NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

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DODD-FRANK ACT

Dodd-Frank Precludes Arbitration on Pre-existing Account in Limited Circumstance [4TH CIR]

In 2005, Debtor opened a Home Equity Line of Credit (HELOC) with National City Bank (National City). In 2010, he opened three deposit accounts at PNC Bank (PNC) and signed an Account Agreement authorizing PNC Bank to set off some of his funds in the account to pay any indebtedness he owed. The Account Agreement also permitted PNC to amend the agreement. Three years later, PNC added an arbitration clause and gave its customers 45 days to opt-out. Debtor's opt-out deadline was June 11, 2013. He took no action to opt-out. One year later, Debtor opened another deposit account with PNC (2014 Account), and he agreed to be bound by the Account Agreement, which included the arbitration provision. In 2015, Debtor's HELOC ended, but it took him five more years to pay off the credit. During those five years, PNC set off about $1,400 from one of his 2010 accounts (2010 Account) and about $1,600 from his 2014 Account to pay the overdue HELOC per the Account Agreement. Debtor filed suit, and PNC moved to compel arbitration. The district court found that the Dodd-Frank Wall Street Reform and Consumer Protection Act's (Dodd-Frank Act) provisions relevant to this case, which impose "restrictions on the use of mandatory arbitration agreements for mortgage-related transactions," was effective on June 1, 2013. Therefore, the Dodd-Frank Act prohibited arbitration on the 2014 Account but did not apply retroactively to the 2010 account because "there was no language in the statute evidencing an intent for the provisions to overcome the presumption against retroactivity." The United States Court of Appeals for the Fourth Circuit affirmed in part and reversed in part to conclude that the Dodd-Frank Act applied to both the 2010 and 2014 Accounts.

In LYONS v. PNC BANK, 26 F. 4th 180 (4TH CIR. 2022), the court began by clarifying why the Dodd-Frank Act applied to Debtor's accounts. Chapter 15 Section 1639(c)(e)(3) of the United States Code clearly, unambiguously, and expressly provides that an agreement cannot prevent a consumer from bringing a Truth in Lending Act claim to federal court when it is related to a residential mortgage loan. The Account Agreement at issue "stands in relation to, pertains to, refers to, and has bearing on or concerns" the Debtors HELOC, which is precisely the type of loan the Act intends to cover. The Account Agreement intended to prevent its parties from going to federal court by attempting to compel arbitration. The court quickly agreed with the district court and concluded that the Dodd-Frank Act applied to and therefore precluded arbitration of issues involving the 2014 Account because the Debtor opened it and signed the Account Agreement after the June 1, 2013, Dodd Frank Act enactment date. The application of Dodd-Frank to the 2010 Account took a bit more analysis. When a consumer is given a deadline to opt-out of a newly added agreement provision and takes no action to do so, Maryland law presumes that the consumer agreed to the provision and is bound by it. Also, statutes specifically governing contractual agreements that are effective at the time of making the contract govern the contract. So, if a contract is made before a law that preempts it is enacted, that contract, at least in Maryland, is not subject to the rule of that statute. Here, Debtor failed to opt-out of the arbitration period before the deadline. However, his deadline to opt-out of the arbitration provision was June 11, 2013, ten days after the Dodd-Frank Act effective date. Therefore, the arbitration clause on the 2010 Account is prohibited by the Dodd-Frank Act, and PNC could not compel Debtor to arbitration. By: Madison Pyle Madison.Pyle@ttu.edu.

