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Idaho First Bank v. Bridges Appellant's Reply Brief Dckt. 44532

IN THE SUPREME COURT OF THE STATE OF IDAHO

IDAHO FIRST BANK, Appellant, vs. MAJ-LE TATE BRIDGES, et al., Respondents.	Supreme Court No. 44532 Valley Co. Case No. CV-2015-00145-C

APPELLANT'S REPLY BRIEF

Appeal from the Fourth Judicial District, Valley County, Idaho
Hon. Jason D. Scott, District Judge presiding.

WILLIAM H. THOMAS
DANIEL E. WILLIAMS
Thomas, Williams & Park, LLP
225 N. 9th Street, Suite 810
Boise, ID 83702

Attorneys for Appellant

FREDRIC V. SHOEMAKER
LOREN K. MESSERLY
Greener, Burke, Shoemaker, Oberrecht, PA
950 W. Bannock, Ste. 950
Boise, ID 83702

Attorneys for Respondents

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A. THE BRIDGES DETERMINED THE NATURE OF THEIR IMPROVEMENTS AS PERSONAL, NOT REAL, PROPERTY.

Channeling Claude Rains as Captain Louis Renault in *Casablanca* (Warner Bros. 1942), the Bridges feign to be "shocked, shocked" that Idaho First would regard their improvements as personal property.[1] Their shock comes despite the fact that they agreed with the State in their 2014 Lease that their improvements were "Personal Property." R., p. 400. It comes despite the fact they paid taxes on their improvements as personal property.[2] And it comes despite the fact that Idaho First could not obtain any interest in their leasehold through a real property foreclosure or otherwise, as acknowledged originally by their counsel.[3] Neither the District Court before nor the Bridges now acknowledge the unique complexity of the situation faced by a lender whose defaulting borrower enjoys only a personal property interest in their improvements on state endowment land.

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[1] "IFB surprisingly claimed that the cottage and lease was personal property and not real property and therefore not subject to § 45-1503." Joint Respondents' and Cross-Appellants' Brief, at p. 3. Further citations to this Brief are cited to "Respondents' Brief" by page number.

[2] See Section I.A.2. below.

[3] See R., p. 59 and counsel's suggestion that Idaho First set up a straw man.

1. Parties may choose to characterize their improvements as personal property, which characterization is binding.

The Bridges appeal to "common sense and logic, long established real estate legal principles,"[4] as well as other purported reasons to argue that a $1.6 million "cottage" just has to be real property. Respondents' Brief, p. 17. Contrary to this bare claim, what is actually a long-standing real estate principle is that parties are free to characterize improvements as personal or real. One court stated it well:

> Houses and other improvements placed [on land] by man may or may not be a part of the realty--depending upon contracts and intentions of parties thereto. Everyone knows that in many cases that have been before the courts men erect structures and even very valuable improvements on lands of another under contracts, agreements, and evident intentions that such improvements shall never be a part of the land and never become the property of the land owner. When such conditions arise the improvements do not become real property but remain personal.

Rogers v. Fort Worth Poultry & Egg Co., 185 S.W.2d 165, 167 (Tex. Civ. App 1944), *cited in, Monasco v. Gilmer Boating & Fishing Club,* 339 S.W.3d 828, 835 (Tex. Civ. App. 2011). The same contractual freedom was recognized in *Boise-Payette Lumber Co. v. McCornick*, 32 Idaho 462, 468, 186 P. 252, 253 (1919) (except when intention is determined by contract or agreement, look to all the circumstances to impute intention).[5]

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[4] Leasehold interests are not straightforward real property interests. *See, e.g., Intermountain Realty Co. v. Allen*, 60 Idaho 228, 232-33, 90 P.2d 704, 705-06 (1939) (defining leaseholds as "chattels real" as opposed to a freehold, which is realty).

[5] Quoted in Appellant's Opening Brief at p. 9. The Bridges do not address, distinguish or even mention this case in their response.

Third parties, such as lenders, must live with the intention expressed in the parties' contract. In *Mace v. G.E. Capital Mortg. Serv. (In re Mace),* 2000 Bankr. LEXIS 2047 (U.S. Bankr. D. Neb. Dec. 1, 2000), for example, the Maces owned a leasehold interest in real estate upon which their house was located. They provided to Norwest Mortgage a promissory note and a deed of trust, describing the leased land. They later provided to Rosen Auto Leasing a promissory note and security agreement, which described the same leasehold interest. Upon filing a Chapter 13 petition, the bankruptcy court had to determine the nature of their interest to establish priorities. The Court noted first that the real estate lease documents contained specific language concerning the status of improvements, which made clear that all existing and future improvements would remain the property of the lessee. 2000 Bankr. LEXIS 2047 *5. Additionally, the Maces received their interest in the real estate and the house by an assignment of lease and a bill of sale, not a deed representing a conveyance of real estate. *Id.*

