

# RECENT DEVELOPMENTS

tried several times to deal directly with the Starks.

The Starks subsequently filed suit against EMC and its attorneys alleging violations of the FDCPA. EMC moved to compel arbitration pursuant to the loan agreement and the motion was granted. During the arbitration, EMC's agent, without the Starks' consent, forcibly entered the home and posted a sign in the front window which indicated that the "[p]roperty ha[d] been secured and winterized." Further, in late 2001 and early 2002, EMC wrote to the Starks directly regarding insurance coverage on the home. In total, the Starks testified EMC contacted them by mail, telephone or in person at least ten times after being advised they were represented by counsel. After these incidents, the Starks moved to amend their complaint to include claims alleging intentional torts against EMC and seeking punitive damages. The arbitrator found that EMC violated the FDCPA and awarded the Starks damages, including 6 million dollars in punitive damages. The district court vacated the award of punitive damages, holding the arbitration agreement was unambiguous and not susceptible to the arbitrator's interpretation. The Starks appealed the judgment of the district court.

**HOLDING:** Reversed.

**REASONING:** In the case of an arbitration award the courts accord an extraordinary level of deference to the underlying award itself, because federal courts are not authorized to

consider the merits of an arbitral award. The court held that the situation where the arbitration award was completely irrational, or a manifest disregard for the law, would be a situation conducive to vacating the award. An award is irrational where it fails to draw its essence from the agreement. An agreement is a manifest disregard for the law where the arbitrator clearly identifies the applicable, governing law and then proceeds to ignore it.

The court held that because the arbitration agreement waived the right to sue for punitive damages to the fullest extent of the law, and the applicable law in this case was Missouri law, which precludes waivers of punitive damages, the arbitration provision was ambiguous. In this situation, the court stated it would construe the provision against the party who drafted it, in this case EMC. Because the waiver provision was construed against EMC, the court held the award of punitive damages drew its essence from the agreement. The court stated, "[a] party seeking vacatur [based on manifest disregard of the law] bears the burden of proving that the arbitrators were fully aware of the existence of a clearly defined governing legal principle, but refused to apply it, in effect, ignoring it." To the extent the arbitrator's decision set forth the basis for the punitive damages award, it was apparent the arbitrator did not disregard governing law. The arbitrator's award was intended to punish EMC and to deter others from similar conduct.

## UNIFORM COMMERCIAL CODE

### BAD FAITH UNNECESSARY FOR BREACH OF GOOD FAITH

### NEW BUSINESS RULE DOES NOT PRECLUDE DAMAGES TO AN ENTERPRISE THAT HAS NEVER TURNED A PROFIT

O'Tool v. Genmar Holdings, Inc., \_\_\_ F.3d \_\_\_ (10th Cir. 2004).

**FACTS:** Cassandra and John O'Tool and Geoffrey Pepper ("Plaintiffs") sold their business, Horizon Marine, ("Horizon") to Genmar Holdings, Inc. ("Genmar"). Under the terms of the parties' written purchase agreement, Genmar created a new subsidiary ("GMK") that assumed all of the assets and liabilities of Horizon. GMK also offered written employment agreements to Pepper, who became President of GMK, and to Pepper's daughter and son-in-law ("O'Tools"). The purchase price paid by Genmar for Horizon was comprised of two components: (1) cash consideration of \$ 2.3 million dollars; and (2) "earn-out consideration" that could total up to \$5.2 million dollars if certain performance targets were met over the next 5 years.

Shortly after the sale, Genmar moved production for two of Genmar's other brands to the GMK facility, made these new brands a priority over the existing boat line, shifted additional costs to the facility for design of new boats, and made other accounting changes that prevented the GMK facility from meeting the targets needed for the "earn-out." After Pepper expressed his concerns to the CEO of Genmar, he and

the O'Tools were terminated. After plaintiffs' termination, Genmar converted all the old Horizon dealers to other Genmar brands and in July 2001 stopped producing all of the old line of boats.

Plaintiffs filed suit asserting claims for fraud, breach of the purchase agreement, tortious interference with a contract, breaches of their individual employment agreements, etc. The District Court granted summary judgment in favor of defendants on Pepper's breach of employment agreement claim and the tortious interference claims. The jury found in favor of Plaintiffs on the breach of the purchase agreement and awarded \$2.5 million in damages and found in favor of the O'Tools' on their breach of employment contract claims. The jury found against Plaintiffs on all remaining claims. Genmar filed a motion for judgment as a matter of law, or for remittitur or a new trial, all of which were denied. Genmar appealed.

**HOLDING:** Affirmed

**REASONING:** Every contract imposes a duty of good faith and fair dealing on each party. In the instant case, breach of good faith occurred when Genmar changed known brand names; shifted production priority to benefit its original line of boats; required the new subsidiary GMK to bear the costs of design and production of the new line of Ranger boats; failed to give Pepper the necessary operational control; discontinued the Plaintiff's prior brand of boats; flipped Plaintiff's customers to Defendants' prior brands

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of boats; and shut down the GMK facility. The court found that while Genmar's actions did not rise to the level of bad faith, they did rise to the level of a breach of the covenant of good faith and fair dealing.

