

NO. 227642

COURT OF APPEALS,
DIVISION III
OF THE STATE OF WASHINGTON

Cashmere Valley Bank, a Washington corporation,

Respondent

v.

Terry B. Brender, a single man,

Petitioner

BRIEF OF RESPONDENT

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I. ASSIGNMENT OF ERROR

Whether the trial court correctly dismissed Terry B. Brender's Truth in Lending Act (the "TILA") counterclaim and affirmative defense.

II. STATEMENT OF CASE

This appeal arises from Cashmere Valley Bank's ("CVB") lawsuit against Terry B. Brender ("Brender") to collect on a promissory note dated November 30, 2001 (the "2001 Note"), and to recover the collateral Brender pledged to secure that note. (CP 513-534). In defense to CVB's lawsuit, Brender alleged CVB failed to give him disclosures required by the TILA.¹ (CP 505-512).

The 2001 Note is a consolidation of two prior loans from CVB to Brender. The first loan was made in 1993 for the principal amount of \$358,095.70 (the "1993 Loan"). The second loan originated in 1999 for the principal amount of \$33,040 (the "1999 Loan"). (CP 83-105 and 336-357). It is undisputed that the 1999 Loan was primarily for business purposes and, therefore, excluded from the TILA. (CP 336-357).

¹ In addition to the TILA, Brender raised the following affirmative defenses and claims to CVB's lawsuit: fraud/misrepresentation, breach of contract, breach of the covenant of good faith and fair dealings, and violation of the State Consumer Protection Act. (CP 505-512). Chelan County Superior Court recently dismissed all of Brender's claims and affirmative defenses.

Brender's argument is that the 1993 Loan was subject to the TILA, as it was primarily for consumer purposes.

The primary purpose of the 1993 Loan was for Brender to pay off \$203,178.94 in unsecured business debts owed CVB (the "Pre-1993 Business Loans"). (CP 83-105 and 293-335). At the time of the 1993 Loan, Brender was in default on the Pre-1993 Business Loans and CVB was suing Brender to collect on those unsecured debts. (CP 83-105 and 380-482). The 1993 Loan paid off the Pre-1993 Business Loans and settled CVB's lawsuit. (CP 83-105 and 293-335).

As a condition to CVB making the 1993 Loan and settling its lawsuit, CVB required Brender pledge his orchard, shake mill, and mobile home free and clear of the interests of Brender's soon-to-be ex-wife, Brenda Brender. (CP 83-105). Brenda Brender owed a one-half interest in these properties and wanted about \$150,000 to release her interests (CP 83-105 and 293-335). Of the \$358,095.70 CVB loaned Brender, Brender used about \$200,000 to pay off the Pre-1993 business loans and about \$150,000 to buyout Brenda Brender's interests in the orchard, shake mill, and mobile home (CP 293-335). Brender then pledged these properties as collateral for the 1993 Loan. (CP 83-105 and 293-335).

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

The TILA applies only to consumer transactions. It does not apply to loans made primarily for business purposes. 15 U.S.C. §1603(1).

Courts use two methods for determining if a loan is primarily for business or consumer purposes. The method used depends on whether the loan is a “hybrid loan” (i.e. a loan made for both consumer and business purposes). Federal Land Bank of Jackson v. Kennedy, 662 F. Supp. 707 (N.D. Miss. 1987).

For hybrid loans, courts look to where the majority of the loan proceeds were to be used. If the majority of loan proceeds were for business purposes, the loan is excluded from the TILA. Federal Land Bank of Jackson, at 790 (“By using the word ‘primarily,’ the [TILA] recognized 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 total exempt from the requirements of the [TILA], where more than half of the proceeds were devoted to the exempt purpose.”)

For non-hybrid loans, courts examine the loan transaction as a whole and the purpose for which the loan was made. Tower v. Moss, 625

F.2d 1161 (5th Cir. 1980)(loan to improve real property was consumer transaction, because borrower intended to use property as her residence, despite renting property at time loan made).

In Brender's case, the 1993 Loan is a hybrid loan and exempt from the TILA. More than half of the 1993 Loan proceeds were for the business purpose of resolving the Pre-1993 Business Loans and settling CVB's lawsuit on those debts. (CP 83-105 and 293-335). The fact Brender used some of the loan proceeds to buy out Brenda Brender's interests in the properties CVB required Brender pledged as collateral does not alter the 1993 Loan's primary business purpose.

A. TILA does not apply to 1993 Loan, because majority of loan proceeds used to pay off Brender's pre-existing business debts and resolve lawsuit.

As indicated above, a loan is excluded from the TILA when the majority of the loan's proceeds were for business purposes. Kurtis A. Kemper, Annotation, What Constitutes "Business or Commercial" Purposes Within Meaning Of § 104(1) Truth In Lending Act, 54 ALR Fed. 491, §3; Consumer and Borrower Protection, 17 Am. Jur.2d §14; Stillman v. First National Bank of North Idaho, 791 P.2d 23 (Idaho App. 1990); In re Stipetich, 294 B.R. 635 (W.D. Pa. 2003); In re Klutzaritz, 46 B.R. 368 (Bankr. E.D. Pa. 1985); and Toy National Bank v. McGarr, 286 N.W.2d 376 (Iowa 1979).

