1-8-2013

Bank of Commerce v. Jefferson Enterprises Appellant's Reply Brief Dckt. 40034

IN THE SUPREME COURT OF THE STATE OF IDAHO

Docket No. 40034-2012

THE BANK OF COMMERCE,
an Idaho banking corporation

Respondent,

vs.

JEFFERSON ENTERPRISES, LLC,
an Idaho limited liability company,

Appellant.

APPELLANT'S REPLY BRIEF

Appeal from the District Court of the Sixth Judicial District for Bannock County.
Honorable Robert C. Naftz, District Judge, Presiding.

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INTRODUCTION

Appellant will continue to refer to the parties to this appeal in the same manner as they are referred to in the opening brief. The Respondent Bank of Commerce (the "Bank"). and Appellant, Jefferson Enterprises, LLC, ("Jefferson").[1] The Bank in its Response Brief generally follows the arguments made before the District Court and recites the same facts and law as were argued before the Court. However, the Bank argues against the determinations made below in respect to its findings that an agreement by the bank to take a second priority position on a part of the collateral for the loan existed and that Jefferson had a Prospective Economic Advantage. Jefferson replies with the following.

ARGUMENT

A. The Bank Agreed to Subordinate.

The Bankpresents a number of factual statements gleaned from the affidavit of Steve Worton. The statements are disputed by Jefferson, and were not relied upon by the trial court in its Memorandum Decision. The dispute concerning these facts is well documented in the record and are material and relevant to the issues in this appeal.

The Bank relies on the affidavit of Steve Worton in an attempt to establish that "*as early as at least April 21, 2006, that its mortgage would need to be in first position for all property securing the loan to Jeffersen(sic)...*" (*Respondents Brief p. 2*). Pamela Wake who was present at the meeting on April 21, 2006, stated in her deposition (*R. at Vol. II, p.438 Depo. P. Wake p. 68, Lines 10-14)* that:

10. Q. And you don't recall any discussions during
11. your April 21, 2006, meeting of subordinating Mr.
12. Morrison, having his lender subordinate to the bank on

[1] Jefferson agrees that a typo was made as pointed out and corrected by the Bank in its footnote.

13. this 80 Acres, Inc., property?

14. A. No.

Dustin Morrison in his deposition testified *(R. at Vol. II, p.466 Depo. D. Morrison p. 55, Lines 20-25 p56 Lines 1-3)* that:

20. Development. And then we met on the 8th, I believe, or

21. the 9th, or we spoke on the 9th, I guess, about the 80

22. Acres, Inc., piece. And I know Steve testified or

23. whatever you call it that you do in a deposition that I

24. had always represented that we could get subordination

25. on 80 Acres, Inc., and it was absolutely false, never

1. represented that, never hinted to that. And the notion

2. seems just silly to me that why would 80 Acres, Inc.,

3. give up a first position with no consideration.

Eric Polatis as a Title Officer for First American Title participated in the preparation of a series of Commitments for Title Insurance on real property in a transaction between the Bank and Jefferson. The transaction involved the Bank loaning money to Jefferson, to be secured by real property located in Bannock County, Idaho. After the issuance of the First Commitment, Mr. Polatis met with representatives of the Bank including Steve Worton to discuss and explain the contents of the Commitment and in particular the exceptions set out in the Commitment. The meeting took place sometime during the first week of May 2006 at First American Title Company's offices in Pocatello. Mr. Polatis states that the representatives of the Bank did not express any need to have the first mortgage holder on Parcel 4, "80 Acres, Inc." subordinate it's interest under the mortgage to the in order to complete the transaction with Jefferson Enterprises,

LLC or that Jefferson would be required to pay off the 80 Acres, Inc., obligation as a condition of the closing. *(R. at Vol. III, p.551 ¶¶ 2,3and 6).*

Mr. Polatis learned some time on May 9, 2006 that there were problems with the pending closing involving the transaction because the Bank was requiring that Jefferson have 80 Acre, Inc., subordinate it's mortgage to the Bank of Commerce. The need for the subordination had not been discussed in the meeting that occurred a few days earlier with the representatives of the Bank. *(R. at Vol. III, p.552, Aff. E. Polatis ¶ 10).*

