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The newsletter of the Illinois State Bar Association's Section on Commercial Banking, Collections and Bankruptcy

Commercial Banking, Collections, and Bankruptcy in the Summer of 2020

BY JUDGE MICHAEL CHMIEL

Commercial banking, collections, and bankruptcy in the summer of 2020 remain vibrant areas of the law, notwithstanding our continuing need to socially distance and proceed in circumspect ways. In fact, these days seem to be as busy as ever, as we either continue to get caught up from two-and-half-months of activity away from courthouses or continue to learn new ways to engage each other. For the latter, back in the day of riding the circuits and/

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For Everyone's Sake: Get Terms of Commercial Credit in Writing

BY JAMES RICHARD MYERS & ARIANA E. THURNAU

Although we may long for a world where such is not the case, oral agreements to extend or modify commercial credit terms are not legally enforceable in Illinois.

Introduction

Business can move too fast these days. Many people have relationships with a banker or lender spanning years (or even decades) over which a level of mutual trust and confidence develops. People should do as they say. While all this may be true, it will make no difference when it comes to commercial credit agreements in Illinois, as the Illinois Credit Agreements Act makes oral modification or forbearance agreements unenforceable in this setting.

The Illinois Credit Agreements Act Bars All Actions Based on or Related to Oral Credit Agreements in a Commercial Setting

Section 2 of the Illinois Credit Agreements Act (the "Act") states: "A debtor may not maintain an action on or in any

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or districts, I seem to recall a partner who would argue he could [be more protective] at his desk than in going to court. Now, he may get to do both, as we continue to engage remote operations.

Recently, I was also reminded by an attorney from the suburbs of Chicago and a member of the federal judiciary that a few differences exist in the handling of cases in the state versus federal court systems. (In the federal system, I may recall engaging remote a couple of decades ago; now, by necessity, remote operations have become the norm in each system.) Nice is the ability of those involved in each system to collaborate and learn from each other, as we work to arrive at substantial justice for parties. Furthermore, it remains important for those in the legal system to add value.

In this newsletter, three members of the Commercial Banking, Collections & Bankruptcy Section Council offer insight in the commercial arena. As Michael Weissman notes: "It is always a pleasure to work with someone who appreciates interesting cases." We hope this issue will be helpful. Questions or comments on any of this are welcome, along with other relevant items for publication, through mjchmiel@22ndcircuit.illinoiscourts.gov. Continued good wishes are for you for the remainder of a unique summer.■

For Everyone's Sake: Get Terms of Commercial Credit in Writing

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way related to a credit agreement unless the credit agreement is in writing, expresses an agreement or commitment to lend money or extend credit or delay or forbear repayment of money, sets forth the relevant terms and conditions, and is signed by the creditor and the debtor."[1] The Act defines a "credit agreement" as "an agreement or commitment by a creditor to lend money or extend credit or delay or forbear repayment of money not primarily for personal, family or household purposes, and not in connection with the issuance of credit cards."[2] In practice, Section 3 of the Act frequently comes into play. It reads, in part:[3]

> The following actions do not give rise to a claim, counter-claim, or defense by a debtor that a new credit agreement is created, unless the agreement satisfies the requirements of Section 2:
>
> > (3) the agreement by a creditor to modify or amend an existing credit agreement or otherwise take certain actions, such as entering into a new credit agreement, *forbearing from exercising remedies in connection with an existing credit agreement*, or rescheduling or extending installments due under an existing credit agreement.

Lenders and borrowers are generally good at getting the initial credit terms in writing- signing notes, guarantees and mortgages. They often become more lax later in the relationship, and, in the authors' experience, particularly when the credit goes bad. Agreements to work through debt issues, particularly when a lender agrees to forbear collection in exchange for partial payments or other action by the borrower, often are oral. These oral agreements are unenforceable under the Act.