The case of Stillman v. First Nat. Bank of North Idaho is similar to Brender's situation, and provides an example of a loan excluded from the TILA, because a majority of the loan proceeds were for business purposes. The Stillman Court ruled, as a matter of law, that a loan was excluded from the TILA where the debtor had borrowed \$32,000 and used \$16,411 for business purposes and \$15,559 for personal reasons. In reaching its decision, the Court stated:

A single loan may have both exempt and non-exempt purposes. In deciding how such a loan should be characterized, the 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 disclosure requirements are deemed not to apply. See Federal Land Bank of Jackson v. Kennedy, 662 F. Supp. 787 (N.D. Miss. 1987) (loan is "primarily" for an exempt purpose, and therefore totally exempt from the requirements of the Truth in Lending Act, where more than half the proceeds were devoted to the exempt purpose). Accord, Bokros v. Associates Finance, Inc., 607 F.Supp. 869, 871-72 (D.C.Ill.1984); In re Klutzaritz, 46 B.R. 368, 370 (Bankr. E. D. Pa 1985).

Stillman, at 25.

The following cases are also similar to Brender's situation and provide examples of loans excluded from the TILA, because a majority of the loan proceeds were for a business purpose.

In Toy Nat. Bank v. McGarr, 286 N.W.2d 376 (Iowa 1975), a borrower refinanced into a single loan a promissory note to buy a pleasure boat and a note for business purposes (and as security pledged his residence). The borrower sought to avoid his refinancing by alleging the lender violated the TILA. The Court dismissed the borrower's claim, finding the refinancing was primarily for business purposes. At the time of the refinancing, the boat loan had a balance of about \$1,000, and the business loan had a balance of about \$12,000. The Court also stated that the pledging of the borrower's residence did not change the business nature of the refinancing. Id. at 378.

In Bokros v. Associates Finance Inc., 607 F. Supp. 869 (N.D. Ill. 1984), Csada Bokros attempted to rescind a promissory note secured by his personal residence citing the TILA. The promissory note consolidated two pre-existing obligations: one for \$8,000, which retired the mortgage on Mr. Bokros' residence; and a second for \$9,000, which Mr. Bokros used to finance the purchase of a tractor trailer for his business. The Court dismissed Mr. Bokros' TILA claim, as a matter of law, because less than half of the loan proceeds were used to retire Bokros' existing residential mortgage. Id. at 871-872. The Court reasoned:

If "primary" is to have any substantive content (as it must), and 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 conceitedly 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.

Id., at 872.

In In Re Klutzaritz, 46 B.R. 368 (E.D. Pa. 1985), the Klutzaritzs unsuccessfully cited the TILA to challenge the validity of a loan from the First National Bank of Allentown. The loan refinanced of about \$33,000 in business debts and about \$21,000 in personal debts. The Court rejected the Klutzaritzs’ claim, finding the loan exempt from the TILA, because “over 60% of the money involved in the [loan] was used to satisfy a debt owed to the bank by Mr. Klutzaritz’s business.” Id. at 370.

In Brender’s case, Brender used more than half of the proceeds of the 1993 Loan to satisfy the Pre-1993 Business Loans and settle CVB’s lawsuit against him on those debts. CVB loaned Brender \$358,095.70. Of this amount, \$203,178.94 paid off the Pre-1993 Business Loans and settled CVB’s lawsuit. Only about \$150,000 was used to secure Brender’s interests in the orchard, shake mill, and mobile home free and clear of the interests of Brenda Brender. Thus, the 1993 Loan was primarily for business purposes and excluded from the TILA.

Based on the foregoing, CVB requests this Court affirm Chelan County Superior Court's dismissal of Brender's TILA claim and affirmative defense.

B. Brender's use of loan proceeds to purchase his ex-wife's interests in orchard, shake mill, and mobile home does not change business purpose of 1993 Loan.

It is the use of loan proceeds that determines whether a loan is exempt from the TILA. A personal benefit to a borrower such as the retirement of a judgment lien or other encumbrances on real property to facilitate the obtaining of a loan does not change the loan's business purpose. First National Bank v. Skidis, 403 N.E.2d 56, 57 (Ill. App. 1980); and Kinkead v. Union National Bank, 907 S.W.2d 154, 159 (Ark. App. 1995).

In Brender's case, the \$150,000 used to secure the release of Brenda Brender's interests in the orchard, shake mill, and mobile home does not change the business purpose of the 1993 Loan. The loan's primary purpose remained resolving Brender's defaults on the Pre-1993 Business Loans and settling CVB's lawsuit against Brender on those debts. (CP 83-105 and 293-335). Even Brender agrees the \$150,000 only facilitated the resolution of the Pre-1993 Business Loans. At Brender's deposition, he testified:

Question: So it's your testimony that all those loans that got refinanced were related to the orchard operations or to the mill operation?

