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MATRIX DEVELOPMENT — WELCOME TO THE REAL WORLD

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On October 9, 2008, in *Matrix Development Corporation*, Case No. 08-32798 (Bankr D Or 2008), the court issued a letter ruling that will be of great interest, and some concern, to lenders that use dragnet clauses in their loan documents. Judge Brown's decision brings to light an earlier decision, *In re Wollin*, 249 BR 555 (Bankr D Or 2000), and its application to all dragnet clauses, consumer and commercial. If the *Wollin* case didn't catch your attention in 2000, you should take note of it now in conjunction with the *Matrix* decision.

Bank made a series of loans to Matrix Development Corporation (Debtor), with each loan evidenced by a promissory note. Bank also made a loan to Debtor's wholly-owned subsidiary (Subsidiary), evidenced by a separate promissory note. Debtor guaranteed the note from the Subsidiary. Debtor signed separate loan agreements for each note. Each loan agreement included the following provision, purporting to cross-default and cross-collateralize all the loans to Debtor and Subsidiary:

> **G. Cross-Default/Cross-Collateral:**
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> Borrower understands that the Loan is cross-defaulted with the other loans from Lender to Borrower or its affiliates (collectively, the "*Related Loans*"), such that a default under any one of the Related Loans constitutes a default under the Loan. Additionally, all of the Related Loans are cross-collateralized, such that following an event of default under any of the Related Loans, Lender, in its discretion, may exercise its rights and remedies against any and all of the collateral securing any of the Related Loans…. [emphasis in original]

Debtor gave Bank trust deeds to secure its debts to Bank. Each trust deed included the following provision as section 1.2, stating what obligations the deed of trust secured:

> Borrower makes the grant, conveyance, transfer and assignment set forth in Section 1.1, and grants the security interest set forth in Section 2.1 for the purpose of securing the following obligations (the "*Secured Obligations*") in any order of priority that Lender may choose: [emphasis in original]

Three sub-paragraphs of Section 1.2 listed the obligations that the deeds of trust secured and were relevant to the court's ruling. These were:

> 1.2.2. Loan Documents. Payment and/or performance of each and every other obligation of Borrower under the Note, this Deed of Trust, any construction or land loan agreement executed in conjunction therewith (the "Loan Agreement"), all other documents evidencing, securing, or otherwise governing the Loan (specifically excluding, however, for purposes of establishing the Secured Obligations, any obligations of Borrower arising

> solely under any guaranty of the Secured Obligations or any indemnity agreement that by its terms is not secured hereby), and any and all amendments, modifications, and supplements thereto (collectively, the "Loan Documents"), the provisions of which are incorporated herein by this reference;
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> 1.2.3. Related Loan Documents. Payment and/or performance of each covenant and obligation on the part of Borrower or its affiliates to be performed pursuant to any and all loan documents (the "Related Loan Documents") that have been or may be executed by Borrower or its affiliates evidencing or securing one or more present or future loans by Lender or its affiliates to Borrower or its affiliates (collectively, the "Related Loans"), whether now existing or made in the future, together with any and all modifications, extensions and renewals thereof; provided, however, that nothing contained herein shall be construed as imposing an obligation upon Lender, or as evidencing Lender's intention, to make any Related Loan to Borrower or its affiliates . . .
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> 1.2.4. Future Obligations. Payment to Lender of all future advances, indebtedness and further sums and/or performance of such further obligations as Borrower or the then record owner of the Project or the then owner of the balance of the Collateral may undertake to pay and/or perform (whether as principal, surety, or guarantor) for the benefit of Lender, its successors or assigns, (it being contemplated by Borrower and Lender that Borrower may hereafter become indebted to Lender in such further sum or sums), when such borrowing and/or obligations are evidenced by a written instrument reciting that it or they are secured by this Deed of Trust;

