

News & Types: Commercial, Competition & Trade Update

"Fiasco" Creates "Peculiar Case" – Unpaid Creditor Loses Chance for Summary Judgment

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A common scenario in which a bank offered a line of credit based on a daily cash collateral report created a "peculiar case" which the court acknowledged was a "fiasco." The dispute was caused by mistakes on both sides. The bank sought and obtained summary judgment at the district court level. But the 7th Circuit Court of Appeals, meticulously laying out the complicated situation, sent the case back to the district court, finding issues of fact that precluded summary judgment. (*Wells Fargo Business Credit v. Hindman*, 7th Circuit Court of Appeals, No. 12-1208, October 30, 2013).

Wells Fargo Business Credit (WFBC) offered to Clark National, Inc., and its three related companies, a line of credit using inventory and accounts receivable that WFBC closely monitored through a daily collateral report. All incoming cash (including loans) was reported on the daily collateral report and deposited into a cash-collateral account held by WFBC for Clark's benefit. WFBC used the incoming funds to pay down Clark's line of credit, which created available credit on which Clark could take additional advances. So Clark's cash position at any point in time was very important to WFBC's exposure.

As part of the line of credit, WFBC required the owner of Clark, Donald J. Hindman, to subordinate to WFBC. As would be expected, the terms of the subordination were very favorable to WFBC, basically prohibiting Hindman from receiving any payment from Clark without WFBC's prior written consent. Hindman was the owner of Clark, but had retired in 2005, leaving day-to-day management to his son Donald D. Hindman, (who the court referred to as D.D.H. to avoid confusion with his father, Donald J. Hindman).

Then it got interesting. In late 2009, Clark needed additional capital. Hindman, although retired, was still the deep pocket for Clark. So Hindman asked Tom Bassett, a Vice President of Wells Fargo Bank (not Wells Fargo Business Credit) to sell some of Hindman's stock investments to provide \$1 million in working capital to Clark. The "fiasco" referenced by the court followed, as shown by the timeline below.

- January 6, 2010 – Hindman asked Bassett to sell his shares to provide \$1 million capital to Clark.
- January 7, 2010 - D.D.H. asked Bassett by email to hold the funds until D.D.H. provided wiring instructions.

- January 8, 2010 – Clark's board of directors met. Three directors attended, Hindman, D.D.H. and Robert Early, creating a quorum. Also attending were Clark's CFO, Mark Bruno; Kevin Cleary, an investment advisor to Clark; and T.D. Decker, Clark's turn-around consultant and financial advisor. At the meeting, D.D.H. was removed from corporate decision-making to focus on sales. Bruno and Decker would operate Clark "in the best interests of the creditors." The presence of a turn-around consultant and the need to protect creditors reflected Clark's bleak prospects. The amount that Hindman planned to invest in Clark seemed quite insufficient.
- January 12, 2010 – Bassett of Wells Fargo Bank, not knowing that D.D.H. had been stripped of decision-making authority, emailed D.D.H. that Bassett was ready to make the transfer from Hindman's account to Clark's account.
- January 13, 2010 – D.D.H. called Hindman (his father) and asked Hindman to release the funds from Hindman's investment account. Hindman, no doubt to his later regret, did so. But Bruno and the Clark directors, who had apparently given up on Clark, were not aware of this transfer which they considered throwing good money after bad.
- January 14, 2010 – Maria Preston, Clark's A/R and Cash Manager, contacted Bassett and told him the transfer could not be deposited in Clark's account because Bassett had designated the wrong account - the payroll account, rather than the cash-collateral or master-funding account. This was eventually straightened out so that Hindman's funds were deposited into Clark's cash-collateral account.
- Apparently on or around January 14, 2010 – Bruno, D.D.H. and the Clark board conferred, resulting in a direction to D.D.H. to contact Bassett of Wells Fargo Bank to stop or reverse the funds transfer. D.D.H. contacted Bassett and believed he did so before the \$750,000 hit Clark's cash-collateral account.
- January 15, 2010 – Preston, Clark's A/R and Cash Manager, emailed Bassett acknowledging Clark's receipt of the \$750,000, but that it appeared "the originator is trying to reverse payment." D.D.H. also sent Bassett an email asking Bassett to hold the wire transfer. About two hours later, D.D.H. emailed Bassett to reverse the transfer, which Bassett responded with an enthusiastic "Done!" apparently unaware of the damage he had done to the position of his employer's affiliate, WFBC.

While all this was going on, WFBC, seeing the \$750,000 in Clark's cash-collateral account, used the \$750,000 to pay down Clark's line of credit. In turn, according to WFBC, Clark used the pay down to draw advances totaling \$3,036,089.96 between January 15 and January 21.