LENDING

Subordinate Lender Liable for Conversion After Accepting Payment of Loan [8TH CIR]

This case involves a subordinate and senior lender. Both lenders had security interests in a farm owned by the debtors. The senior lender perfected its security interest in the debtors' crops and assets. The subordinate lender also perfected its security interest and received notice from the senior lender of its existing security interest. Because the senior lender's interest held priority over the assets, the senior lender requested that the subordinate lender send any payments the debtors made to it to the senior lender. The subordinate lender agreed to comply with this arrangement and entered into a subordination agreement providing that it would forward payments it received to the senior lender. Issues arose when the debtor paid its debt to the subordinate lender in full. The subordinate lender was unaware and uninvolved in the transaction that allowed the debtor to pay off the full amount of the subordinate loan. The senior lender sued the subordinate lender, claiming that the subordinate lender's acceptance of the debtors' checks constituted conversion of assets belonging to the senior lender in light of the subordination agreement. The subordinate lender argued that it was a holder in due course of the debtors' note and that its status as a holder in due course was a defense to conversion. The district court ruled in favor of the senior lender and the subordinate lender appealed.

In AGRIFUND, LLC v. HEARTLAND CO-OP, 8 F. 4th 660 (8th Cir. 2021), the circuit court held that the subordinate lender did not qualify as a holder in due course. Instead of denying the senior lender's claim of conversion, the subordinate lender had raised the affirmative defense that it was a holder in due course of the note on which it was paid. If this were true, the court noted, it would not impose liability for conversion on the subordinate lender. To be a holder in due course, the holder must take the instrument for value, in good faith, and without notice of any contrary claim to rights in the instrument. Here, the subordinate lender paid value. Thus, the only questions related to good faith and notice which the court merged into a single test to determine whether the senior lender had put the subordinate lender on constructive notice. In making the constructive notice inquiry, the court asked whether the subordinate lender abided by reasonable commercial standards of fair dealing. The court disagreed with the subordinate lender's argument supporting its commercially reasonable behavior. The court reasoned that minimal effort was required for the subordinate lender to investigate whether the senior lender had been paid in full before the subordinate lender was paid. Therefore, the court rejected the subordinate lender's argument that it qualified as a holder in due course because it had received proper notice of the senior lender's superior interest. By: Julia Ferron juferron@ttu.edu.

EFTA

Bank's Inaction Helps Plaintiff Survive Pleading State on EFTA Claim [9TH CIR]

A wealthy foreign national (Consumer) who spends most of the year outside the United States banks with Chase Bank (Chase). In 2017, unidentified thieves made two transfers from one of her checking accounts to their Union Bank (Union) account. Because the unidentified thieves had no relation to Consumer and because the transfer amounted to almost $30,000, Union contacted Chase, and the two banks concluded that the transfer was fraudulent without informing Consumer. Union refunded Consumer. Despite knowing Consumer's account had been compromised, Chase did not take any steps to protect her account. According to Consumer, it was because of Chase's inaction that the unidentified thieves later made more than 100 transfers from that same checking account for nearly one and a half years, amounting to nearly one million dollars. Each transaction appeared on her monthly statement; it took Consumer until 2019 to report the unauthorized withdrawals. Chase refunded some of the money, but it refused to reimburse $300,000, claiming that the Electronic Funds Transfer Act (EFTA) requires bank customers to report an initial unauthorized transfer within 60 days of its appearance on a bank statement. Consumer contended that her extenuating circumstances (she was abroad and had "very limited or no access to her banking records and/or to the internet") excused her from the 60-day reporting requirement. She also argued that she was relieved from the 60-day reporting requirement because Chase was on notice that her account had been compromised when Union had notified it of the initial fraudulent withdrawal one and a half years earlier. The district court dismissed the Consumer's claims, and, on appeal, the United States Court of Appeals for the Ninth Circuit affirmed in part, reversed in part, and remanded.

