

NO. A09-2059

State of Minnesota  
 In Court of Appeals

American Bank of St. Paul,

*Respondent,*

vs.

Coating Specialties, Inc., et al.,

*Defendants,*

and

Co-op Credit Union of Montevideo,

*Appellant,*

vs.

Coating Specialties, Inc., et al.,

*Defendants.*


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**APPELLANT'S REPLY BRIEF**

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## ARGUMENT

### **I. The Parties' Subordination Agreement is Ambiguous Because it Omitted a Term Specifying to What CCU Was Subordinating Its Interest.**

The Respondent, in its responsive brief, points out that CCU failed to point to a single term contained in the parties' subordination agreement that is in any way ambiguous. (Resp. Brief at 10). Respondent's assertion highlights a fundamental flaw in the Respondent's understanding of the Appellant's argument. The Appellant does not argue that the subordination agreement is ambiguous as the result of a specific ambiguous term contained therein, rather, the agreement is ambiguous due to an *omitted* term that is necessary to resolve the current dispute between the parties.

The Respondent's position is, in essence, that CCU agreed to subordinate its entire interest in CSI collateral to two short-term \$25,000.00 notes, as well as any and all "renewals, extensions, modifications, refinances, consolidations or substitutions" of those two short-term notes. The Appellant's position is essentially the same as the Respondent's except that the Appellant denies that it agreed to subordinate its interest to any and all "renewals, extensions, modifications, refinances, consolidations or substitutions" of those two short-term notes. Hence, because the parties agree that CCU subordinated its stated interest to the two short-term \$25,000.00 notes, the dispositive issue is as follows: Whether CCU agreed to subordinate its interest to all "renewals, extensions, modifications, refinances, consolidations or substitutions" of the two short-term \$25,000.00 notes.

If, as the Respondent suggests, the subordination agreement is indeed unambiguous, the parties should be able to look to the four corners of the document in

order to resolve this issue. However, upon such examination, one quickly determines that the text of the subordination agreement fails to address the issue as to what CCU agreed to subordinate its interest.

Moreover, the Respondent's argument actually betrays Respondent's own theory of the case, that the agreement is unambiguous on its face such that an examination of extrinsic evidence in order to resolve the outstanding issue is precluded. Ironically, in its responsive argument, instead of directing the Court's attention to the specific contract term that resolves the issue, the Respondent asks the Court to look outside the document to extrinsic evidence. This is the same smoke and mirrors that confused the trial court.

For example, in support of Respondent's position that CCU agreed to subordinate its interest to all "renewals, extensions, modifications, refinances, consolidations or substitutions", Respondent does not point to a supporting term in the subordination agreement. Instead, Respondent directs the Court's attention away from the subordination agreement to the Business Loan Agreements between American and CSI. (Resp. Brief at 6). Not only are these agreements impermissible extrinsic evidence under American's theory of the case, they are not even relevant to the issue at hand, as CCU was not a party to said Business Loan Agreements.

Also, in support of its theory that the agreement itself unambiguously reflects CCU's intention to subordinate the whole of its interest to all "renewals, extensions, modifications, refinances, consolidations or substitutions", American once again directs the Court's attention away from the document itself to the Affidavit of William Wassweiler, in which Mr. Wassweiler avers that CCU's attorney admitted that

American's lien priority was superior to that of CCU.<sup>1</sup> (Resp. Brief at 8). This affidavit too constitutes impermissible extrinsic evidence under American's own theory of the case.

Therefore, because the subordination agreement was ambiguous on its face, the trial court erred in refusing to admit extrinsic evidence to resolve the parties' dispute.

## **II. The Conduct of The Parties Was Consistent With The Parties' Implicit Recognition That The Subordination Agreement Had Been Satisfied.**

In its responsive brief, the Respondent, as it had done to the trial court, attempts to distract this Court from the relevant issues by attempting to portray CCU's actions in this matter as somehow being in bad faith. For instance, the Respondent alleges that CCU liquidated American Bank's collateral by "levying upon and seizing inventory and equipment – despite being fully aware of American Bank's superior interest in the inventory and equipment of Coating Specialties pursuant to the Subordination Agreement". (Resp. Brief at 9). There is no evidence in the record that CCU was aware of any such superior interest. In fact, it remains CCU's position that American holds no interest that is superior to that of CCU. A closer examination of the record, however, reveals that American's conduct was wholly inconsistent with what one would expect from an entity that believed it held a superior interest in collateral.