The Court noted that "improvements to a leasehold interest in real estate are personal property if the lease documents show an intent by the parties that the improvements remain personalty. *Id.* It further noted that a lessor of real property and a lessee of real property may contract with regard to the status of improvements as either "fixtures" or personal property. *Id.* Accordingly, the Court found that Rosen Auto Leasing had priority over the competing interest of Norwest Mortgage. *Id.*

Similarly, in *Pacific Metal Co. v. Northwestern Bank,* 667 P.2d 958 (Mont. 1983), Burlington Northern leased a portion of its right-of-way in Helena to Carson Company, allowing Carson to construct, maintain and operate a warehouse and office. Paragraph 14 of the lease

required Carson to remove from the leased premises, prior to the date of termination of the lease, all structures not belonging to the lessor and to restore the premises to substantially their former state. Carson constructed a 180' by 55' warehouse and office, which was affixed to the land by a cement foundation and abutted by cement loading docks. 667 P.2d at 959.

Northwestern Bank advanced funds to Carson and secured its loans with a series of security agreements and perfected by filing a series of financing statements. Additionally, Carson, Burlington Northern and Northwestern Bank entered into a collateral security agreement by which Burlington Northern consented to an assignment of the lease to Northwestern Bank should the improvements be taken over by the Bank in collection proceedings against Carson. 667 P.2d at 960.

Later, Pacific Metal obtained a judgment against Carson, which became a judgment lien upon all real property held by Carson. Carson transferred its interest in the leased property and building to Northwestern Bank by a bill of sale. Pacific Metal filed a declaratory judgment action against the Bank seeking a judgment that the Carson warehouse was real property and that the Bank did not have a security interest. Despite Montana fixture statutes suggesting that buildings resting upon land are fixtures, the Montana Supreme Court affirmed the District Court determination that the building was personal property. 667 P.2d at 960. The Court stated that, despite the fixture statutes, it "is possible for parties to agree that a building is personal property even though it is attached to and resting upon land." *Id.* (further citation omitted).

The Court also rejected Pacific Metal's argument that the lease gave Carson only a theoretical or conditional right of removal of the improvements, given the character of the

structure and the manner in which it was affixed to the land. Reviewing the three-prong test common to fixture analysis,[6] the Court noted that, of the three prongs, "the intent of the parties has the most weight and is the controlling factor." 667 P.2d at 971. The Court then explained:

> In landlord-tenant situations, whether an improvement is personal property or part of the realty is to be determined by the intention of the parties, as expressed in the lease. Rights between a landlord and tenant with respect to fixtures may be modified, restricted or extended by agreement. 36A C.J.S. Fixtures § 15(a) (1961).

Id. (emphasis added). The Court then noted that the lease's characterization of the improvements as personalty demonstrated the requisite intent. Moreover, the removal provision also evidenced the parties' agreement that the warehouse was not to be considered as permanently affixed to the lessor's realty. *Id.* Thus, despite the existence of concrete foundation, the size of the structure, the expense of the improvements, the Court focused on the intent of the parties as expressed in their lease agreement.

Here, the Bridges and the State agreed that "all buildings, structures, additions or developments belonging to LESSEE that have been erected upon, affixed or attached to, the Leased Premises" would be deemed "Personal Property." R., p. 400. Both the 2014 Lease and the original Assigned Lease stated that, upon default, the State could remove or require the Bridges to remove any personal property improvements. R., pp. 408; 98. Similar language existed upon any abandonment. R., pp. 410; 98. Upon expiration of a lease, the State had the

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[6] The same three part-test set forth in *Spencer v. Jameson*, 147 Idaho 497, 502, 211 P.3d 106, 111 (2009).

right to require the Bridges to remove all approved improvements on the premises and to restore them as its natural condition. R., pp. 409; 98.

The District Court was wrong to dismiss these contractual provisions blithely away as "theoretical" or "remote." R., p. 781. It was not for the District Court to speculate as to the probability of future events, especially given the multitude of situations that could arise in which the State would decide to exercise these contractual powers. Instead, the focus should have remained on the intention of the parties as expressed in the lease, the most important of the three-prong text for fixtures. Simply put, the Bridges could not have intended their improvements to become a permanent fixture when the State forbade that intention through the plain language of the lease. Bridges are trying to call both heads and tails on the same coin flip. They could not have the intention to make their improvements a permanent accession to the realty when their state lease language says they are not permanent and we can require removal.