In WIDJAJA v. JPMORGAN CHASE BANK, NO. 20-55862, 2021 U.S. APP. LEXIS 37512 (9TH CIR. DEC. 20, 2021), the court noted that the relevant portion of the EFTA is 15 U.S.C § 1693(g). It provides that in most circumstances, a bank customer's liability for unauthorized electronic funds transfers is capped at $50. However, according to 15 U.S.C. § 1693(g)(a), that cap on liability is lifted (thus, the bank's customer bears unlimited liability) if: "(1) an unauthorized transfer appears on the monthly statement… (2) the consumer fails to report the unauthorized transfer to her bank within 60 days after the statement is sent… and (3) the bank can establish that unauthorized transfers made after the 60-day period would not have occurred but for the consumer's failure to provide timely notice of the unauthorized transfer." Addressing Consumer's extenuating circumstances argument, the court, agreeing with the district court, decided that her cursory allegation did not plausibly allege extenuating circumstances because it was hard to believe that someone with her financial means lacked internet access or access to her bank records for a year and a half. Circling back to the statutory language, to avoid unlimited liability and survive the pleading stage, a bank customer must allege "facts plausibly suggesting that even if [she] had reported an unauthorized transfer within the 60-day period, the subsequent unauthorized transfers for which [she] seeks reimbursement would still have occurred." While nothing in the language says that the 60-day requirement can be satisfied by a third party, Consumer's argument allowed the court to make a reasonable inference that Chase would not have taken action to prevent subsequent fraudulent withdrawals even if she met the 60-day requirement because of its inaction after the Union transactions. Therefore, the court reversed and remanded the district court's dismissal because, at the pleading stage, Consumer's arguments survived. By: Madison Pyle Madison.Pyle@ttu.edu.

Failure to State a Claim Gets You Nowhere [ED NY]

A lawyer (Plaintiff) had an attorney trust account with Victory State Bank (Bank). An individual (Individual) used her cell phone to initiate electronic fund transfers out of Plaintiff's account without authorization. Amazon and Synchrony Bank (the Corporate Defendants), which had received the transfers, processed the transfers without checking whether Individual was authorized to use Plaintiff's account. Individual took over $100,000 out of Plaintiff's account, and Plaintiff did not become aware of the transactions until over a year after Individual began making them. Bank returned about $55,000 to Plaintiff, but the remaining sums remained with the Corporate Defendants. Plaintiff, seeking declaratory relief, sued the Corporate Defendants under the Electronic Funds Transfer Act (EFTA), the New York General Business Law (GBL), and for conversion and negligence.

In PRIGNOLI v. BRUCZYNSKI, NO. 20-CV-907, 2021 U.S. DIST. LEXIS 186052 (E.D. N.Y. SEPT. 28, 2021), Plaintiff did not identify a specific provision of the EFTA that he alleged the Corporate Defendants violated. Instead, he just blanketly stated that the 12 C.F.R. 1005.3 "provides a private cause of action," which was something neither party briefed. Even if the parties had briefed that issue, the court found that Plaintiff would fail on that claim regardless. Chapter 12, Section 1005.3 of the Code of Federal Regulations only concerns electronic fund transfers based on physical checks, and the transfers at issue here were made online with a mobile phone. Additionally, Plaintiff failed to allege that the EFTA covered his account. For the EFTA to cover an account, it must be a "demand deposit account, saving deposit, or other asset account… established primarily for personal, family, or household purposes." So, accounts used for commercial purposes, such as Plaintiff's attorney trust account, do not fall under the EFTA. Regarding the GBL claims, Plaintiff also alleged violations of Section 349 and Section 380-s of the N.Y.S. General Business Law. Section 349 requires a plaintiff to allege that a business's "act or practice was consumer-oriented; misleading in a material respect; and… the plaintiff was injured as a result." Plaintiff did not plead facts beyond mere cursory allegations. He simply restated the factors he was required to prove and did not draw inferences to support a finding that the Corporate Defendants' conduct met the elements of Section 349. Section 380-s states that identity theft occurs when "someone misappropriates another person's name or other personal information in order to engage in fraud or other crimes." Again, Plaintiff only presented cursory allegations and failed to allege that the Corporate Defendants' actions fell within Section 380-s. The court then turned its attention to the tort claims. In New York, conversion occurs when a defendant exercises "dominion over the (plaintiffs] property or interferes with it, in derogation of (the] plaintiffs rights." Here, Plaintiff failed to allege that the Corporate Defendants "had an obligation to return the funds and failed to do so." To establish negligence, the plaintiff must establish that the defendant breached an owed duty that proximately and foreseeably resulted in an injury to the plaintiff. Here, Plaintiff failed to state a negligence claim because he did not establish the breach element. In short, the United States District Court for the Eastern District of New York found that Plaintiff failed to state a claim on each count and gave him 30 days to file an amended complaint. By: Madison Pyle Madison.Pyle@ttu.edu.

