MORE MISTAKEN MOMENTS

COUNSEL'S CORNER

Last month I discussed how a mistake in a Contract can destroy it. This month I present Part Two.

On December 15, 2008, David Duckworth borrowed $1.1 million from the State Bank of Toulon. The bank's loan officer prepared loan docs.

The Note was dated and signed December 15, 2008, but the Security Agreement was dated two days earlier – December 13, 2008. The Note referenced the Security Agreement. But the Security Agreement had a critical mistake. It stated that it secured a Note dated *December 13, 2008*. Not December 15, 2008.

There was no Note dated December 13, 2008.

David Duckworth filed a Chapter 7 bankruptcy petition, and the Trustee defended the Bank's position that the mistaken date did not defeat the Bank's secured position. The bankruptcy court issued two decisions in favor of the Bank, essentially validating the Bank's collateral position.

The Trustee appealed both decisions to the US District Court, where the appeals were assigned to different judges. Both district judges affirmed, and the Trustee again appealed.

The Trustee's basic argument was that extrinsic testimony (we call this "parol evidence") should not used to correct the mistake in the Security Agreement. And that the Bank's error should not be overlooked.

The Bank claimed an enforceable security interest, and even if there was a mistake it was readily apparent to anyone who had reviewed the papers. And, that it was a minor error. Also, that there was no question but that the Bank had loaned Duckworth $1.1 million, Duckworth had signed a Note and Security Agreement, Duckworth had defaulted and filed bankruptcy, and the Bank needed to seize its collateral under its Security Agreement.

The US Court of Appeals reviewed the Security Agreement and concluded that the Security Agreement could not secure the December 15 Note. The Court then further concluded that although the parol evidence rule could have fixed the mistake as between the Bank and Duckworth, the same legal theory could not be used against the bankruptcy trustee to correct the error.

The Appellate Court reasoned that bankruptcy trustees are in the unique position of maximizing the recovery of unsecured creditors. To assist in the job, trustees exercise a "strong-arm power," which allows them to avoid secured interests that a subsequent creditor could have avoided.

Further, bankruptcy trustees may ". . . void security interests because of defects that need not have misled, or even have been capable of misleading, anyone."

And so the US Appellate Court determined that the mistaken identification of the debt to be secured cannot be corrected against the US bankruptcy trustee by using outside-the-contract testimony or evidence. The judgments of both US District Courts were reversed. The Trustee wins as the debt is converted from secured to unsecured; the Bank loses its collateral.

See *In Re: David L. Duckworth; State Bank of Toulon v. Charles E. Covey, Trustee;* No. 1:13-cv-01258-JBM and 1:13-cv-01087-JES; US Court of Appeals, 7th Circuit; November 21, 2014.

Lessons learned:

1. Proofread your Leases, Contracts, correspondence, emails, texts, listings, buyer and tenant rep agreements, brokerage contracts, commission agreements, everything. Read it all closely. Then wait at least one hour before you read it again.

2. Catch a mistake somewhere, even a minor one? Fix it now via an Amendment. If the previous doc was recorded (think Deed, Memo of Lease, Deed of Trust, etc.), then be sure the Amendment is also recorded.

3. Practice Point: On the really important stuff, enlist the help of a buddy to proofread too.

Stuart A. Lautin, Esq.**

** Board Certified, Commercial (1989) and Residential (1988) Real Estate Law,
Texas Board of Legal Specialization

Licensed in the States of Texas and New York

Higier Allen & Lautin, PC
5057 Keller Springs Road, Suite 600

Addison Texas 75001
P: 972.716.1888
E: slautin@higierallen.com
W: www.higierallen.com

HIGIER ALLEN & LAUTIN
ATTORNEYS & COUNSELORS