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2023 VT 2

No. 22-AP-053

Berkshire Bank	Supreme Court
v.	On Appeal from Superior Court, Bennington Unit, Civil Division
Dorothea Kelly & Thomas Kelly	September Term, 2022

Cortland Corsones, J.

James B. Anderson of Ryan Smith & Carbine, LTD., Rutland, for Plaintiff-Appellant.

Alexander M. Dean of Barr, Sternberg, Moss, Silver & Munson, P.C., Bennington, for Defendant-Appellee Thomas Kelly.

PRESENT: Reiber, C.J., Eaton, Carroll, Cohen and Waples, JJ.

¶ 1. **WAPLES, J.** Plaintiff Berkshire Bank filed this action seeking possession of funds in an investment account owned by defendant Thomas Kelly, which defendant purportedly pledged as security for a business loan to his sister Dorothea Kelly.[1] The civil division granted summary judgment in favor of defendant, concluding that plaintiff did not have a valid security interest in the account. We agree and affirm.

[1] Thomas and Dorothea Kelly were both named as defendants in plaintiff's complaint. The civil division entered judgment against Dorothea and she did not appeal that decision or participate in this appeal. For simplicity, we refer to Thomas Kelly as "defendant" in this opinion.

¶ 2. The following facts were undisputed for purposes of summary judgment. In March 2018, defendant's sister borrowed $200,000 from plaintiff to fund her new business. She executed and delivered a promissory note to plaintiff on March 2, 2018.

¶ 3. The same day, defendant signed a "Commercial Pledge Agreement" that purported to give plaintiff a security interest in defendant's Merrill Lynch investment-management account to secure repayment of his sister's loan.[2] The pledge agreement stated in part:

> GRANT OF A SECURITY INTEREST. For valuable consideration, Grantor grants to Lender a security interest in the Collateral to secure the Indebtedness and agrees that Lender shall have the rights stated in the agreement with respect to the Collateral, in addition to all other rights which Lender may have by law.
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> COLLATERAL DESCRIPTION. The word "Collateral" as used in this Agreement means all of Grantor's property (however owned if more than one), in the possession of, or subject to the control of, Lender (or in the possession of, or subject to the control of, a third party subject to the control of Lender), whether existing now or later and whether tangible or intangible in character, including without limitation each and all of the following:
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> A first priority perfected security interest in the following property owned by Thomas John Kelly: Merrill Lynch Investment Management Account XXXX7779, including all balances as of the date of this Agreement, plus future deposits, interest, and other credits thereto.

¶ 4. Defendant also signed a "Control Agreement and Acknowledgement of Pledge and Security Interest" that was addressed to Merrill Lynch. The control agreement stated that defendant had granted a security interest in his investment management account to plaintiff. It asked Merrill Lynch to acknowledge the security interest, to agree not to transfer any of defendant's interest in the account without plaintiff's written consent, and to follow plaintiff's

[2] Defendant co-owned the Merrill Lynch account with his wife, Lavinia. Lavinia did not sign the commercial pledge agreement. The civil division determined that because defendant and Lavinia owned the account as joint tenants with right of survivorship, defendant could unilaterally encumber the account without Lavinia's consent. Neither plaintiff nor defendant challenges this determination on appeal.

written instructions concerning the account. Plaintiff submitted the control agreement to Merrill Lynch, but Merrill Lynch never signed it. Plaintiff concedes that it never obtained control of defendant's account because the control agreement was not signed by Merrill Lynch. Despite this, plaintiff funded the loan to defendant's sister.

¶ 5. Defendant's sister defaulted on the loan in November 2019. In October 2020, plaintiff filed a complaint against defendant and his sister in the civil division of the superior court. Plaintiff sought judgment against defendant's sister for amounts due on the note and an overdraft. It also sought a permanent injunction directing defendant to turn over the Merrill Lynch account or its proceeds to plaintiff to satisfy the amount due on the note. Separately, plaintiff moved for a preliminary injunction ordering defendant to turn over the account to plaintiff. The court granted the motion for a preliminary injunction but instead ordered defendant to set aside $208,000 from the pledged account "as security for the asserted debt." Defendant subsequently transferred $208,000 to an escrow account held by his attorney.

