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STATE OF WISCONSIN

C O U R T O F A P P E A L S

DISTRICT III

Case No. 2012AP2309

STATE OF WISCONSIN,

Plaintiff-Respondent,

v.

GREG LAPEAN,

Defendant-Appellant.

DEFENDANT-APPELLANT'S REPLY BRIEF

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On appeal from the Circuit Court
of Dunn County, Hon. William C. Stewart, Jr.,
Circuit Judge, presiding.

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ARGUMENT

I. THE REAL CONTROVERSY WAS NOT FULLY TRIED BECAUSE THE JURY HAD NO INSTRUCTION ON THE TERMS OF THE SECURITY AGREEMENT.

The State continues to base its theory of the case on LaPean selling the collateral without notice and failing to pay the sale proceeds directly to Security Bank ("Security") in full. (State's Brief, pp. 13-14; see also 71:193). The State argues that LaPean did not act within his rights under the security agreement and therefore was not prejudiced by the lack of additional jury instructions because, in fact: 1) he *was* required to notify Security before the collateral was sold; and, 2) he *was* required to pay Security the proceeds from those sales. (State's Brief, p. 15).

The State relies on Sections 3(a) and 3(k) of the security agreement to support its argument that LaPean had an obligation to notify Security "as soon as" he sold any of the collateral.

Section 3(a) of the "Debtor's Warranties" states in relevant part:

> Debtor warrants that while any of the Obligations are unpaid: **(a) Ownership and use.** Debtor owns (or with spouse owns) the Collateral free of all encumbrances and security interests (except Lender's security interest). .... The Collateral is used or bought for use primarily for business purposes.

(R-Ap. 108). In 3(k) under the same section, the security agreement reads:

> (k) Location. The address where the Collateral will be kept, if different from that appearing below Section 10, is __________. Such location shall not be changed without prior written consent of Lender, but the parties intend that the Collateral, wherever located, is covered by this Agreement.

(R-Ap. 108).

The State reasons that under either of these provisions, LaPean was required to notify Security as soon as a piece of collateral was sold. Under Sub (a) he was required to inform Security the collateral was sold because "he no longer owned it." Under Sub (k) he was required to notify the Bank by virtue of his obligation to obtain written permission when the location of the collateral presumably changed upon sale. (State's Brief, p. 14).

As a threshold matter, neither Sections 3(a) nor 3(k) (nor any other Section in the security agreement) explicitly require the debtor to notify the lender upon the sale of collateralized inventory. Rather, the State attempts to create a notification requirement by engaging in a self-serving contractual interpretation that is neither intended nor logical.

While it's true LaPean could no longer warrant that he "owned" the collateral once he sold it, at the same time the item ceased to be "collateral." Contrary to the State's contention, a Bank's security interest in collateralized inventory is severed upon sale in the ordinary course of business. See Comment 2 to Wis. Stat. § 409.315:

> Likewise, the general rule that a security interest survives disposition does not apply if the secured party entrusts goods collateral to a merchant who deals in goods of that kind and the merchant sells the collateral to a buyer in the ordinary course of business. Section 2-403(2) gives the merchant the power to transfer all the secured party's rights to the buyer, even if the sale is wrongful as against the secured party.

See also Wis. Stat. § 409.320(1):

> **Buyer in the Ordinary Course of Business.** Except as provided in sub. (5), a buyer in the ordinary course of business, ..., takes free of a security interest created by the buyer's seller, even if the security interest is perfected and the buyer knows of its existence.

The purpose of Section 3(a) is to assure that equipment put up as collateral is owned by the debtor and not someone else. The initial warranty of ownership serves the Bank's interest by showing the debtor's equity, and continues to serve the Bank's interest when a sale occurs by assuring the proceeds belong to the debtor. The debtor would then have funds to make the loan payments. What this clause is trying to prevent is a borrower using equipment he does not own to secure the loan, such as machinery he takes on consignment[1] or possesses for

1 For example, the aborted tractor sales the State references on pages 24 and 28 of

repair. Section 3(a) neither explicitly nor implicitly creates a duty on the part of the debtor to notify the Bank upon sale.