After Debtor filed its bankruptcy petition, Bank argued that all the notes from Debtor and Subsidiary were secured by all the trust deeds from Debtor and Subsidiary.[1] Bank also argued that Debtor's guarantee of Subsidiary's note was secured by Debtor's other trust deeds to Bank. Debtor countered with a three-part argument: First, because paragraph 1.2.2 of the notes excludes from the Secured Obligations any guaranty of the Secured Obligations, Debtor's guaranty of Subsidiary's debt was not itself secured by the trust deeds; second, loans that the Bank made in connection with a particular trust deed were not secured by any prior trust deed because no written instrument for any loan recited that the loan was secured by the prior deeds of trust (relying on the language of section 1.2.4); and last, that no trust deed secured antecedent debt; that is, no trust deed secured any debt that Debtor already owed to the Bank. Debtor thus argued that each trust deed secured only its own loan and not any of the other loans.

The Court ruled in favor of the Bank on the first issue, but ruled in favor of the Debtor on the others.

Guaranteed Debt

On the first issue, the court agreed that paragraph 1.2.2 did exclude from the Secured Obligations any guaranty of the Secured Obligations, but ruled that paragraph 1.2.3 included within Secured Obligations any debt of an affiliate of Debtor. The loan to Subsidiary was a loan to an affiliate of Debtor, and was therefore included in the definition of a Secured Obligation under 1.2.3 even though it wasn't covered under 1.2.2. Accordingly, the Subsidiary note was secured by antecedent and subsequent trust deeds to the same degree that the Debtor's own obligations were secured by those trust deeds.

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[1] The opinion doesn't say why the Bank had to make this argument. One inference is that some of the properties were worth more than their debt, and others were worth less than their debt, and the Bank wanted to use the equity surplus in the first group against the undersecured debt in the second group.

Future Advances

On the second question (whether the loans were secured by the earlier trust deeds), the court considered the language of paragraph 1.2.4, said that it plainly applied to all future advances and was not limited to future advances under any specific note. The court held that the trust deeds did not secure any later debt incurred by Debtor because none of the later notes said they were secured by any identified earlier deed of trust. The court then took away Bank's victory on the first issue, ruling that the Subsidiary note qualified as a future advance, relative to prior trust deeds from Debtor, but because the Subsidiary note did not say it was secured by any of Debtor's property (only by Subsidiary's property), it was not a Secured Obligation.

Antecedent Debt

The court's ruling on the third question should cause Oregon lenders to consider redrafting their dragnet clauses. The Bank argued that section 1.2.3, which states that obligations existing at the time the deed of trust is executed are to be Secured Obligations, made each note secured by any trust deed executed afterward a Secured Obligation. The court agreed that section 1.2.3 says exactly that, but ruled against Bank based on *In re Wollin*, 249 B.R. 555 (Bankr. D. Or. 2000). In *Wollin*, the debtors borrowed from a credit union to buy cars, and gave the credit union a security interest in the cars. Each security agreement said the security interest in the car secured not only the current loan but all prior loans. The *Wollin* court rejected the credit union's argument that the language meant what it said, holding instead that (as quoted by Judge Brown in *Matrix*): since the antecedent debt is already owed by the borrower to the lender, the parties would have had no good reason not to identify it in the subsequent security instrument if they had truly intended that the deed of trust or mortgage to cover it.

All the notes and trust deeds in *Matrix* were signed after 2000, when *Wollin* was decided. The court, stating that *Wollin* was good law, concluded that the Bank was on notice that, if it wanted a trust deed to secure antecedent debt, it must identify the antecedent debt in the trust deed. Thus none of the trust deeds secured any of the antecedent debt, because the Bank didn't specifically identify any antecedent debt in any of the trust deeds.

What lesson does *Matrix* offer banks that use dragnet clauses?

In Oregon, and under the jurisdiction of the Bankruptcy Court, a dragnet clause in any security agreement or trust deed must specifically describe all antecedent debt intended to be secured by that security agreement or trust deed. Each subsequent security agreement or trust deed must again recite all known antecedent debt of the borrower in order to properly secure and cross-collateralize the debt. Unless you specifically list the prior debt, "all prior debt is secured" now means "no prior debt is secured."