Bank That Prolonged Wrongful Transfer Investigation Acted in Bad Faith [D CONN]

For four years, a customer (Customer) of Citizens Financial Group (Citizens) rarely accessed the funds in his checking account and never received any account statements. One day he needed a large amount of cash. When he went to a Citizens branch, he had insufficient funds to make the withdrawal because his account had been drained. Customer immediately reported the transactions as fraudulent, and Citizens informed him he was the victim of a hacker, and it was working to recover and return his money. After a 15-month investigation, Citizens reimbursed Customer only half of his money and sent a letter stating that he would not be getting the other half due to his delay in notifying Citizens of the errors in his account. Two months later, Customer brought this suit alleging breach of contract, violation of the implied covenant of good faith and fair dealing, and failure to reimburse for unauthorized transfers under the Electronic Funds Transfer Act (EFTA). Citizens moved for summary judgment, and the United States District Court for the District of Connecticut denied its motion.

In SACHS v. CITIZENS FIN. GRP., INC., NO. 3:20CV570 (JBA), 2021 U.S. DIST. LEXIS 146108 (D. CONN. AUG. 4, 2021), the contract at issue was the Personal Deposit Account Agreement (PDAA) which gives Citizens' account holders 60 days to report errors in their accounts and gives Citizens 10 days to investigate and correct an error, or it will be liable for the account holder's losses. Customer argued that Citizens breached the contract because it did not promptly investigate and reimburse the errors when it took over a year to conclude the investigation, and then only reimbursed half of his losses. The court agreed that Citizens violated its unambiguous obligation and denied summary judgment. Moving to Customer's second argument, the court stated that Citizens must have acted in bad faith to have breached the implied covenant of good faith and fair dealing. To act in bad faith "implies both actual or constructive fraud, or a design to mislead of deceive another, or a neglect or refusal to fulfill some duty or some contractual obligation, not prompted by an honest mistake as to one's rights or duties, but by some interested or sinister motive." Citizens had a contractual obligation to timely conclude its investigation of Customer's account (or otherwise recredit him), and yet took 15 months to do so in an attempt to time-bar Customer's suit. The court found that the only reason Citizens would have acted this way was simply out of self-interest to evade reimbursing Customer and dodge a lawsuit. Thirdly, Customer argued that Citizens never sent him periodic statements and failed to timely reimburse him for the unauthorized transfers, in violation of the EFTA. Citizens argued, in response, that Customer missed the ETFA 60-day notice requirement because the 60 days began after its allotted10-day investigatory period. Customer asked the court to equitably toll the 60-day requirement until the day the investigation actually concluded. Because the EFTA permits equitable tolling after a "showing of 'rare and exceptional circumstances' that prevented the party 'in some extraordinary way' from exercising" their rights, and because Citizens acted in bad faith in stringing Customer's account investigation on for so long, the court equitably tolled the 60-day notice requirement to the day the investigation actually concluded. Customer brought this action two months after that date; therefore, his suit was timely (the statute of limitations on ETFA claims is one year). Finally, the court stated that because Citizens did not provide evidence that it supplied Customer with monthly statements and because it only gave Customer back half of its losses, Customer survived summary judgment on his ETFA claim. By: Madison Pyle Madison.Pyle@ttu.edu.