¶ 6. In May 2021, defendant moved for summary judgment in his favor. Plaintiff cross-moved for summary judgment against both defendant and his sister. Defendant's sister did not oppose plaintiff's motion, and in September 2021, the court granted plaintiff's motion and entered judgment against her. In January 2022, the court granted defendant's motion for summary judgment on plaintiff's claims against him. The court held that because plaintiff never possessed or controlled the Merrill Lynch account as required by the plain language of the pledge agreement, the collateral as described by the agreement never existed, and a security interest never attached under 9A V.S.A. § 9-203(b). Plaintiff moved to alter or amend the judgment, arguing that the collateral physically existed and was accurately described in the agreement, which contemplated that possession or control of the collateral could take place after the agreement was signed. The court denied plaintiff's motion. This appeal followed.

¶ 7. On appeal, plaintiff argues that the civil division erred in granting summary judgment to defendant because the commercial pledge agreement signed by defendant satisfied the requirements for creating a valid security interest. Plaintiff argues that the pledge agreement accurately describes the collateral as defendant's Merrill Lynch account ending in 7779, which is all that is required under Article 9 of Vermont's Uniform Commercial Code (UCC). It contends that the possession-or-control language is mere boilerplate that any pledge agreement must have to create a pledge and can be interpreted as expressing defendant's intent to turn over control of the account to plaintiff rather than as a precondition to the creation of the security interest. According to plaintiff, defendant clearly intended to pledge his account as security for his sister's loan, and therefore plaintiff was entitled to take possession of the account when his sister defaulted. Plaintiff alternatively argues that it did eventually acquire possession of the funds, and thereby satisfied the description in the pledge agreement and perfected its security interest, when defendant transferred $208,000 from the account into an escrow account as security for the asserted debt.

¶ 8. When reviewing a decision granting summary judgment, this Court applies the same standard as the civil division. Richart v. Jackson, 171 Vt. 94, 97, 758 A.2d 319, 321 (2000). Summary judgment is appropriate where there is no genuine dispute of material fact and the moving party is entitled to judgment as a matter of law. Politi v. Tyler, 170 Vt. 428, 431, 751 A.2d 788, 790 (2000); see V.R.C.P. 56(a). The facts in this case are undisputed; thus, the only question before us is whether the civil division correctly determined that the pledge agreement did not give rise to an enforceable security interest. We review the court's interpretation of the agreement de novo. Dep't of Corr. V. Matrix Health Sys., P.C., 2008 VT 32, ¶ 11, 183 Vt. 348, 950 A.2d 1201. Because we conclude that the agreement unambiguously required plaintiff to have possession or control of defendant's account to create an enforceable security interest, we affirm the award of summary judgment to defendant.

¶ 9. This dispute is governed by Article 9 of the Vermont UCC, which covers secured transactions. Article 9 provides that a creditor has a secured interest in collateral when the interest attaches, meaning "when it becomes enforceable against the debtor with respect to the collateral." 9A V.S.A. § 9-203(a). In general, a security interest becomes enforceable against the debtor when "value has been given," "the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party," and one of four specified evidentiary conditions is satisfied. Id. § 9-203(b). "These minimal prerequisites lessen the probability of future misunderstandings, prevent collusion and misrepresentation and provide information to third parties who may be bound by the existence of a security interest." Finley v. Williams, 142 Vt. 153, 155, 453 A.2d 85, 86 (1982).

¶ 10. It is undisputed that plaintiff gave value by making the loan to defendant's sister and that defendant had rights in the Merrill Lynch account. The parties also agree that prior to the commencement of this litigation the Merrill Lynch account was never in plaintiff's possession or control, ruling out those methods of satisfying the evidentiary requirement.[3] See 9A V.S.A. § 9-203(b)(3)(B)-(D) (providing for possession, delivery, or control pursuant to security agreement as alternative evidentiary tests of enforceability). Accordingly, the security interest only attached if the evidentiary condition set forth in § 9-203(b)(3)(A) was met; that is, if defendant "authenticated a security agreement that provides a description of the collateral."

¶ 11. "[A] security agreement is effective according to its terms between the parties." Id. § 9-201. We interpret a security agreement using well-settled principles of contract construction. Besaw v. Giroux, 2018 VT 138, ¶ 21, 209 Vt. 388, 205 A.3d 518. Our goal is "to give effect to the parties' intent, which we presume is reflected in the contract's language when that language is clear." In re Adelphia Bus. Sols. of Vt., Inc., 2004 VT 82, ¶ 7, 177 Vt. 136, 861 A.2d 1078. "We

[3] Plaintiff argues that the account later came into its possession as a result of the court's preliminary injunction order. As discussed below, we find this argument to be without merit. See infra, ¶¶ 19-20.

also strive to give effect to every part of the instrument and form a harmonious whole from the parts." State v. Philip Morris USA Inc., 2008 VT 11, ¶ 13, 183 Vt. 176, 945 A.2d 887 (quotation omitted).