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<sup>1</sup> The affidavit is from a Lindquist and Vennum attorney who previously represented American in this case. The accusation is derived from Mr. Wassweiler's November 2008 recollection of a July 2007 conversation. Due to the inaccuracy, inadmissibility, irrelevance, and self-serving nature of the averment, as well as the risk of being drawn into the substance of the litigation, the particular averment was not responded to at the trial court level.

First, American's CSI loan documents fail to make any mention of the subordination agreement upon which American relies for its claimed superiority. (A.55 – A.111). Shockingly, not only was the existence of the subordination agreement not recited in the \$100,000.00 loan documents, the \$100,000.00 loan was secured only by an assignment of life insurance and assignment of life insurance and not even secured by CCU's collateral. (A.101). Given the significance of the subordination agreement, it is hard to believe that such agreement would not have been memorialized somewhere in the loan documents.

Second, neither American's original pleadings against CSI, nor the resulting findings of fact, make any reference to the existence of any valid subordination agreement. (A.167-172). It does not make any sense that, where the relevant UCC-1 filings clearly reflected that American was holder of a second place lien priority, the existence of the subordination agreement would not have been pled.

Finally, American's inexplicable failure to pursue replevin of its alleged collateral after receiving judgment against CSI is inconsistent with one who believes it has a first priority lien interest in said collateral. American received its judgment and right to recover collateral on April 3, 2007. (*Id.*). CCU did not receive such judgment until August 31, 2007. Yet, American undertook no action to recover the collateral in which it alleges it had a first place lien interest even after being notified of the existence of collateral by CCU's counsel on June 20, 2007. (R.4).

Further, Wassweiler's averments regarding his exchanges with CCU's counsel are inconsistent with American's stated belief that it held a superior lien interest. In the telephone message, CCU's counsel clearly indicates CCU's intention to proceed to

judgment and recover collateral. (*Id.*). Despite this revelation, Mr. Wassweiler never indicates that he ever mentioned to CCU's counsel that he believed American had a superior lien priority based on the existence of the subordination agreement. Indeed, if Mr. Wassweiler is to be believed, it appears that American intentionally "sat on its hands" and allowed CCU to suffer the costs of collection and resale before asserting any superior right in the replevied collateral.

Finally, Mr. Wassweiler's November 18, 2008 recollection of an alleged June 20, 2009 conversation with CCU's counsel is not consistent with the facts. According to Mr. Kluver's phone message, CCU believed a local firm was holding eight million dollars of CSI assets. (*Id.*). Given the fact that the total amount of money CSI owed both CCU and American was less than \$750,000.00, it does not seem likely that a lien priority discussion would have ensued, particularly since Mr. Wassweiler does not aver that he even mentioned the subordination agreement. What seems more likely, given the text of the earlier message, is that CCU's counsel believed that American was "ahead" of CCU only in terms of receiving judgment against CSI, which American could use to attach to the eight million dollars pending CCU's receiving judgment, and not in terms of lien priority.

In conclusion, there is no evidence in the record that either party was even aware of the existence of the satisfied subordination agreement until American's counsel, in a bit of creative lawyering, decided to resurrect the defunct subordination agreement in its response to CCU's motion to intervene in hopes of defeating CCU's lien priority. It is telling that, prior to such resurrection, American behaved consisted with one holding a

subordinate interest while CCU, on the other hand, always conducted itself consistent with one holding a superior lien interest.

**III. CCU Properly Raised All Appealed Issues Prior to The Trial Court's Order For Summary Judgment.**

**A. The "omitted term" argument was presented to the trial court in CCU's response to American's motion for summary judgment.**

Respondent argues that CCU's argument, that the subordination agreement was ambiguous due to its omission of terms describing exactly what CCU was subordinating its interest to, was not properly raised at the trial court level. (Resp. Brief at 18). This could not be further from the truth, as this very argument was raised in CCU's response to American's motion for summary judgment, dated December 7, 2008. (A.117-118). Further, the notion that ambiguity can be created based on the parties' omission of a necessary term is well based in law and seems far from novel in any event.