BANKRUPTCY

Bankruptcy Code Moots Bankruptcy Sales to Good Faith Purchasers [11TH CIR]

A married couple and their familyowned printing business each separately borrowed money from a bank, each served as the guarantor for the other's debt, and each declared bankruptcy. The couple used their real property to secure their loans from the bank. The bankruptcy court allowed the printing business to acquire a debtor-in possession loan from the bank to "roll up" its debt. This loan cross-collateralized the pre petition and post-petition debt. The bankruptcy court permitted the bank to buy the couple's real property under Bankruptcy Code (Code) section 363(b) and expressly found that the bank was "a good faith purchaser under Section 363(m)" because, among other reasons, it had made "the highest and/or best offer" and its price exceeded the liquidation value of the property. After the bankruptcy court's final approval of the sale, the couple claimed their debts also had been "rolled up" in the debtor in-possession loan, and that, as a result, the bank's lien on their real property had been extinguished. On that ground, the couple moved to amend and stay the sale. At a hearing, the bankruptcy court denied the motion, holding that (l) the only effect of the debtor-in-possession loan was to make the printing business a co-obligor on the couple's debt rather than a guarantor of their debt; and (2) because the couple never argued that the loan had eradicated the bank's interest in the property until the sale was finalized, they had waived that argument. While the couple's appeal to the district court was pending, they delivered and executed the deed to their property to the bank, thereby consummating the sale. As a result of the delivery of the deed, the bank asked the district court to dismiss the appeal as moot. Agreeing, the district court granted that motion. This court, the United States Court of Appeals for the Eleventh Circuit, affirmed.

In REYNOLDS v. SERVISFIRST BANK (IN RE STANFORD), NO. 20- 11652, 2021 U.S. APP. LEXIS 32503 (11TH CIR. NOV. 1, 2021), the Eleventh Circuit Court of Appeals analyzed the mootness argument under section 362(m) of the Bankruptcy Code. According to section 363(m), an appellate court is precluded from, "reversing or modifying a bankruptcy court's authorization of a sale of a bankruptcy estate's property to someone who 'purchased... such property in good faith' under section 363(b) or (c), unless the sale was 'stayed pending appeal.'" Thus, Code section 363(m) statutorily moots sales authorized under section 363(b) or (c). The couple claimed, however, that Code section 363(m) did not apply to their appeal, arguing that the section does not apply to sales authorized by bankruptcy courts. The couple argued in the alternative that even if it did apply, the bank was not a good faith purchaser. The Eleventh Circuit Court of Appeals rejected both arguments. First, the case law supports a plain language interpretation of Code section 363(m), which makes it clear that all sale authorizations are covered--once any sale is "approved by the bankruptcy court and consummated by the parties, the bankruptcy court's authorization of the sale cannot be effectively altered on appeal." Second, the court stated that while the Code does not define what it means to be a good faith purchaser, many jurisdictions accept that a good faith purchaser is "one who buys in good faith, that is, free of any fraud or misconduct and for value and without knowledge of any adverse claim." The court concluded that there was no evidence that the bank engaged in fraudulent, bad faith behavior. Specifically, the bankruptcy court below had found, as a matter of fact, that the sale was, "non-collusive, fair and reasonable' conducted... at arm's length and resulted in the [couple] obtaining the highest and/or best value" for the property." Indeed, during the argument on the couple's motion to approve the sale, the couple had previously argued that the bank was a good faith purchaser. Accordingly, the court dismissed the case as statutorily moot. By: Madison Pyle Madison.Pyle@ttu.edu.

Automatic Stay Lifted on Mortgaged Property [BKR WD TX]

A couple (the Movants) were the original owners of a house (the Property). They sold it to a trust (the Trust) for which a debtor (the Debtor) serves as trustee. The Trust and the Debtor executed various wraparound promissory notes and deeds of trusts in favor of the Movants and failed to pay on those obligations. Eventually, the Movants posted the Property for a nonjudicial foreclosure sale. The Debtor's husband filed a temporary restraining order in an attempt to stop the foreclosure, which the state court nonsuited. The Movants again posted the Property for a nonjudicial sale. Next, a county judge prohibited all foreclosure sales because of the COVID-19 pandemic. Two months later, the Debtor's husband filed for Chapter 13 bankruptcy, listed the Property as his residence, and claimed an interest in and a homestead exemption on the Property, which automatically stayed the Property's sale. The bankruptcy court granted the Movant's motion for relief from the automatic stay and required the Debtor's husband to list the Property for sale, close on escrow, and pay monthly adequate protection payments until the sale closed. He did none of these things before the bankruptcy court's deadline. For that reason, the Movants posted the Property for nonjudicial sale once again and set a date for the sale. Four days before the sale date the Debtor filed for Chapter 7 bankruptcy, listing the Property as her current residence claiming an interest in and a homestead exemption on the Property, and listing the Property's value as $575,000. Her actions prevented the foreclosure for the third time. The United States Bankruptcy Court for the Western District of Texas, San Antonio Division, heard the Movants' motion for relief from the automatic stay.

