Mr. Geary, which is undisputed by Brender. In response to questions from Brender's attorney, Mr. Geary

testified that the 1993 Loan consolidated the Defaulted Business Loans with the \$150,000 Brender claims he used for a consumer purpose:

Question. Alright. Is one of the reasons that you extended this loan [the 1993 Loan] to Brender was so that you could get some security?

Answer: Yes.

Question. Okay. Because the Bank was kind of unsecured out there on the \$230,000?

Answer: Yes.

...

Question: Okay. And so, in order to better the Bank's position by giving them the \$353,000 loan, isn't it true that the Bank got security when it didn't have security before?

Answer: Yes.

(CP 380-482).

Brender also ignores the full text of the Memorandum to Credit File made at the time of the 1993 Loan. An honest reading of the Memorandum establishes the hybrid nature of the 1993 Loan. The Memorandum reads: "Loan Purpose: Divorce settlement & consolidation." It also states: "These new funds and *the restructuring of our present debt* would put the bank in a fully secured and amortizing position." See Appendix A (emphasis added).

Based on all the undisputed facts, the Court of Appeals' decision correctly affirmed the Trial Court's grant of summary judgment in favor of CVB, as a matter of law.

IV. CONCLUSION

Based on the foregoing, CVB respectfully requests this Court deny Brender's Petition for Review.

RESPECTFULLY SUBMITTED this 19th day of October, 2005.

OGDEN MURPHY WALLACE, P.L.L.C.

By: 

Brian A. Walker, WSBA #26586
Attorneys for Respondent
Cashmere Valley Bank

APPENDIX A

Memorandum for Credit File

Pre-Approval
 Confirmation
 Renewal
 Line of Credit
 Letter of Credit

BORROWER: TERRY BRENDER

Date of Approval of Loan: 2-9-93 Amount: \$ 175,000/new
200,000/renew
 Interest Rate: 9.00% Interest Payable: Quarterly
 Loan Purpose: Divorce settlement & consolidation
 Repayment Agreement: 15 yrs/quarterly payments
 Source of Repayment: Business revenues
 Secondary Source: Liquidation
 Collateral: 1st lien on orchard, shake mill & equipment
 Collateral Value: \$525,000
 Present Debt: Secured: \$ _____
 Unsecured: \$ 203,178
 Deposit Balances: \$ _____ Related Balances: \$ _____

FINANCIAL CONDITION (For Commercial and Real Estate Loans Over \$25,000)	
Balance Sheet	Income Statement:
Dated: <u>3-18-91</u>	No. Months: _____
C.A. : \$ _____	Sales: \$ _____
F.A. : _____	Net Profit: _____
T.A. : _____	Depreciation: _____
C.L. : \$ _____	CASH FLOW: \$ _____
L.T.L.: _____	Draws/Bonus: \$ _____
T.L. : _____	Av. Debt. Sv.: _____
EQUITY: <u>1,613,500</u>	Debt Payments: _____
	Net Difference: \$ _____

Request Approved: mt Request Declined: _____
 If Declined, Reasons: _____

 Recommendations to qualify for approval:
2-9-93

 Committee Initial: mt

Pertinent Credit Comments:

Terry has been a well regarded borrowing customer of the bank for about 30 years. For the past year and a half he has been in the middle of a complicated and costly divorce proceeding. These new funds being requested would finally settle the divorce and allow him to retain full ownership of his orchard and mill which provide his livelihood. This past year and a half has been an unproductive and costly time for Terry as he has been defending himself in the divorce proceeding, which has distracted him from his main activity of cutting and selling shakes. Also during this time he has been forced to pay out considerable sums to both attorneys. These new funds and the restructuring of our present debt would put the bank in a fully secured and amortizing position.

Jerry Geary
 Lending Officer's Signature

RECORD OF LOAN REVIEW, RECOMMENDATIONS AND CORRECTIVE ACTION TAKEN:

LOAN REVIEW

JUL 14 1993

By: _____

Loan Review Officer