Accordingly, under this authority the State and the Bridges determined the character of the improvements as personal property. The District Court erred in overriding their characterization as evidenced in the lease agreements. The parties' characterization in the agreements is hardly "insignificant," as the District Court termed it. R., p. 780. Rather, it is the clear expression of their intent as to the nature of the improvements as personal property. As a matter of law, only one reasonable conclusion may be drawn from this lease language – that the improvements remained personal property and did not constitute a fixture.

As to this personal property, Idaho First was not obligated to follow the collateral-first dictate of I.C. § 45-1503(1) nor the time limitation for a deficiency action set forth in I.C. § 45-1512. Summary judgment in favor of the Bridges must be reversed.

2. Even if the language of the lease agreements was not determinative, the totality of circumstances indicates the improvements were intended to remain personal property.

The Bridges chide Idaho First for not addressing the nine factors for consideration of intent as to fixture versus personal property approved in *Liberty Bankers Life Ins. Co. v. Witherspoon, Kelley, Davenport & Toole, P.S.*, 159 Idaho 679, 692, 365 P.3d 1033, 1046 (2016). Respondents' Brief, pp. 18-19. As noted in Section A.1, above, examination of these factors is unnecessary where only one reasonable conclusion may be drawn from the parties' agreement as to the nature of improvements. In *Liberty Bankers*, there is no indication of an agreement explicitly characterizing the improvements at issue – different components of a boat marina. Even if the Bridges lease agreement with the State were not determinative, however, examination of the nine factors does not support the District Court's conclusion that the Bridges were entitled to summary judgment.

The Bridges claim that "the nine factors all weigh in favor of showing objective intent to affix the Cottage" and that "each of the *Liberty Bankers* objective factors is addressed by the undisputed evidence." Respondents Brief, pp. 18-19. Such is simply not the case. The nine factors are:

> (1) the nature of the article; (2) the manner of annexation to the land; (3) the injury to the land, if any, by its removal; (4) the completeness with which the chattel is integrated with the use to which the land is being put; (5) the relation

> which the annexer has with the land such as licensee, tenant at will or for years or for life or fee owner [sic]; (6) the relation which the annexer has with the chattel such as owner, bailee or converter; (7) the local custom respecting treating such chattel as personal property or a fixture; (8) the time, place and degree of social, economic and cultural development, (e.g., a luxury in one generation is a necessity in another . . .); and (9) all other relevant facts surrounding the annexation.

159 Idaho at 692, 365 P.3d at 1046 (citations omitted).

The Bridges claim in their summary table that under factor (3) regarding any injury to the land by removal of the improvement, that "there is no contingency for removal and therefore likely significant damage, if not complete destruction." As the Court is well aware, structures are regularly removed or demolished without "significant damage, if not complete destruction" of the underlying land. Indeed, state endowment land surrounding Payette Lake retains its aesthetic and recreational value with or without the Bridges' improvement.

Factor (5)'s focus on the "relation which the annexer has with the land" brings the lease agreement back into view. The Bridges' status as lessees with only very limited rights in their improvements in the event of default, abandonment or non-renewal suggests they could not intend a permanent fixture, because their lessor would not allow it. Similarly, under factor (6) their relation with their chattel is limited under these same lease terms.

Under factor (7) as to local custom, it is clear that improvements on State lease land are treated as personal property, not fixtures. For instance, other state law taxes the improvements as personal, rather than real, property. I.C. § 63-602A exempts, *inter alia*, property belonging to the State of Idaho from taxation. I.C. § 63-309(1)(indicates that all taxable improvements on state land or other exempt land "shall be assessed and taxed as personal property").

Thus, examination of these factors does not support the District Court's conclusion that the McCall collateral was real property.

3. The loan documents and security agreements between the Bridges and Idaho First are not determinative.

At Section V.B.1.b. of Respondents' Brief, the Bridges echo the District Court's puzzling conclusion that, although the characterization in the 2014 Lease Agreement that their improvements remain Personal Property is "insignificant," the fact that Idaho First utilized a Deed of Trust document in the loan transaction is somehow determinative. The simple fact is that Idaho First utilized documents, as it would with all such transactions, that included language both as to real and/or personal property, so that regardless of the outcome of any potential legal battle over the nature of collateral, it was secure. In addition to the language cited by the Bridges, the Deed of Trust "grants to Lender a Uniform Commercial Code security interest in the Personal Property and Rents." The Deed of Trust clearly provides that any personal property is also pledged to secure all indebtedness. The Deed of Trust,

> **"INCLUDING THE ASSIGNMENT OF RENTS AND THE SECURITY INTEREST IN THE RENTS AND PERSONAL PROPERTY, IS GIVEN TO SECURE (A) PAYMENT OF THE INDEBTEDNESS AND (B) PERFORMANCE OF ANY AND ALL OBLIGATIONS UNDER THE NOTE AND THE RELATED DOCUMENTS. . . .**

R., p. 386 (emphasis in original).