After this point, the facts, as described in the opinion become murky. Hindman's personal account statement reflected the return of the \$750,000 on January 15. Then, on January 15, the funds were withdrawn from Hindman's account without his authority, but with a note that the original transaction could not be reversed. Upon discovering this, Hindman contacted the ever-helpful Bassett and asked Bassett to wire the funds to Hindman's bank in Florida, out of the reach of any Wells Fargo entity and Bassett did so on January 21. According to the court, this \$750,000 reflected a portion of the advances drawn by Clark, made available by WFBC in reliance on the same \$750,000, which now had disappeared from Clark's account. On February 2, 2010, WFBC sent a notice to Hindman claiming that the \$750,000 payment returned to Hindman was a violation of his subordination agreements with WFBC.

Shortly after these events, Clark, as the court put it, "went belly up" and began liquidating its assets. As of March 25, 2011, Clark owed WFBC \$7,306,098.34.

The district court treated the case as a straightforward breach of the subordination agreement and granted WFBC's motion for summary judgment. The appeals court did not see the case in such straightforward terms and reversed the district court. The appeals court found several factual issues which were not appropriate for summary judgment.

The first issue found by the court of appeals is whether there was a valid loan contract between Clark and Hindman. If so, repayment to Hindman would be a violation of the subordination agreement between Hindman and WFBC. If not, then Clark had no debt owed to Hindman which Hindman could subordinate. Hindman clearly intended to make a loan when he transferred the \$750,000, but did Clark accept it? To show that this remained a factual issue, the court cited the board meeting in which D.D.H. was stripped of his managing authority. In spite of his lack of authority, on January 13, D.D.H. asked Hindman (his father) to release the funds to Clark. But did he have authority to do so on behalf of Clark? The other board members had, by this time, given up on Clark and there was evidence that they would never have authorized Clark to request the funds from Hindman, which they considered throwing good money after bad. So if D.D.H. had no authority to borrow money from his father on behalf of Clark, then there was no agreement. Anyway, this is how Hindman could argue. The court acknowledged this "strange case", and could not conclude that WFBC was entitled to summary judgment on this issue.

The second issue was whether Clark actually used the \$750,000 to take cash advances. The court noted that \$3,086,089.96 was advanced between January 15 and January 21, when the \$750,000 was showing in Clark's cash-collateral account. But the court also noted that WFBC had failed to demonstrate that those advances could not have been taken "but for" the receipt of the \$750,000. To confirm whether the advances could not have been taken "but for" the receipt of the funds required a complicated analysis of the amount available to Clark to borrow, with and without the \$750,000. So during the relevant period, each days' collateral report reflecting Clark's incoming cash had to be compared to the advances to determine if "Clark took advances that it could not have taken but for the influx of \$750,000 from Hindman . . ." If so, then Clark "accepted the loan as a matter of law", and a valid loan contract was created between Clark and Hindman.

The third issue of fact was whether Hindman rescinded the loan agreement with Clark, even if Clark accepted the loan agreement. The court agreed with WFBC that, if there was a loan agreement between Hindman and Clark, Hindman could not rescind it without WFBC's prior consent. This is where Hindman was assisted by Wells Fargo Bank's Tom Bassett who accommodated Hindman's request to transfer the funds out of Wells Fargo Bank into Hindman's account at a Florida bank. But could Bassett who, after all, was employed by Wells Fargo Bank, consent to the rescission on behalf of WFBC? Here, WFBC's broad subordination did not help. The subordination agreements defined "Lender" as "Wells Fargo Bank . . . acting through its Wells Fargo Business Credit operating division." So it was another issue of fact as to whether Bassett could, on behalf of WFBC, consent to the rescission of the loan agreement between Clark and Hindman, if there was such a loan agreement, which was another issue of fact.

So far, Hindman had successfully overturned WFBC's summary judgment victory. But on one issue, Hindman was not successful. Wells Fargo claimed damages of \$750,000, the amount of the transfer. But Hindman said WFBC's damages should be limited to the amount of additional advances taken against the \$750,000. So if WFBC only advanced \$100,000, then its damages should only be \$100,000. But the court disagreed. If it turned out that Hindman breached the subordination agreement when he had the \$750,000 transferred out of Clark, then the damages for his breach are \$750,000.

It is difficult to see lessons in this case, which the court itself calls "strange", "peculiar" and "a fiasco." The case was caused by blunders all around that could have been avoided. Hindman blundered in letting \$750,000 be transferred to Clark, when he knew it was on the cusp of failure. But Wells Fargo's Bassett also blundered in allowing the \$750,000 be returned to Hindman, although he apparently knew of WFBC's exposure to Clark. Although \$750,000 is a lot of money, the cost to either side in proving its case in such a complicated scenario may make settlement the most viable option.

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