Answer: Yes.

Question: Because I think at the time of the 1993 loan there was about \$200,000 you owed Cashmere Valley Bank; does that sound about right?

Answer: Yes.

Question: So it's your testimony that \$200,000 that was being refinanced was due to loans the bank had made on your businesses; the orchard and the mill?

Answer: Yes.

Question: Now, the bank also gave you \$150,000 cashier's check at the time of that 1993 loan, right?

Answer: Not me.

Question: Who did they give the check to?

Answer: Apparently to John Hotchkiss because I never saw it.

Question: Hotchkiss was your attorney?

Answer: Yes.

Question: He was representing you in your divorce?

Answer: Correct. Yes.

Question: And it's your understanding that -
- that those funds were going to be -- were

going to your --were going to Brenda, your soon-to-be ex-wife?

Answer: Yes.

Question: And it's my understanding that the -- that the purpose for that \$150,000, as you testified to earlier, was to -- was to go towards securing from her a quit claim deed on the orchard and the mill and your home and then you said "everything"; is that correct?

Answer: Basically, the lady only wanted money.

Question: So you -- the \$150,000 went to her to primarily pay off -- pay her off so you could keep all the interest in the orchards and the mill?

Answer: Yes.

Question: And the orchards and the mill are your primary income source? That was your business back in August of 1993?

Answer: Yes. It's always been.

(CP 293-335).

The deposition testimony of Brender's loan officer at CVB, Jim Geary, further explains that Brender's pledging of the orchard, shake mill, and mobile home was to facilitate the settlement of Brender's defaults on the Pre-1993 Business Loans:

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).

Based on the foregoing, CVB requests that this Court find the pledging of the orchard, shake mill, and mobile home did not change the primary business purpose of the 1993 Loan and affirm Chelan County Superior Court's dismissal of Brender's TILA claim and affirmative defense.

C. Brender's argument ignores and misinterprets facts and law.

Brender mistakenly focuses on his alleged subjective motivations to argue the 1993 Loan was for consumer purposes. A borrower's subjective motives are irrelevant. The proper focus is on how the loan funds are to be used; not the borrower's subjective intent. Kinkead, supra.

Strong policy justifications support the focus on how loan proceeds were applied; and not on a borrower's subjective motives. The focus on loan proceeds allows for an easy and effective mechanism to decide whether a loan is primarily for business purposes. If a borrower's subjective motivations were a factor, it would "create uncertainty in the application of the [TILA] and could completely swallow the [TILA's] business purpose exception. The only workable approach is to characterize a loan transaction by the use to which the proceeds were originally placed" Toy, at 378.

Brender cites an isolated portion of Jim Geary's deposition transcript and a Memorandum to Credit File in an effort to support his claim that Brender's motive for the 1993 Loan was funding his divorce. As explained below, Mr. Geary's testimony and the Memorandum do not change the primarily business purpose 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." Lastly, by listing the orchard, shake mill, and mobile home as collateral for the loan, the Memorandum shows

that CVB conditioned the 1993 Loan on Brender pledging these properties.

As for the selected portion of Jim Geary's deposition transcript cited by Brender, that testimony does not establish the purpose of the 1993 Loan. The relevant facts are that Brender was in default on the Pre-1993 Business Loans, that CVB was suing Brender on those debts, and that the majority of the 1993 Loan's proceeds were to pay off those debts. Further, the isolated portion of the Jim Geary deposition transcript cited by Brender does not contain Mr. Geary's full testimony. As indicated above, Mr. Geary's testimony is that the purpose of the 1993 Loan was to consolidate Brender's pre-existing business debts, and the \$150,000 payment to Brenda Brender was to give Brender title to the orchard, shake mill, and mobile home free of his ex-wife's interests, so Brender could pledge those properties as collateral for the 1993 Loan. (CP 83-105 and 293-335).

Brender's reliance on Conrad v. Smith, 42 Wn. App. 559 (1996) is misplaced. Conrad does not address a hybrid loan. It concerns loan proceeds applied for only one purpose: to pay off an existing business debt. Unlike Brender's situation, Conrad does not deal with a loan where a majority of the proceeds are used to pay off prior business debts and the balance used for what Brender argues was a consumer purpose.

To the extent Conrad relates to Brender's case, Conrad supports 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. 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. The Smiths required these liens be released before they would make a loan to the Conrads. At the time of making the Smith loan, the Conrads signed a statement admitting the loan was for business purposes. Finding the loan excluded from the TILA, this Court ruled the purpose of the Smith loan was to pay off the debt owed Pacific Security Companies. In support of its decision, this 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. Id. 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 get 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. While the release of these encumbrances benefited Brender (like it did Mrs. Conrad), this personal benefit did not change the business purpose for the 1993 Loan.

IV. CONCLUSION

Based on the foregoing, CVB respectfully requests this Court affirm the order of Chelan County Superior Court dismissing Brender's TILA claim and affirmative defense.

RESPECTFULLY SUBMITTED this 15th day of July, 2004.

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