In IN RE MACHADO, NO. 21- 51329, 2022 BANKR. LEXIS 244 (Bankr. WD Tex. January 26, 2022), the Movants argued they deserve relief based on 11 U.S.C § 362(d)(l), (d)(2), and (d)(4). Section 362(d)(l) "provides that a court shall grant relief from the stay 'for cause, including the lack of adequate protection of an interest in property of" the movant. A creditor seeking relief must establish a prima facie case for cause by showing that the collateralized property's value is declining. A creditor can also establish cause by showing a lack of good faith. Here, the Debtor listed the Property at $575,000 and provided proof that a potential buyer agreed to that amount. However, the Movants showed that the home had a history of needing repair and that neither the Trust, the Debtor, nor the Debtor's husband had paid property taxes, homeowner-association dues, homeowner's insurance, nor the court-ordered adequate protection payment, encumbering roughly

$100,000 on the Property's value. The Movants were able to show that the Debtor was not acting in good faith mainly because she kept resorting to perfectly coordinated bankruptcy petitions to stall the previous two foreclosure sales. These facts led the court to conclude that the Property's value was declining, the Debtor lacked good faith, and that the Movants were entitled to relief under Bankruptcy Code section 362(d)(l). For the Movants to prevail on their Section 362(d)(2) claim, they needed to prove the debt on the Property was greater than the value of the Property. All parties agreed that the value of the Property was around $575,000. The court did not figure the exact amount of debt owed to the Movants, but once it calculated the unpaid taxes, premiums, dues, attorney's fees, and interest incurred on the various promissory notes and deeds, it found that even the minimum amount of debt amount undoubtedly was greater than $575,000. Thus, the court found that Movants were entitled to relief under Section 362(d)(2). Under Section 362(d)(4), the Movants needed to show that the Debtor's bankruptcy filing was part of a scheme to delay hinder or defraud the Movants and that the "scheme" involved either a transfer of real property without the Movants' consent or court approval or that multiple bankruptcy filings affected the real property at issue. The foreclosure on the Property had been impacted by the Debtor's husband and her own bankruptcy petition, and each was strategically filed right before the Property's scheduled sale date to avoid foreclosure. Likewise, the court found a scheme to delay or hinder the Movants from exercising their right to foreclosure and therefore ruled for the Movants under Section 362(d)(4). By: Madison Pyle Madison.Pyle@ttu.edu.

Debtor Made Misrepresentations to Lender [BKR MD FL]

The debtor, a businessman, started an accounts receivable factoring company. His company acquired a watermelon brokering company as a customer. After years of receiving loans, the borrower notified the debtor that it could not pay on the accumulated debt. To offset this loss, the debtor convinced a bank to lend to the broker by claiming that the account with the broker contained no encumbrances and that it could be used to pay back the debtor in full. After first denying a loan to the broker, the lender approved this loan, relying on these representations. The debtor understood that the lender would not have approved the loan if it had been given truthful reports regarding the broker's finances. Ultimately, the broker failed less than a year later. The bank sued the debtor, claiming fraud among other allegations. Litigation on these claims stopped as a result of the automatic stay, upon initiation of an involuntary Chapter 7 liquidation case against debtor's company and a Chapter 11 bankruptcy petition filed by the debtor. The bank brought an adversary proceeding seeking a monetary judgement and a determination that the debt was non dischargeable under § 523(a)(2)(A) of the Bankruptcy Code.