The Illinois Credit Agreement Act Is Broad in Scope

The language of the Act is broadly worded and courts have determined that the Act should be interpreted and applied broadly.[4] "The plain language of the [Illinois Credit Agreements] Act is very clear and very broad. The language bars all actions by

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a debtor based on or related to an oral credit agreement."[5] For example, in *McAloon v. Northwest Bancorp, Inc.*, the plaintiff's claims were based on allegations that the defendant orally agreed to lend money and then failed to do so.[6] The appellate court held that the Act barred all actions which depend upon an oral credit agreement for their existence.[7] The *McAloon* court held that the Act barred enforcement of oral credit agreements even in situations where the Frauds Act[8] would not, such as instances where equitable estoppel would apply.[9]

Application of the Act

There are many appellate court cases construing the Act which demonstrate the breadth of the Act's application. Examples include:

First National Bank v. McBride Chevrolet, Inc.,[10] a case where a lender foreclosed upon certain mortgages and guarantees. The defendants raised various affirmative defenses and counterclaims, all predicated upon an oral promise by the bank's officer to hold an overdraft check until sufficient funds could be deposited. The appellate court construed the oral promise to hold the check to be an extension of credit, which is a "credit agreement" under the Act, and therefore unenforceable.[11]

Teachers Insurance & Annuity Ass'n of America v. La Salle National Bank,[12] where the appellate court found that a borrower's defenses and counterclaims were based on alleged oral agreements by the lender to restructure an existing loan, and that these allegations amounted to agreements to "modify or amend" an existing loan. Because the agreements to restructure were not in writing, they were barred under Section 3 of the Act as an agreement to modify or amend an existing loan agreement.[13]

Nordstrom v. Wauconda National Bank,[14] a case where the appellate court heard claims brought against a bank after equipment that was being used as collateral was destroyed by fire. The claims were based on an alleged oral promise by the bank's officer that the bank would procure insurance for the equipment. The borrower argued that its claims against the bank were not barred by the Act because a written agreement existed that provided that if the borrower failed to procure insurance, the bank "may" do so at the borrower's expense. The Nordstrom court held that because the agreement to provide insurance did not obligate the bank to procure insurance, but only gave it discretion to do so, the bank's oral promise to procure insurance was an unenforceable oral modification of the contractual agreement.[15] The court held that "although the modification agreement to procure insurance is not, itself, a credit agreement, the requirement of insurance for the collateral is an integral part of the credit agreement. Therefore, the agreement relates to the credit agreement and the claims predicated on it are thereby barred by [Section 2] of the Act."[16]

Bank One, Springfield v. Roscetti,[17] the appeal of a case in which a bank sought to enforce a guaranty of a business loan. The defendant filed various affirmative defenses and counter claims, all of which were premised on a breach of an oral contract with the defendant that the bank would keep the defendant informed of the operations of the business and would watch the business "like a hawk."[18] The appellate court held that the "alleged promise [was] properly characterized as an oral agreement to modify or amend an existing credit agreement" and was therefore unenforceable.[19] In so doing, the court confirmed the breadth of the Act, observing that "A credit agreement often consists of several documents that, together, create the terms of the extension of credit. The documents are, in many instances, conditioned upon each other, and a default under one is usually a default under all. Significantly, the Act does not limit the definition of "credit agreement" to being a single document."[20]

Lastly, *Cox v. Washington Savings Bank*,[21] a case in which your authors successfully used the Act to bar a borrower's claims related to an alleged oral agreement to use insurance proceeds to rebuild a business. The borrower alleged that although the bank made an oral promise to use approximately $300,000.00 of a fire insurance claim proceeds to rebuild his business, the bank instead applied the funds to his debts, making it impossible for him to rebuild. The trial court granted summary judgment to the bank, finding the borrower's claims barred by the Act.[22] The appellate court affirmed, noting that "Plaintiff's reliance on this purportedly oral agreement is precisely the situation the Act prohibits and is typical of the types of disputes which caused our General Assembly to enact a statutory bar to actions by debtors on oral promises."[23] The court held that "the trial court was justified in concluding that as a matter of law the oral promise to allow plaintiff to use the insurance proceeds to rebuild his business was a 'credit agreement' covered by the Act."[24] As such, the oral promise was unenforceable.

Conclusion

Borrowers would be wise to get the terms of any agreements they have with lenders related to commercial debts in writing. Without such a writing, agreements will likely be unenforceable in courts of law under the terms of the Illinois Credit Agreements Act.■

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Ariana E. Thurnau is a shareholder in Law Group of Illinois, where she mainly focuses on family law and related matters. A significant portion of Mrs. Thurnau's practice is representing banks in foreclosure matters, including several where the Illinois Credit Agreements Act has been determinative.