Similarly, Section 3(k) no longer applies to inventory sold in the ordinary course of business because once sold, it likewise ceases to be collateral. The purpose of Section 3(k) is to allow the lender to inventory the collateral that does exist by knowing where it is "kept."   Section 3(k) says nothing about notifying the lender or seeking permission to change location prior to *sale* under Section 5(a), and such a requirement would, in any event, be impractical. Once the collateral is sold the debtor/merchant could only speculate as to what "address" the equipment is being "kept." The buyer would be free to "keep" the equipment wherever he desired, or turn around and sell it.   Section 3(k) only makes sense with regard to "collateral" which remains within the debtor's ownership and control.

The State also cites *Fulton v. Anchor Savings Bank*, 452 S.E.2d 208, 216 (Ga. 1994) in support of its contention that LaPean was required to inform Security of any change of address due to sales made during the term of the loan. *Fulton*, however, did not involve the sale of collateralized inventory, and there was no sales clause in the security agreement even remotely similar to Section 5(a). Rather, *Fulton* involved a new car loan, with 60 monthly payments and a requirement the collateral be maintained as security at an agreed location during the life of the loan. *Fulton*, at 210. The State's reliance on *Fulton* only underscores its continued refusal to acknowledge the difference between a typical consumer loan and a commercial loan specifically set-up to finance sales inventory.

The State likewise misses the mark when it claims LaPean was required to provide all sales proceeds from Purchase Money Security Interest (PMSI) collateral directly to

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its brief were consignments that had nothing to do with Security. (71:34-35; 75-76; 155-156).

Security Bank. Again, there is no such requirement stated in the note or the security agreement. Nonetheless, the State attempts to construct such a requirement by referencing Wis. Stat. § 409.315 and Section 5(c) of the security agreement. (State's Brief, pp. 14-15). The problem is that neither of these sources say what the State wants them to.

The State cites Wis. Stat. § 409.315 for the proposition that Security Bank has a security interest in the *proceeds* of the collateral. Again, Wis. Stat. § 409.315 does not apply to inventory financing. *Supra*, p. 6. A security interest in the sales proceeds does not, in any event, equate to an automatic requirement that all proceeds be paid directly to the Bank.

Likewise, Section (5)(c) does not require payment to the lender. Rather, it provides that a lender "*may require* that all proceeds of Collateral received by Debtor" be re-paid directly. (Emphasis added). By its own terms, this provision does not mandate re-payment but merely gives the lender that option. The State does not contend this option was ever exercised.

The State argues, nonetheless, that the Bank was deprived of using this option because it never received notice of sale. Again, *there is no requirement* LaPean give notice of sale. Further, nothing prevented the Bank from exercising this option preemptively: "*At any time* Lender may require that *all proceeds* of Collateral received by the Debtor...." As long as LaPean was paying his installments, the Bank had no reason to do so.

The State also argues the PMSI status of this original collateral "survived" the loan restructuring in June of 2005. The State fails to articulate, however, how this continued PMSI status bears on the question of notice or mandates direct re-payment of sales proceeds. There is no dispute the Bank retained its security interest in the collateral after restructuring--assuming the collateral hadn't already been sold. What the restructuring clearly did do, however, was change how the loans were paid as well as how the balance due was calculated.

Regardless of how one characterizes the restructuring, three facts are undisputed: 1) the remaining balances[2] on the original PMSI notes were no longer distinguishable as they were combined with other debt into a much larger loan balance; 2) the installment payments were applied against the new loan balance and not assigned to individual collateral; and 3) the initial notes were no longer being serviced. Whether the initial loans were "paid off" by the restructured loans or "renewed into" them, as a practical matter they ceased to exist. (71:68).

As a result, the State's theory of liability--that LaPean failed to repay the sale proceeds against each of these specified pieces of collateral--has no basis in fact. Once the old balances were combined with the new, LaPean was only required to make periodic payments which were applied against the combined total balance, without allocation.[3] LaPean was "current" on his loans from June of 2005 through December of 2006 simply by making these periodic payments. There is no evidence the Bank made any demand LaPean pay over his sales proceeds during that time. (71:20-21, 29, 43). Indeed, LaPean made payments of approximately $680,000 to Security from general revenues. (71:120, 159).