In BMO HARRIS BANK, N.A. v. RICHERT (IN RE RICHERT), 632 B.R. 877 (Bankr. M.D. Fla. 2021), the court held that the bank proved the elements of a claim under §523(a)(2)(A), resulting in a nondischargeable fraud judgment against the debtor. Under the statute, a debtor may not discharge a debt obtained by false pretenses, a false representation, or actual fraud. The court looked to the four elements of common law fraud that the claimant must prove. For the first element, the court analyzed the actions taken by the debtor to obtain the loan for the broker. The debtor not only participated in the fraud by keeping the extent of the farm's debt to the debtor secret from the bank, but also directed the sending of falsified reports to the bank. In this manner, the court determined that the debtor acted as the "master conductor" behind the fraud, designed to maximize payments to his company at the expense of both the broker and bank. For the second element, the broker relied on the misrepresentations of the debtor to the lender. As to the third element, the debtor argued that because the bank had rejected a prior loan application by the broker, the bank should have realized "red flags" in the subsequent loan application and checked for inaccuracies. For that reason, the debtor argued, the creditor had not reasonably relied on his misrepresentations. However, in determining justifiable reliance, a creditor need not prove it acted in accordance with ordinary care and prudence, the court reasoned. Here, following procedures in the normal course of business, the bank rightfully assumed the honesty of its client. For the final element, the court concluded that the bank suffered losses due to the debtor's misrepresentations. Thus, the court ruled that the debt could not be discharged. By Jessica Longoria Jessica.longoria@ttu.edu.

Debtor's Plan was More Than a Pipe Dream [BKR WD PA]

The debtor's primary asset before its bankruptcy was a retail shopping mall, which had been damaged by a tornado in the spring of 2019. The repair company that performed the repairs to the mall filed a mechanic's lien on the property because the debtor did not pay for repairs it had made to the mall. The insurance proceeds related to the tornado had been paid to a capital investment company that owned the debtor. Indeed, it is important to note that the upper management of the capital investment company and the debtor were the same or very closely related individuals. The debtor and the investment company never paid the repair company for the repairs, despite having received the insurance proceeds. Before filing its Chapter 11 bankruptcy petition, the debtor found itself burdened on several fronts. The debtor found itself involved in extensive litigation with the company that had performed repairs, the debtor lost its anchor tenant, and the global pandemic negatively impacted the retail industry. As of the date of the bankruptcy filing, seven tenants occupied spaces in the mall. Furthermore, two buildings remained completely empty, and three buildings were undamaged. Upon filing for bankruptcy, the debtor filed an adversarial complaint against the repair company to determine the amount and secured status of the repair company's claim. The debtor also filed its

Chapter 11 plan, which proposed paying the allowed claims in full, including the repair company. The debtor maintained, however, that the repair company's claim was significantly less than the repair company claimed it was owed. Subsequently, the repair company filed a motion to dismiss the case, convert the Chapter 11 case to a case under Chapter 7, or appoint a Chapter 11 trustee in the case.