¶ 12. "[A] security interest cannot exist in the absence of a security agreement, and it follows that a security interest is limited to property described in the security agreement." Allis-Chalmers Corp. v. Staggs, 453 N.E.2d 145, 148 (Ill. App. Ct. 1983). Here, the agreement between the parties defined the collateral as "all of [defendant's] property . . . in the possession of, or subject to the control of, [plaintiff] . . . whether existing now or later and whether tangible or intangible in character, including" defendant's Merrill Lynch account. (Emphasis added.) Under the plain meaning of this language, collateralization was dependent on plaintiff's possession or control of the Merrill Lynch account. Because that event never occurred, the security interest never attached.

¶ 13. Plaintiff created this problem for itself by incorporating the condition of possession or control into the description of the collateral. If the description did not contain such a condition, it likely would have been sufficient to create a security interest, as Article 9's description requirement is relatively easy to satisfy. See 9A V.S.A. § 9-108 ("[A] description of personal or real property is sufficient, whether or not it is specific, if it reasonably identifies what is described."); id. cmt. 2 ("This section rejects any requirement that a description is insufficient unless it is exact and detailed (the so-called 'serial number' test)."). Compare In re Bucala, 464 B.R. 626, 631 (Bankr. S.D.N.Y. 2012) (holding that typographical error in description of manufactured home did not prevent attachment of security interest), with In re Hintze, 525 B.R. 780, 785 (Bankr. N.D. Fla. 2015) (holding that description of collateral as "all of Maker's assets" insufficiently precise to create security interest).

¶ 14. However, the language of the agreement is clear and, because plaintiff drafted the agreement, is construed against plaintiff. See Toys, Inc. v. F.M. Burlington Co., 155 Vt. 44, 49,

582 A.2d 123, 126 (1990) ("[A] doubtful provision in a written instrument is construed against the party responsible for drafting it."); In re Kohl, 18 B.R. 670, 672 n.1 (Bankr. W.D. Wis. 1982) (stating terms of security agreement are strictly construed against drafter, particularly when there is substantial disparity in bargaining power between parties and standard form is supplied by drafter). We must therefore give its plain meaning effect. See Sutton v. Purzycki, 2022 VT 56, ¶ 37, __ Vt. __, __ A.3d __ ("If the plain language is clear, we take the words to represent the parties' intent, and the plain meaning of the language governs our interpretation of the contract." (quotation omitted)). Under the plain meaning of the agreement, plaintiff's security interest was contingent on it obtaining possession or control over the account, and because that precondition was never satisfied, the interest never attached. Put differently, defendant's Merrill Lynch account simply does not fit within the pledge agreement's description of the collateral because the account is not, and never was, within plaintiff's possession or control.

¶ 15. Plaintiff argues that the possession-or-control clause is mere boilerplate and should be interpreted to mean that defendant agreed to turn over possession or control of the account at plaintiff's demand. However, the language of the clause does not support plaintiff's interpretation, since it refers to the account already being in plaintiff's control. Plaintiff essentially asks us to ignore the possession-or-control language and give effect only to the section specifically describing the Merrill Lynch account.[4] But "[i]n construing contracts, we must conclude that the parties included provisions for a reason." Houle v. Quenneville, 173 Vt. 80, 86, 787 A.2d 1258, 1262 (2001); see also Grievance of Graves, 147 Vt. 519, 523, 520 A.2d 999, 1001 (1986) ("Our duty is to interpret disputed contract language, not remake it, or ignore it." (quotation omitted)).

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[4] Plaintiff also argues that the agreement states that defective collateralization is a default for which it may exercise certain listed remedies, including "[c]ollect[ing] any of the Collateral and, at Lender's option and to the extent permitted by applicable law, retain[ing] possession of the Collateral while suing on the Indebtedness." This provision only allows plaintiff to take and hold the collateral while a suit is pending; it does not create a security interest where none exists.