Moreover, under "**SECURITY AGREEMENT; FINANCING STATEMENTS**," the following provisions appear:

> **Security Agreement.** This instrument shall constitute a Security Agreement to the extent that any of the Property constitutes fixtures, and Lender shall have all

> of the rights of a secured party under the Uniform Commercial Code as amended from time to time.
>
> **Security Interest.** Upon request by Lender, Grantor shall take whatever action is requested by Lender to perfect and continue Lender's security interest in the Personal Property...Lender may, at any time and without further authorization from Grantor, file executed counterparts, copies or reproductions of this Deed of Trust as a financing statement...

While this language may not track the exact distinctions at issue now regarding "fixtures" as real property versus improvements as personal property, it is clear that the instrument pledged all property regardless of characterization. The fact that a Deed of Trust form is utilized and references to buildings as real property are included does not alter the legal nature of the improvements at issue.

What neither the District Court nor the Bridges address is the question of how Idaho First was to conduct a real property foreclosure when it could obtain no legal rights in the leasehold, the ground upon which the improvements sat. According to Idaho law, Idaho First could not hold the property, as the Bridges' counsel originally conceded. Thus, the District Court and the Bridges conclude that they intended a legal impossibility – that Idaho First would be required to follow real property foreclosure requirements when it could not. Once it foreclosed, it could not possess the improvements it had obtained through foreclosure.[7]

Accordingly, Idaho First was not required to resort to collateral first before seeking collection from the Bridges nor the follow the time limitation for a deficiency action set forth in

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[7] As noted previously, the Bridges' counsel understood this very well, suggesting originally that Idaho First utilize a straw man "entity" to take assignment of the lease, a subterfuge that doubtless would have violated IDAPA 20.03.13.02. *See,* R., p. 59.

I.C. § 45-1512. Summary judgment in favor of the Bridges must be reversed and Idaho First's deficiency claim should be allowed to proceed before the District Court.

B. EVEN IF IDAHO FIRST WERE REQUIRED TO FOLLOW I.C. § 45-1512, THE DISTRICT COURT ABUSED ITS DISCRETION IN NOT ALLOWING RELATION BACK OF THE DEFICIENCY CLAIM.

1. The Bridges had notice of Idaho First's claims and cannot be prejudiced by an amendment.

As noted previously, the District Court erroneously concluded that Idaho First was required to follow Idaho's collateral-first rule and time limitation for seeking a deficiency under real property law. Even if, somehow, Idaho First were obligated to follow these statutes as if the Bridges improvements were not personal property, it is absurd to suggest that its deficiency claim does not arise from the same transaction as its original collection action. The District Court conceded, as it had to, that "[t]o be sure, the original and first amended complaints involved attempts to collect on the same loan involved in the section 45-1512 claim." R., p. 776. Yet, the District Court then went on to insist on a type of code pleading, noting that the "prior complaints did not mention the deed-of-trust collateral." *Id.* (emphasis in original). Whether mentioned or not, as could be predicted, the Bridges immediately raised the existence of the Deed of Trust in a motion to dismiss. R., p. 375. All of the substantive issues regarding foreclosure were engaged from the beginning. The only change was that the property was sold, resulting in a deficiency. Rule 15(d) is designed for exactly these circumstances. The Bridges can hardly claim unfair surprise or prejudice when the resulting amount they owe to Idaho First is now less than it was prior to the sale.

2. The District Court abused its discretion in concluding that it was inequitable to allow a deficiency claim because of a purported failure to follow the collateral-first rule of I.C. § 45-1503(1).

Noting that Rule 15(c) has its roots in the former federal equity practice, the District Court then felt it could sideline the long-standing tests under Rule 15(c) and 15(d)[8] in favor of its own sense of equity. R., p. 778. And it seemed to the Court "entirely inequitable" for Idaho First's deficiency claim to relate back, because it had not followed I.C. § 45-1503(1). Just what prejudice was caused by the supposed failure to follow the collateral-first rule is unclear, however. As a result of Idaho First's original collection suit against the Bridges, experienced lawyers[9] with experienced counsel, the suit immediately became a de facto declaratory judgment action with the Court determining whether it believed the collateral to constitute personal or real property. Luckily for the Bridges, a sale intervened during the case to relieve them of a large share of their indebtedness.