1. The Subordination Agreement is Not Barred by the Statute of Frauds.

The court below stated that " *This Court has also accepted as true that the conditions of the loan agreement provided, among other things, that the Bank would be secured on the 80 Acre parcel in a second priority position".*[2] The court disposed of the argument in its determination that the agreement to subordinate was barred by the Statute of Frauds, in particular §9-505(5). [3] There is no dispute that the bank agreed to loan money in excess of $50,000.00 and in fact did loan Jefferson in excess of two million dollars. However, the Court below reached a legal conclusion that subordination agreement was barred by the Statute of Frauds. The standard of review adopted by this court when ruling on issues of law that were considered in a ruling on summary judgment are stated as follows: "This Court conducts a de novo review of a district court's grant of summary judgment, using the standard the trial court used in ruling on the motion". *Taylor v. McNichols, 149 Idaho 826, 832, 243 P.3d 642, 648 (2010) (quoting Curlee v. Kootenai Cnty. Fire & Rescue, 148 Idaho 391, 394, 224 P.3d 458, 461 (2008)).* Therefore, the

[2] *Memorandum Decision and Order on Motion to Reconsider, R. Vol. III p.733*

[3] I.C. 9-505(5) "*A promise or commitment to lend money or to grant or extend credit in an original principal amount of fifty thousand dollars ($50,000.00) or more made by a person or entity engaged in the business of lending money or extending credit."*

Court affirms a grant of summary judgment when "the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." *I.R.C.P. 56(c).* "When there is no question of material fact, only a question of law remains, over which this Court exercises free review." *Youngblood v. Higbee, 145 Idaho 665, 668, 182 P.3d 1199, 1202 (2008) (citing Kiebert v. Goss, 144 Idaho 225, 227, 159 P.3d 862, 864 (2007)).* Under this standard, "disputed facts are construed in favor of the non-moving party, and all reasonable inferences that can be drawn from the record are drawn in favor of the non-moving party." *Stonebrook Const., LLC v.. Chase Home Fin., LLC, 152 Idaho 927, 929, 277 P.3d 374, 376 (2012) (quoting Curlee, 148 Idaho at 394, 224 P.3d at 461).* The court below interpreted the legal issue of whether the Statute of Frauds barred the Bank's agreement to subordinate to the 80 Acre encumbrance, treating that agreement as an agreement to loan money in excess of fifty thousand dollars. That determination is subject to the standard of review of this court that: "Interpretation of an ordinance or statute is a question of law over which this Court exercises free review." *Lane Ranch P'ship v. City of Sun Valley*, 145 Idaho 87, 89, 175 P.3d 776, 778 (2007) (citing *Friends of Farm to Market v. Valley Cnty.*, 137 Idaho 192, 196, 46 P.3d 9, 13 (2002)). "We apply the same principles in construing municipal ordinances as we do in the construction of statutes." *Friends of Farm to Mkt.*, 137 Idaho at 197, 46 P.3d at 14 (quoting *Cunningham v. City of Twin Falls*, 125 Idaho 776, 779, 874 P.2d 587, 590 (Ct.App.1994)). *Kootenai County v. Harriman-Sayler*, --- P.3d ----, 2012 WL 6621149 (Idaho, 2012).

The issue of the agreement on the part of the Bank to take a second priority position on the 80 Acre parcel is not an agreement (not in writing) to loan money in excess of the $50,000.00 threshold of the Statute of Frauds. The agreement only affects collateral for the loan. By the

plain unambiguous language of the statute it does not bar the agreement made by the Bank to take a second priority position. "The interpretation of a statute 'must begin with the literal words of the statute: those words must be given their plain, usual, and ordinary meaning; and the statute must be construed as a whole. If the statute is not ambiguous, this Court does not construe it, but simply follows the law as written.' " *Verska v. Saint Alphonsus Reg'l Med. Ctr.*, 151 Idaho 889, 893, 265 P.3d 502, 506 (2011) (quoting *State v. Schwartz*, 139 Idaho 360, 362, 79 P.3d 719, 721 (2003)). "A statute is ambiguous where the language is capable of more than one reasonable construction." *Porter v. Bd. of Trustees, Preston School Dist. No. 201*, 141 Idaho 11, 14, 105 P.3d 671, 674 (2004). "We have consistently held that where statutory language is unambiguous, legislative history and other extrinsic evidence should not be consulted for the purpose of altering the clearly expressed intent of the legislature." *Verska*, 151 Idaho at 893, 265 P.3d at 506 (quoting *City of Sun Valley v. Sun Valley Co.*, 123 Idaho 665, 667, 851 P.2d 961, 963 (1993)).