¶ 16. Plaintiff appears to suggest throughout its briefing that even if the pledge agreement does not create a security interest under Article 9, it should still have a valid lien on defendant's account based on the common law of contracts. However, Article 9 makes clear that any contractual arrangement that purports to create a security interest is covered by its provisions, subject to certain exceptions that do not apply here. See 9A V.S.A. § 9-109(a) (stating that Article 9 applies generally to "a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract"); id. cmt. 2 ("When a security interest is created, this Article applies regardless of the form of the transaction or the name that parties have given to it."). "Security interests under Article 9 are consensual, and do not ordinarily arise by operation of law." Vt. Indus. Dev. Auth. v. Setze, 157 Vt. 427, 431, 600 A.2d 302, 305 (1991). Where, as here, the parties' agreement does not satisfy Article 9, a valid security interest does not exist.

¶ 17. Plaintiff, citing the Vermont UCC, argues that "a security agreement may create or provide for a security interest in after-acquired collateral." 9A V.S.A. § 9-204(a). According to plaintiff, this provision supports its claim because the pledge agreement described the collateral as property within plaintiff's possession or control "whether existing now or later." Thus, plaintiff reasons, the security interest attached to the collateral when the pledge agreement was signed even though the possession-or-control condition was not satisfied at that point. We are not persuaded by this argument because § 9-204 applies to property in which the debtor does not have any rights at the time the security agreement is executed. See id. cmt. 2 (explaining that rule on after-acquired property validates security interests in debtor's existing and, upon acquisition, future assets). This is not a case where a creditor seeks to attach property that the debtor did not yet own at the time of the agreement; defendant had rights in the Merrill Lynch account at all relevant times. Rather, the account never met the description of the collateral because plaintiff never took control of it as the agreement contemplated. Thus, the rule on after-acquired property does not assist plaintiff.

¶ 18. Finally, plaintiff argues that its security interest eventually did attach when defendant complied with the court's order directing him to set aside $208,000 "as security for the asserted debt in this matter" by placing that amount in escrow with his attorney, because at that point, plaintiff took possession of the collateral under 9A V.S.A. § 9-313(c)(1). We disagree. Section 9-313(c)(1) provides that a secured party takes possession of collateral held by a person other than the debtor when "the person in possession authenticates a record acknowledging that it holds possession of the collateral for the secured party's benefit." The comments to § 9-313 explain that "if the collateral is in possession of an agent of the secured party for the purposes of possessing on behalf of the secured party, and if the agent is not also an agent of the debtor, the secured party has taken actual possession." Id. cmt. 3. However, "a court may determine that a person in possession is so closely connected to or controlled by the debtor that the debtor has retained effective possession, even though the person may have agreed to take possession on behalf of the secured party." Id.

¶ 19. We conclude that such is the case here. We see nothing in the record indicating that defendant's counsel was acting as an agent of plaintiff or on behalf of both parties equally when he took possession of the funds. Rather, it is clear that defendant's counsel was acting as defendant's agent, consistent with the usual attorney-client relationship. The parties stipulated that defendant would "establish an escrow account with his counsel . . . and transfer the amount of $208,000 to be held in that account as security for the asserted debt in this matter, as described in the Court's Order dated April 28, 2021." The court's order directed defendant himself to set aside the funds; thus, in essence, defendant's counsel was acting in the place of defendant. Defendant's counsel deposited the funds into his firm's IOLTA account, consistent with his status as an agent of defendant. Under these circumstances, we conclude that plaintiff did not take possession of the collateral when the funds were placed in escrow by court order. See In re Liddle, 608 B.R. 356, 363 (Bankr. S.D.N.Y. 2019) (holding that secured creditor did not take possession of cash

collateral when it was transferred into escrow account held by debtor's counsel, because facts indicated counsel was acting as debtor's agent, not on behalf of creditor).

¶ 20. Because defendant's Merrill Lynch account was never within plaintiff's control, it did not fall within the description of collateral contained in the parties' pledge agreement, and no security interest ever attached to the account.[5] The civil division therefore correctly granted summary judgment in favor of defendant.

Affirmed.

FOR THE COURT:

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Associate Justice

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[5] We appreciate the benefit that has accrued to defendant in being released from an obligation he intended to undertake. Defendant concedes in his brief that a security interest would have attached if Merrill Lynch had consented to encumbrance of the account. However, according to the plain language of the agreement, this obligation never came to exist, and we therefore cannot enforce it. We further note that the pledge agreement did not require defendant to take any specific steps to ensure that Merrill Lynch delivered control other than signing the control agreement.