1. 815 ILCS 160/2 (West 2016) (emphasis added).
2. 815 ILCS 160/1(1) (West 2016).
3. 815 ILCS 160/3(3) (West 2016) (emphasis added).
4. *First Nat. Bank v. McBride Chevrolet, Inc.*, 267 Ill.App.3d 367, 372-3 (4th Dist. 1994).
5. *McAloon v. Bancorp, Inc*., 274 Ill.App.3d 758, 762 (2d Dist. 1995).
6. *Id*. at 761.
7. *Id*. at 764.
8. 740 ILCS 80/1 *et seq*.
9. *McAloon v. Bancorp, Inc*., 274 Ill.App.3d at 765.
10. 267 Ill.App.3d 367 (4th Dist. 1994).
11. *Id*. at 371-2.
12. 295 Ill.App.3d 61 (2d Dist. 1998).
13. *Id*. at 70-1.
14. 282 Ill.App.3d 142 (2d Dist. 1996).
15. *Id*. at 143-5.
16. *Id*. at 145-6.
17.. 309 Ill.App.3d 1048 (4th Dist. 1999).
18. *Id*. at 1052-3.
19. *Id*. at 1058.
20. *Id*.
21. 2017 WL 9289361 (5th Dist. 2017) (Rule 23 Unpublished Opinion).
22. *Id*. at ¶ 13.
23. *Id*. at ¶ 20.
24. *Id*. at ¶ 23.

Proving Up Damages in a Home Construction/Remodeling Case

BY ADAM WHITEMAN

Proving up damages in a residential construction defect case can be tricky business. Whereas the general rule is that the cost of repairing the defective work might seem the appropriate path to proving up damages, this is not the case when correction of the work would require a substantial tearing down and rebuilding of the structure, in which case the measure of damages is the difference in value between the work if it had been performed according to the contract and that which was actually performed.

In the case of *Witty v. C. Casey Homes*, Inc., 430 N.E.2d 191 (1st Dist. 1981), the plaintiff alleged that contrary to the specifications in their building contract for a new home, which called for "face brick veneer," the defendant contractor substituted defective ordinary brick. At trial, the plaintiffs called an engineer as a witness who testified about the defects in the brick and that "it would cost $50,000 or more to replace the face brick in the residence." The trial court determined that the plaintiff had applied the incorrect measure of damages on the case and denied their request for repair damages. The appellate court affirmed, and the plaintiff went back to their defective home empty handed.

The court initially set out the general rule as follows:

> As a general rule, the measure of damages or the credit due the purchaser, when performance by the builder has been less than full performance, is the cost of correcting the defects or completing the omission.

But then the court explained:

> But this general rule only applies where the correction or completion would not involve unreasonable destruction of the work done by the contractor and the cost thereof would not be grossly disproportionate to the results obtained. If to repair the defects or omissions would require a substantial tearing down and rebuilding of the structure, the measure of damages is the difference in value between the work if it had been performed according to the contract and that which was actually performed.

The court used the phrase "dimunition in value" to describe "the difference in value between the work if it had been performed according to the contract and that which was actually performed". Because the plaintiff in the Witty case had failed to introduce any evidence of "diminution in value", their complaint was denied. In other words, the court determined that the plaintiffs failed to prove the proper measure of damages. See also *Park v. Sohn*, 89 Ill.2d 453 (1982) (stating rule of damages calculation).

How, then, does one go about proving dimunition in value? For this, expert testimony will be required.

In *Knowles v. Westbrook Builders Ltd.*, 544 N.E.2d 121 (3rd Dist. 1989), the plaintiffs sued their builder for failing to complete the home it had been contracted to build in conformity with applicable building codes. In proving up their damages, the plaintiffs provided evidence of both the cost to repair the defects as well as the lost value of the home given the existing defects. The expert witnesses who presented this testimony included a real estate appraiser and an architect. The jury verdict in plaintiff's favor was affirmed, the evidence being deemed sufficient to prove damages.

As a litigator, if you are presented with a case where the cost of repairs would exceed the dimunition in value of the defective structure, then it is prudent to submit evidence of both the cost of repairs and the dimunition of value since you cannot reach the question of dimunition of value until you have first shown it exceeds the cost of repairs, the jury should then be instructed to consider both elements of damages. Thus, where the question of dimunition will be addressed, the jury should be instructed that, "it must first consider costs of repair, and that it could go to diminution of value only if it found (1) the cost of correcting the defects was unreasonably disproportionate to the benefit of the purchaser, or (2) if correcting the defects would entail an unreasonable destruction of the builder's work." *Wells v. Minor*, 578 N.E.2d 1337, 1343 (4th Dist. 1991)

The lesson here is to be very careful about how you prepare for trial in regards to a residential construction defect. Nothing would be worse than spending the time and money to construct what you believe is the foundation for a winning case, only to see it come tumbling down because you did not present proper evidence of damages.■

Adam Whiteman is a commercial collection attorney who practices in Chicago. He is a member of the Commercial Banking, Collections & Bankruptcy Section Council.