2. Consideration

Jefferson gave consideration for the agreement by agreeing to provide its equity position in the 80 Acre parcel as collateral for the loan. The Bank was providing financing to purchase the Wood property but not the 80 Acre parcel. Jefferson's agreement providing the consideration of allowing the Bank to have a second priority secured interest in the property is sufficient to support the agreement. To be enforceable at law, an agreement must be supported by valid consideration. *Great Plains Equip., Inc. v. N.W. Pipeline Corp.*, 132 Idaho 754, 769, 979 P.2d 627, 642 (1999). * * * Generally, courts will not assess the sufficiency of consideration. *McMahon v. Auger*, 83 Idaho 27, 38–39, 357 P.2d 374, 380 (1960). Consideration "must have some value in the eyes of the law; but in the absence of fraud or overreaching, the promisor, if competent, can fix on anything not in itself unlawful as a consideration and put his own value on

it. and whether it is equivalent" to the benefit bargained for is a matter left to the determination of the parties. Id. (quoting 94 C.J.S. Wills § 113(1)). *Weisel v. Beaver Springs Owners Ass'n, Inc.*,152 Idaho 519, 272 P.3d 491(Idaho 2012). Dustin Morrison testified about the consideration for the second priority position in his deposition clearly explaining that the equity in the 80 Acre parcel as collateral was what he was offering. (*R. at Vol. II, p.470 Depo. D. Morrison p. 109, Lines 3-10)*

3. A. The balance of value or the balance of equity,
4. whether that be a second position or not, whatever that
5. value was, could be a guarantee, it could be whatever,
6. would be subordinated by me, from me to the Bank of
7. Commerce. But nothing would ever be subordinated by 80
8. Acres, Inc., never represented, never implied. In fact
9. quite the opposite on this (indicating), that he said
10. was the first page of my loan request.

B. THE BANK INTENTIONALLY INTERFERED WITH A PROSPECTIVE ECONOMIC ADVANTAGE

The District Court determined that Court determined there "was a valid economic expectancy by Jefferson and that the Bank was aware of that expectancy."[4] However, the disputed facts show that the Bank was aware that if it insisted on having Jefferson use its working capital to pay off the 80 Acre encumbrance that the advantage would be lost. The Bank also knew that the capital ratios that it relied upon in making the loan would have changed to the point that the Bank would not have made the loan if the information had been made known to the

[4] *Memorandum Decision and Order on Motion to Reconsider, R. Vol. III p.736*

Bank's Board of Directors. Steve Worton the Bank's Vice President testified in his deposition (*R. at Vol. II, p.466 Depo. S. Worton p. 73, Lines 7-21)*that:

7. Q. And the board of directors in this short
8. period of time between their approval on the 9th and the
9. loan closing on the 10th had no opportunity to review
10. the loan itself to see if any of those numbers or
11. financials would have changed based on how the loan was
12. actually closed?
13. A No.
14. Q. On the 9th had that working capital, if the
15. working capital amount was over $700.000 less than what
16. was presented to the board, would you have recommended
17. the loan for approval?
18. A. No.
19. Q. And do you believe that the board would have
20. approved it with that change?
21. A. No.

Worton also knew at the time of the closing that the only likely source of money to pay off the 80 Acre encumbrance would have been from Jefferson's working capital. (*R. at Vol. II, p.466 Depo. S. Worton p. 73. Lines 7-21),* where Worton states:

13. Q. Did Mr. Morrison tell you where he was going
14. to get the money to close the loan?
15. A. No, he didn't.

16. Q. From your review of his financial information,

17. where was the most likely spot that he was going to get

18. the money?

19. A. Cash in the bank.

20. Q. And that was a significant portion of the

21. working capital that you had referenced in 803.

22. A. Yes.

There are clearly disputed issues of fact that support the inference that the Bank knew that the requirement of paying off the 80 Acre encumbrance would materially interfere not only with the advantage of that transaction but would also reduce the financial resources of Jefferson to the point that it would not have been able to qualify for the loan with the Bank. The information about the requirement of the use of working capital to place the Bank in a first priority position was not communicated to the Board of Directors of the Bank prior to their approval of the loan. These underlying circumstance support the inference from the disputed facts that the Bank intended to interfere with the transaction. Jefferson was immediately damaged by the loss of its working capital and the loss of the favorable terms of the 80 Acre financial arrangement.