Finally, the reason the issue was again brought before the trial court on a motion to reconsider was to give the trial court the opportunity to correct its own error, thereby obviating the necessity of this appeal.

**B. The identifiable proceeds argument was properly raised prior to the order for summary judgment.**

The procedural history of this case is truly bizarre. First, on February 5, 2009, after finding that no genuine issue of material fact existed, the trial court ordered that summary judgment be entered in favor of American. (A.131). Next, upon CCU's motion to reconsider, the trial court ordered that an evidentiary hearing be held regarding only one of CCU's stated basis for reconsideration. (A.164). On June 18, 2009, the trial court conducted an evidentiary hearing in which the trial court took testimony and received

evidence. (*Id.*) On September 14, 2009, after conducting a full evidentiary hearing, the trial court retroactively declared the evidentiary hearing a continuance of the previous summary judgment hearing, withdrew the trial court's February 5, 2009 Order, and ordered entry of summary judgment in favor of American. (A.156-163).

CCU first raised the issue that the funds in which American had sought judgment were comingled and therefore not identifiable unless properly traced according to law on February 11, 2009. (R.2). This was approximately four months before the court held the post-summary judgment evidentiary hearing and a full seven months before entry of the final order in this matter. The fact that the trial court chose not to confront this particular issue does not mean that it was not properly raised in a timely manner by CCU.

As before, Respondent's own argument betrays its theory of the case. American argues that, because there is no evidence in the record that the proceeds in which it seeks judgment are comingled, summary judgment was appropriate. (Resp. Brief at 25). However, American fails to point to any evidence or averment in the record that supports a finding that the proceeds in which American seeks judgment were identifiable in the first instance, much less not comingled. Hence, the lack of evidence regarding the identifiability of the proceeds precludes summary judgment.

Respondent's reliance on *Lehman v. Norton* seems misplaced as *Lehman* seems to demonstrate the trial courts error in this case. In *Lehman*, the Plaintiff, after entry of summary judgment, brought forth controlling statutory authority that had been previously overlooked. *Lehman v. Norton*, 253 N.W. 663, 664 (Minn. 1934). The Supreme Court determined that the newly discovered statutory authority constituted a sufficient basis for the Court to change its decision prior to appeal. (*Id.*) In our case, CCU brought forth

controlling statutory authority and sought to have the trial court reconsider its decision based on the controlling law. However, unlike in *Lehman*, the trial court chose to disregard the relevant statute.

This issue goes beyond that of whether a genuine issue of material fact exists regarding identifiability. This issue goes to the subject matter jurisdiction of the trial court to enter judgment in unidentified proceeds. The trial court did not have jurisdiction to award American judgment in anything other than the specific proceeds in which American's alleged lien attached, as according to law, a security interest can only attach to identifiable proceeds. Minn. Stat. § 336.9-315(a)(2). American failed to produce or aver any evidence that that CCU was in possession of any identifiable proceeds. Therefore, the trial court erred as a matter of law and did not have jurisdiction to grant American judgment in proceeds not identified by American as being those that flowed from the sale of the collateral itself.

### CONCLUSION

The issue before the Court is simple in nature. The trial court erred by adding a term to the parties' subordination agreement. In its memorandum, dated February 5, 2009, the trial court stated as follows: "As a matter of law the subordination agreement was valid to apply to the presently existing indebtedness even though it may have changed form from the initial promissory notes." (A.133). This statement is simply not true. By virtue of this statement, the trial court impermissibly added a term to the subordination agreement that extended CCU's subordination to any and all "renewals, extensions, modifications, refinances, consolidations or substitutions" of the initial notes, despite no such language being contained therein.

The Respondent's own reliance on extrinsic evidence to prove that the parties' subordination agreement is unambiguous is tantamount to an admission that there exists a genuine issue of material fact that should have precluded summary judgment in this matter. For this reason, as well as those stated above, CCU respectfully requests that this Court reverse the decision of the trial court and remand with instructions that the trial court consider all of the extrinsic evidence.

Date: January 25, 2010

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