Genmar argued that Delaware law prohibited recovery of lost profits based on the so-called "new business rule." This rule provides that, as a matter of law, a new or unestablished business cannot recover lost profits because absent a history of past profits, future profits are too uncertain, contingent and speculative. In the past fifteen to twenty years, most states have moved away from this rule, finding that regardless of whether a business is new or is established, lost profits can be recovered if it is possible to show by competent evidence and with reasonable certainty that profits would have been made and the amount of those profits. The courts recognize that a strict application of the rule could encourage, as a matter of strategy, tortious behavior or the breaking of contracts by those dealing with new businesses. The court relied on *Moody v. Nationwide Mutual Insurance Co.*, 549 A.2d 291 (Del. 1988), in deciding to go with the national trend away from the strict interpretation. In the present case, the court ruled that testimony from Pepper supported the contention that Horizon was making "significant progress and believed it would be able to show a profit." Pepper's credibility stemmed from his wealth of experience in the recreational boating industry. Genmar's acquisition of Horizon would enable Horizon to achieve an even greater profit margin due to more purchasing power, resulting in lower material costs, provided by Genmar. The damning testimony was that of Pepper stating that, prior to the acquisition, Genmar's CEO assured him that the full amount (\$5.2 million) of the earn-out consideration was obtainable.

Given all of the evidence, the Court ruled that the jury could reasonably have concluded that if Genmar had acted in good faith after the acquisition and allowed Pepper and BMK to focus on producing Horizon/Nova boats, Pepper and Horizon would have achieved at least some of the earn-out consideration available to them under the purchase agreement. Based on this reasoning, the court affirmed the lower court's ruling for Plaintiffs.

## SECURED PARTY MUST PROVE COLLATERAL DISPOSITION WAS COMMERCIALY REASONABLE ONLY IF DEBTOR SPECIFICALLY OBJECTS

*Al Gailani v. Riyad Bank, Houston Agency*, 144 S.W.3d 1 (Tex. App.— El Paso 2003).

**FACTS:** Riyad Bank ("Bank") brought suit against Al Gailani and Adel ("Debtors") to recover a deficiency on a promissory note after the bank sold the Debtors' accounts receivable at a public foreclosure sale. The trial court granted summary judgment in favor of the bank. The Appellate Court reversed the judgment and the Bank appealed to the Texas Supreme Court. The Appellate Court did not reach the issue as to whether the Bank's foreclosure sale of Debtors' intangible collateral, consisting of certain accounts receivable, was

commercially reasonable as required by section 9.504 of the Texas Business and Commerce Code ("Code"). On appeal, the Texas Supreme Court reversed, holding that section 9.502 did not apply because the Bank did not attempt to collect on the accounts. The Texas Supreme Court remanded the cause for consideration of Debtors' claim that the trial court erred in granting the Bank summary judgment because the Bank failed to prove as a matter of law that its foreclosure sale of the accounts receivable was commercially reasonable, as required by section 9.504 of the Code.

**HOLDING:** Reversed and remanded.

**REASONING:** Debtors contended that the trial court erred in granting summary judgment because there was a fact issue as to whether the bank acted in a commercially reasonable manner in conducting its foreclosure sale. The bank was required to conduct its sale of Debtors' collateral in a commercially reasonable manner, in accordance with former section 9.504

## **In their response to the Bank's motion for a partial summary judgment, however, the Debtors did urge that the motion be denied because the foreclosure sale was not conducted in a commercially reasonable manner.**

of the Texas Business and Commerce Code. In a non-substantive revision, this provision now appears in section 9.610(b) of the Code. The parties agreed that the former statute controlled in this case because the foreclosure sale occurred before the effective date of the revision.

In a suit brought by a secured creditor to recover a deficiency following the sale of collateral, if the creditor pleads that all conditions precedent have been performed or have occurred, it is required to prove that its disposition of the collateral was commercially reasonable only if the debtor specifically denied it in his answer. *Greathouse v. Charter Nat'l Bank-Southwest*, 851 S.W.2d 173, 176-77 (Tex. 1992).

In this case, the Bank did not allege that all conditions precedent had been performed or occurred, and the Debtors did not plead in their answers that the foreclosure was not conducted in a commercially reasonable manner. In their response to the Bank's motion for a partial summary judgment, however, the Debtors did urge that the motion be denied because the foreclosure sale was not conducted in a commercially reasonable manner. Because of this, the court held that the Bank was required to prove that it conducted the sale of the accounts receivable in a commercially reasonable manner. The court found there was a genuine issue of material fact as to whether the Bank had proved as a matter of law that it acted in a commercially reasonable manner. The case was reversed and remanded to the trial court.