C. FRAUD AND MISREPRESENTATION

1. Reliance on Misrepresentations.

Jefferson had the "right to rely" on the misrepresentation made by the Bank that it would not allow Jefferson and the related businesses to fail and that the Bank would provide operating funds to Jefferson to that end. The substance of the representation relied upon by Jefferson is summarized by Dustin Morrison The substance of the representation relied upon by Jefferson is

summarized by Dustin Morrison (*R. at Vol. II. p.470 Depo. D. Morrison p. 72, Lines 12-25 p. 73, Lines 1-4)* that:

12. Steve says there is no way the bank wants you
13. to fail. there is no way that the bank wants this to
14. fail. there is no way the bank wants this as an asset.
15. So do whatever you think is the right thing for you to
16. do, but if you do this. my hunch is that you will be
17. able to come back into this bank and they will consider
18. whatever your loss was.
19. So we did that, and we did come back into the
20. bank several months later with applications for
21. construction money to continue our operation in Stone
22. Creek Estates and were denied that. And we brought that
23. in at the encouragement of Steve.
24. So we moved forward understanding that it
25. would be the bank's effort to mitigate this impact of

1. this new requirement on our business.
2. Q. And that's based on what you claim Steve
3. Worton told you?
4. A. He didn't say those words, but yes.

Under the circumstances Jefferson's right to rely is not determined using the negligence concept of "reasonableness," because negligence is not a defense to an intentional tort such as fraud. *W. Prosser & W. Keeton, The Law of Torts* § 108 (5th Ed. 1984), at 750. Rather, Jefferson

has a right to rely on another's misrepresentations unless Jefferson's conduct is "so utterly unreasonable, in the light of the information apparent to it, that the law may properly say that its loss is its own responsibility." Id. Moreover, right to rely, like intent, is a question of fact for the jury. *Umphrey v. Sprinkel*, 106 Idaho 700, 709, 682 P.2d 1247, 1256 (1983).

2. Intention

Fraudulent intent rarely is susceptible of direct proof and normally must be established by circumstantial evidence. *Cresswell v. Sullivan & Cromwell*, 704 F. Supp. 392, 406 (S.D.N.Y. 1989). Parties who are guilty of fraud rarely will admit that they intended to defraud. Rather, intent may be inferred from the surrounding facts and circumstances and is a question of fact for the jury. *W. Prosser & W. Keeton*, supra at 742. Idaho law recognizes that the intent element can be established by circumstantial evidence, and that once plaintiff establishes intent by circumstantial evidence, "the burden of coming forward with rebuttal evidence shifts to the defendant." *DBSI/TRI V v. Bender*, 130 Idaho 796, 948 P.2d 151 (Idaho 1997). Neither Steve Worton nor any other officer of the Bank present any undisputed fact that Bank did not intend for Jefferson to rely on Worton's representations. There was abundant circumstantial evidence presented in the form of disputed facts from which the Court below should have found the representations made by Worton on behalf of the bank were intentional and were made for the purpose of inducing Jefferson to expend the working capital and relinquish the favorable terms of the 80 Acre transaction.

3. Damages from Fraud.

Jefferson by its reasonable reliance on the representations of the Bank suffered damages. Those damages resulted from the loss of its working capital, its inability to perform the loan obligations and the inability to continue to operate the other related businesses. The substance of

the damages suffered by Jefferson is summarized by Dustin Morrison (*R. at Vol. II. p.470 Depo. D. Morrison p. 71, Lines 2-25 p. 72, Lines 1-10)* stating that:

2. A. Absolutely. Two totally different issues.
3. One is I can't have my cash that's been spent
4. reimbursed. The other thing is that they have approved
5. this loan based on. No. 1. my income and my capacity to
6. earn. No. 2, my liquidity and ability to debt service
7. over time because we knew this project wouldn't generate
8. a dime based on these numbers that I provided the bank
9. as a break even point of year four or year seven. So it
10. was going to require debt service for a period of time.
11. Keep in mind the reimbursement wasn't to come
12. to my pocket, it was to go to a CD to debt service the
13. darn loan at Bank of Commerce. That's one issue, I can
14. live without that issue.
15. The problem was we have approved you based on
16. your capacity to earn and your capacity to debt service
17. this loan and now you fully acknowledge, Steve,
18. everybody acknowledges there is not an option for
19. subordination, guys. They are not going to just for
20. free give up first position, we have to pay this off if
21. we want first position. In order to pay that off we are
22. going to liquidate our working capital, which will

23. substantially affect our ability to earn because we are
24. a spec home construction company. $700,000 borrows $3
25. million; right? 20 percent, you know, so whatever. $3.5
1. million, I guess.
2. Q. But you continued to operate after that,
3. didn't you?
4. A. No, we suffered, we bled, desperately. So
5. when I told Steve this, you understand there is no way I
6. can maintain my business without my working capital.
7. That working capital will disappear if I do what you are
8. asking me to do. If I don't do what you are asking me
9. to do, I lose this project and every dime that I have
10. spent on this project to date.