This was no garden-variety foreclosure proceeding where the lender, clearly having real property collateral, willy-nilly ignored the collateral-first requirement of § 45-1503(1). Rather, this was an action arising in a nether world where the legal nature of the collateral was in serious doubt. To suggest that Idaho First obtained any unfair or inequitable advantage in this proceeding is demonstrably false. The District Court voiced concern that any lender might avoid the time-for-filing requirement of I.C. § 45-1512 by filing first a collection action, then seeking

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[8] Idaho First does not repeat a discussion of these tests here, but incorporates its prior discussion at Section IV.B of Appellant's Opening Brief, pp. 16-35.

[9] R., p. 544, ¶ 2.

an amendment after the three-month period required, as discussed in *Badger v. Eighth Judicial District Court,* 373 P.3d 89, 94-5 (Nev. 2016). In a typical situation, that kind of amendment could well prejudice debtors. Here, however, where there was a genuine and difficult issue as to the legal nature of the collateral, the District Court was wrong to compare the situations. The Bridges devote considerable time to this argument, but the plain fact is that the situation here is unique because of the vagaries of state endowment land leases.

3. I.C. § 45-1512 is not a statute of repose.

In their argument advancing the notion that the three-month limitation set forth in § 45-1512 is a statute of repose, rather than a statute of limitation, the Bridges reverse the distinction between statutes of repose and of limitation. Respondents' Brief, p. 34. Statutes of limitation are shorter, such as suing upon notice of a defective product. Statutes of repose are longer, acting as bars to stale claims regardless of notice. The Ninth Circuit Court of Appeals has explained the distinction:

> The focus of a statute of repose is entirely different from the focus of a statute of limitations. The latter bars a plaintiff from proceeding because he has slept on his rights, or otherwise been inattentive. Therefore, it is manifestly unjust to tell somebody that he has X years to file an action, and then shorten the time in midstream. However, a statute of repose proceeds on the basis that it is unfair to make somebody defend an action long after something was done or some product was sold. It declares that nobody should be liable at all after a certain amount of time has passed, and that it is unjust to allow an action to proceed after that. In this case, for example, there was an attempt to sue the manufacturer for the allegedly defective design of a part of an aircraft that had been in service for some 23 years after it was first sold. While an injured party might feel aggrieved by the fact that no action can be brought, repose is a choice that the legislature is free to make.

Lyon v. Agusta S.P.A., 252 F.3d 1078, 1086 (9th Cir. 2001).

Here, I.C. § 45-1512 acts just like a statute of limitation. Once there is a sale under a deed of trust, there is a time period in which to seek a remaining deficiency. The debt is not extinguished, as it would be pursuant to an actual statute of repose. This Court recently stated in a similar context:

> However, the running of the statute of limitations does not extinguish the debt. *Joseph v. Darrar*, 93 Idaho 762, 766, 472 P.2d 328, 332 (1970). 'Statutes of limitations are limitations on a party's right to bring an action. A statute of limitations does not apply (1) to defenses where no affirmative relief is sought, or (2) to self-help set-offs and pledges.'

Sallaz v. Rice, 384 P.3d 987, 992-93, 91 U.C.C. Rep. Serv. 2d (Callaghan) 261 (2016), *quoting, Smith v. Idaho State Univ. Fed. Credit Union,* 114 Idaho 680, 683, 760 P.2d 19, 22 (1988).

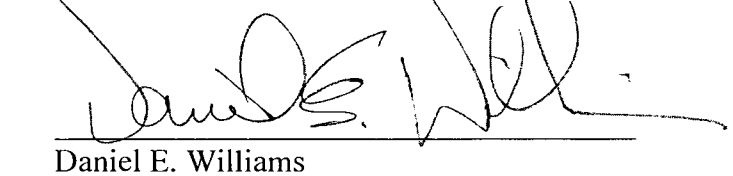
Accordingly, §45-1512 is not a statute of repose and any purported bar to relation back under Rule 15(d) or (c) does not exist.

II. CONCLUSION

For all the foregoing reasons, as well as those first stated in Appellant's Opening Brief, the District Court's entry of summary judgment must be reversed and this case remanded for further proceedings.

Dated this 19th day of September, 2017.

THOMAS, WILLIAMS & PARK, LLP



Daniel E. Williams
Attorneys for Appellant/Cross-Respondent, Idaho First Bank

CERTIFICATE OF COMPLIANCE

The undersigned does hereby certify that the brief submitted is in compliance with all of the requirements set out in I.A.R. 34.1, and that two bound copies were served on Defendants via hand delivery.

DATED AND CERTIFIED this 19th day of September, 2017.

Daniel E. Williams