Trustee's Judicial Lien Trumps Consignor's Unperfected Security Interest

BY MICHAEL WEISSMAN

A recent decision of the Bankruptcy Appellate Panel of the United States Court of Appeals for the Ninth Circuit, *IPC (USA), Inc. v. Ellis*, 917 F.3d 1230; 98 U.C.C.Rep. Serv. 2d 233; 2019 WL 1104662 (Mar. 11, 2019), reminds us of some basic points about consignments under the Uniform Commercial Code.

Petit Oil Company was a distributor of bulk petroleum products. A portion of its business involved the operation of "card lock" sites at which commercial customers purchased petroleum products by means of access cards.

In 2013, IPC signed a consignment agreement with Petit under which IPC delivered fuel on consignment to card lock sites operated by Petit so that Petit could sell fuel to its customers. IPC agreed to pay Petit a monthly commission for the fuel sold at Petit's stations.

Ownership of the fuel remained with IPC until it was sold. At that point, ownership passed to the fuel purchaser. When a customer purchased consigned fuel, Petit prepared an invoice directing the customer to pay IPC. Some did, some didn't. In the latter case, the consignment agreement called for Petit to forward the payments to IPC.

Petit later filed for bankruptcy protection. At that point, it had in its possession fuel sent to it by IPC as well as sales proceeds that had not yet been sent to IPC. The sales proceeds were either cash or accounts receivable. IPC had neglected to file a UCC-1 Financing Statement, nor had it done anything else to perfect a security interest in the consigned fuel, cash and accounts receivable.

When Petit filed for bankruptcy protection, its trustee claimed a superior interest to IPC in the consigned fuel, cash and accounts held by Petit as of the date of filing. The bankruptcy judge ruled in favor of the trustee and the bankruptcy appellate panel affirmed.

In the appeal, IPC argued that even if the trustee had a superior right to the fuel under section 544(a)(1) of the U.S. Bankruptcy Code that did not extend to the cash and accounts receivable. That called for the court to consider whether section 9-319(a) of the Uniform Commercial Code, which grants a consignee "rights and title to the [consigned] goods," such as the fuel held by Petit when it filed for bankruptcy protection, extends to the proceeds from the prepetition sale of the goods still in the hands of the consignee on the day of filing.

IPC's concession on the first point was inevitable because section 9-319(a) of the UCC states "for purposes of determining the rights of creditors of…a consignee, while the goods are in the possession of the consignee, the consignee is deemed to have rights and title to the goods identical to those the consignor had." With ownership established in Petit, IPC's failure to file a UCC-1 subordinated it to the judicial lien of the bankruptcy trustee. But, said IPC, section 9-319(a) only speaks in terms of "goods" and cash and accounts receivable are not goods.

The court rejected IPC's position stating that to interpret the UCC as it contended would create statutory inconsistencies. For example, it cited UCC Section 9-324(b) which states, "a perfected [interest] in inventory has priority over a conflicting security interest in the same inventory… and...also has priority in identifiable cash proceeds of the inventory."

IPC also claimed that that its rights were superior to those of the trustee because it had retained title to the sale proceeds. The court's answer was that IPC's retention of title did not matter under section 9-202 of the UCC. It said: "Retention of title affects the remedies IPC could employ to recover the goods in the event of default, but title is irrelevant to whether IPC or the Trustee has priority in the goods and proceeds".

Pointing to the public policy underlying Section 9-319(a), the court said:

To the outside world, goods and proceeds held by a consignee appear to be owned by the consignee, and creditors might reasonably believe as much when they decide to lend the consignee money. The perfection and priority rules – which require that the consignor publicly announce his interest in the consigned goods or else go to the back of the line when the consignee goes bankrupt – serve to protect unwary creditors and prevent 'secret liens' in the goods that might otherwise dissuade such lending.

What's the point? Cases such as this point out the necessity of filing UCC financing statements in consignments. Title retention will not protect the consignor when the consignee files for bankruptcy protection and the trustee in bankruptcy asserts his judicial lien.■

Michael Weissman practices with Levin Ginsburg in Chicago. He is a member of the Commercial Banking, Collections & Bankruptcy Section Council and chairs its UCC/Commercial Banking Committee.