The State's reliance on "missing" collateral and LaPean's alleged failure to pay sales proceeds directly to the Bank as

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2 LaPean paid approximately $200,000 on the initial notes prior to the restructuring. (71:119-120)

3 The $650,000.00 floor plan loan executed on June 20, 2005, for example, required “11 equal payment(s) consisting of principal and interest in the amount of $4,980.58 each, beginning on July 20, 2005 and continuing monthly thereafter, and one (1) final payment consisting of the unpaid principal and all accrued interest remaining due on June 20, 2006” (Exhibit 9; 71:10)

proof of intent to defraud is without a legal basis. (See State's argument at trial, 70:115; 71:193-194, 205). The fact that LaPean may have used sale proceeds to pay business expenses is likewise irrelevant. See e.g. *In re Hartman*, 254 B.R. 669, 674, (2000). The State succeeded in confusing the jury on this point as the jury specifically asked the trial court during deliberations whether there was a "difference in liability between a business loan and a personal" loan. (72:2-3).

As such, trial counsel should have asked for a jury instruction that under the terms of the security agreement: (1) LaPean had a right to sell or lease inventory collateral without the consent of, and without notice to, the lender; (2) LaPean had no contractual or legal obligation to provide the proceeds of the sale directly to the lender; and, (3) LaPean had a right to use sale proceeds to pay legitimate business expenses.[4] Without an instruction explaining a commercial debtor's right to sell collateralized inventory without notice and without direct payment of the sale proceeds to the bank, the jury was unable to distinguish between fixed collateral typical of a consumer loan, and revolving collateral in a commercial loan. It had no basis for judging whether LaPean's "conduct" evidenced an intent to defraud or was entirely innocent. Trial counsel's failure to do so was deficient and prejudicial. Alternatively, the real controversy was not fully tried.

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4 An instruction containing these three points is more than specific enough for the State to form an objection, as it certainly does on appeal. (See State's Brief, p. 17).

II. THE STATE'S CASE-IN-CHIEF WAS INSUFFICIENT TO PROVE INTENT TO DEFRAUD.

The State's sufficiency of the evidence argument boils down to three essential points: 1) The PMSI collateral supporting LaPean's loans "disappeared without notification, explanation, or full payment to Security"; 2) Smith testified the PMSI collateral "still existed [at the time of] the restructuring" in June 2005; after December 2006, when LaPean first started sliding into default; in June 2007, when Smith saw "some" of the PMSI collateral on LaPean's premises; and after the June 5, 2007 auction (71:30, 83); and, 3) LaPean's constant evasion about the whereabouts of the collateral from the beginning of 2007 until the day the sheriff unsuccessfully attempted to repossess it in 2009. (71:37). (State's brief pp. 27-28).

As discussed earlier, LaPean was fully within his rights under the security agreement to sell the collateral without notice and without direct payment to Security Bank. Smith also conceded she never "specifically" told Greg LaPean that he needed to notify her when PMSI collateral was sold. (71:167).

In addition, Smith's early testimony that she saw "some" PMSI collateral at the time of restructuring in 2005, in early 2007, and after the auction in June of 2007, has no probative value as this assertion was later contradicted by Smith herself.

Even in her initial testimony, Smith never positively identified a single piece of *PMSI* collateral from among the other collateral (such as trade-ins and the like) on LaPean's lot. Smith admitted "the times we went there I didn't check specific serial numbers." (71:30). When pressed on cross-examination, moreover, she conceded that none of the PMSI collateral listed on Exhibit 8 was inventoried when the loan was restructured in June of 2005. (71: 168-170). The only evidence she claimed to have was a photo attached to a real estate appraisal which showed "equipment" on the lot--a photo she did not bring to trial. (71:169-170). She also admitted that none of the PMSI equipment was present at the June 2007 auction. (71:31). Smith ultimately conceded, moreover, that she had no knowledge of when the PMSI Collateral listed on Exhibit 8 was ever at LaPean Implement or when any of it was sold. (71: 82-83, 168).

Smith's testimony that LaPean was being "evasive" about the whereabouts of his equipment in 2007 also fails closer scrutiny.