The arguments of the Bank as they relate to damages are not applicable here because this fraud did not relate to misrepresented benefits of a transaction. Rather, the fraud here caused detrimental action and the loss of working capital, which could reasonably be foreseen to cause pecuniary loss in the form of increased costs and lost income. See, e.g., Restatement (Second) of Torts § 548A. This court has stated that: "The underlying principle is that the victim of fraud is entitled to compensation for every wrong which is the natural and proximate result of the fraud. The measure of damages which should be adopted under the facts of a case is the one which will effect such result." *Watts v. Krebs*, 962 P.2d 387, 392 (Idaho 1998) (citations omitted) (quoting *Weitzel v. Jukich*, 251 P.2d 542, 546 (Idaho 1952)).

D. NOVATION

The Bank cites its two notes and two mortgages to support of its defense of novation. The contention by the Bank is that even if there were valid agreements on the issue of priority Jefferson's execution of those documents resulted in a novation. "The making of a new contract does not necessarily abrogate a former contract unless it explicitly rescinds it, deals with the subject matter so comprehensively as to be complete in itself, or is so inconsistent with the first contract that the two cannot stand together." *Opportunity, L.L.C. v. Ossewarde*, 136 Idaho 602, 38 P.3d 1258 (Idaho 2002). The disputed facts establish that the first Mortgage prepared by the Bank did not specifically rescind the earlier agreement. In fact, the first Mortgage specifically recognizes that the agreement for a second priority position was acceptable. The second Mortgage resulted from the Bank's desire to loan additional funds to service the interest payment on the first Mortgage. The Bank explained the second loan as follows: *(R. at Vol. II, p.470 Depo. M. Morrison p. 82, Lines 2-21)*

2. A. Could you explain additional funding?

3. Q. Were there additional loans made to Mr.

4. Morrison -- not Mr. Morrison, but Jefferson Enterprises?

5. A. Yes.

6. Q. What was the reason for that?

7. A. Interest.

8. Q. Can you describe the circumstances of how the

9. that -- you know, the timeframe and what was done?

10. A. So we made the loan in 2006 -- I guess if you

11. would refer to 1408.

12. Q. Okay.

13. A. We have got a year, the loan has matured.

14. It's still there, the bridge loan has matured and we

15. have interest that's due. And so in June Dustin made

16. application for $400,000 to pay interest on the bank and

17. then create an interest reserve to allow -- and the

18. intention was to allow him to continue marketing the

19. property, to either find an investor or get it sold,

20. whatever. It was to work with the customer and give him

21. more time and bring the loan current.

The second loan transaction did not involve the novation of the earlier agreements with Jefferson.

CONCLUSION

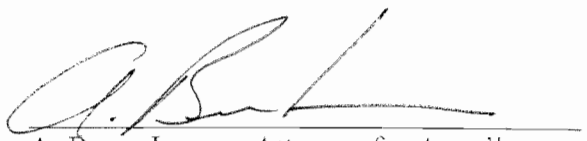
The District Court found the existence of an agreement to take a second priority position on the 80 Acre parcel. As a matter of law the Statute of Frauds does not bar the agreement. The disputed material issues of fact establish that the Bank intentionally interfered with Jefferson's prospective economic advantage, the Bank knew that the interference would cause Jefferson damage and Jefferson was damaged.

There are disputed material issues of fact showing that the Bank intentionally made representations with the intent that Jefferson would rely upon them, Jefferson did reasonably rely upon those representations and did suffer damages.

Jefferson did not agree to rescind the agreement relating to the 80 Acre security position and there are no undisputed facts that establish novation of that agreement.

For the foregoing reasons. Jefferson respectfully requests that the Decisions. Orders and Judgments of the District Court be overruled.

Dated this 8th day of January, 2013.



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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 8th day of January, 2013, two true and correct copies of the within and foregoing Appellant's Reply Brief was served upon:

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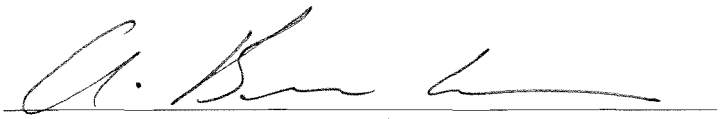

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