First, Smith was often vague about whether the PMSI collateral was the subject of her conversation. She testified that in early 2007, for example, she went to check on "[her] collateral" and "many times I was told that *the equipment* was being sent out ..." (emphasis added) (71:30).

Second, Smith admitted "a lot" of her "weekly" conversations were not with Greg LaPean, but with his wife Amy; and "many" were with his mother Faye. (71:76).

In short, the only evidence even marginally incriminating was that LaPean may have been evasive in 2007 about the whereabouts of equipment that may or may not have been the PMSI collateral.

Trial counsel was ineffective when he failed to move for a directed verdict.

III. THE EVIDENCE AS A WHOLE WAS INSUFFICIENT TO PROVE INTENT TO DEFRAUD.

The State points to three additional pieces of evidence from the defense case which it claims bolster the State's case-in-chief: 1) Smith's testimony the collateral still existed in June of 2005, and as late as June of 2007, in contrast to LaPean's testimony the PMSI collateral was sold before the consolidation in June of 2005; 2) Smith's testimony LaPean was evasive concerning the whereabouts of the collateral; and 3) LaPean's inability to recall what happened to the PMSI collateral; his inability to produce sales records; the missing computer hard drive; and the existence of a tape back-up with a record of payments made to Security Bank. (State's brief p. 38).

Of these three points, only the third is arguably new. The first two were raised in Smith's direct examination and for the same reasons argued in the previous section, have little if any probative value.

On the third point, Smith had previously testified LaPean told her he did not recall where the collateral was. In his testimony LaPean concurred, but did offer an explanation. As to his inability to produce sales records; the missing computer hard drive, and the back-up tape, LaPean also offered an explanation but concedes a jury could draw a negative inference from this evidence. Without some temporal connection between LaPean's "evasiveness" and the sale of PMSI collateral, however, the probative value of is uncertain at best.

Again, the State must not only prove an intent to defraud contemporaneous with the transaction, it must prove the Bank was the object of such intent. The State produced no evidence of when, to whom, and under what circumstances even one piece of PMSI collateral was transferred. Smith ultimately conceded she had no knowledge as to when the PMSI collateral was in LaPean's possession or when it was sold. (71:82-83,168). The State ignores this admission throughout its brief. Ultimately, the State failed to prove that any of the PMSI collateral was sold other than in the ordinary course of business.

IV. DUPLICITY

As the State notes, its discretion to charge separately chargeable offenses as one continuing offense is limited to those circumstances where the offenses "are committed by the same person at substantially the same time and relating to one continued transaction." *State v. Miller*, 2002 WI App 197, ¶23, 257 Wis.2d 124, 650 N.W.2d 850.

Again, the State provides no evidence the PMSI collateral was transferred "at substantially the same time" in relation to "one continued transaction." Smith conceded she had no personal knowledge when LaPean possessed the PMSI collateral; nor when he sold it. Further, the State's own evidence shows the PMSI collateral could have been transferred any time during the four-year-period between 2005 and 2009. Therefore, the State is required to prove *each* of 18 PMSI items listed on Exhibit 8 were sold with intent to defraud.

CONCLUSION

This Court should enter a judgment of acquittal based upon insufficient evidence to convict; or, alternatively, reverse the conviction and remand for a new trial with proper jury instructions; or alternatively, remand for a *Machner* hearing on the ineffective assistance of counsel claims.

Respectfully submitted this 9th day of May, 2013.

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CERTIFICATION

As to Form and Length

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The Argument and Conclusion sections of this brief contain 2941 words.

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I hereby certify that: I have submitted an electronic copy of this brief, excluding the appendix, if any, which complies with the requirements of s. 809.19(12).
I further certify that: This electronic brief is identical in content and format to the printed form of the brief filed as of this date. A copy of this certificate has been served with the paper copies of this brief filed with the court and served on all opposing parties.

Dated this 9th day of May, 2013.

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CERTIFICATION OF MAILING

I certify that this brief or appendix was deposited in the United States Mail for delivery to the Clerk of the Court of Appeals by First Class Mail on May 9, 2013. I further certify that the brief or appendix was correctly addressed and postage was prepaid.

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