In BELFOUR USA GRP., INC. v. SALEM CONSUMER SQUARE OH LLC (IN RE SALEM CONSUMER SQUARE OH LLC), 629 B.R. 562 (Bankr. W.D. Pa. 2021), the bankruptcy court ultimately denied the repair company's motion to dismiss, convert, and/or appoint a trustee. First, the court determined whether dismissal or conversion would be appropriate. To make this determination, the court looked to 11 U.S.C. § 1112(b)(4)(A). This statute requires the creditor to establish "(l) [a] substantial or continuing loss to or diminution of the estate, and (2) [the] absence of a reasonable likelihood of rehabilitation" to permit dismissal or conversion. Under the first prong the bankruptcy court held, monthly operating reports were admitted into evidence. As for the second prong, the repair company argued that the litigation between the parties indicated a low likelihood of rehabilitation for the debtor. Due to the insufficiency of its arguments, the repair company failed to meet its burden, which resulted in the bankruptcy court's denial of its motion to dismiss. Additionally, the bankruptcy court considered the steps the debtor had taken to demonstrate the feasibility of its reorganization plan. The evidence provided by the debtor included a substantial contribution of funds by the capital investment company and plans for the improvement of the mall. Importantly, the plan also considered the impact of the tornado and the pandemic. With this evidence, the court determined that the debtor's plan amounted to a viable one and was "more than [merely] a pipe dream." Next, the bankruptcy court addressed whether appointing a trustee would be appropriate. 11 U.S.C. § 1104(a) provides that the court shall appoint a trustee for cause, or if such appointment is in the interest of the creditors. The court noted that appointment of a trustee is an "extraordinary remedy" because of the implicit presumption within the Bankruptcy Code that a debtor should retain in possession. Despite the most compelling argument made by the repair company, that a conflict of interest existed due to the debtor's fiduciary obligations to creditors combined with debtor's managerial involvement with the other company that had retained the insurance funds, the bankruptcy court rejected the argument. The bankruptcy court noted that the debtor's reorganization plan proposed to pay all allowed claims. As a result, the court could not conclude that the debtor had failed to act in the best interests of creditors and the estate. Presumably as a warning to the debtor and as a deterrent to delay, however, the bankruptcy court expressly stated that the court may reconsider the appointment of a trustee sua sponte. Ultimately, the court denied the motion to dismiss or convert the case and determined that the appointment of a trustee was not appropriate at that time. By Grant Coffey grant.coffey@ttu.edu.

SECURITY INTERESTS

Refined Metal, Unrefined Contracts [BKR SD NY]]

The debtors, precious metal refiners, filed for relief under Chapter l 1 of the Bankruptcy Code. They sought court approval for the use of cash collateral. In response, over forty disputes arose between the debtors and its customers over ownership of the metals purportedly owned by the bankruptcy estate. A contractual relationship between the debtors and its customers governed ownership of the metals. The parties disputed whether the agreements were true leases, or security interests disguised as leases. The debtors and their customers presented two sets of cross-motions for summary judgment to the court. In each set of motions, the customers alleged the contracts represented lease agreements. At the time of the filing of the cross motions, $8.25 million worth of minerals were being held in escrow. If the contracts were lease agreements, the customers had title to the property. However, the debtors argued the contracts were in reality security arrangements, which would keep the metals within the estate.

In IN RE MIAMI METALS I, INC., 634 B.R. 249 (Bankr. S.D.N.Y. 2021), the court held that summary judgment was appropriate in one dispute, but not in the other. In analyzing the first set of motions, the court found the contractual relationship between the parties to be ambiguous. While a section of the agreement was entitled "Leases," and used the terminology "lessee," "lessor," and "lease material," the language looked consistent with that of a lease. However, the agreement also included the terms "bailment," "bailee," and "bailor." Additionally, a provision in the agreement granted a security interest to the customer. The bankruptcy court found the inclusion of this provision unnecessary if the customer intended the transaction to be a lease. The court held that this language was therefore insufficient to ascertain the intent of the parties and therefore denied summary judgment as to the cross claims involving this contractual language. By extension, the ownership of the metals as to the customer with this contractual language presented a sufficient dispute of material fact to survive summary judgment on the first set of cross motions. In contrast, no such ambiguity arose within the four comers of the agreement regarding the contractual relationship involved with the second set of motions. The agreement signed three times by the customer consisted of the same substance in an already-settled dispute involving the debtors. The court explained that the terms of the agreement established a sale, not a bailment, because the contract only required the debtor to return metal of "like kind." In contrast, bailment requires the return of identical metal or the same metal in an altered form. Therefore, the court held that debtors rightfully owned the metal, and thus it was property of the estate. The court denied the customer's motion and granted summary judgment to the debtors. By Morgan Walton Morgan.R.Walton@ttu.edu.

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Tracy Kennedy
NDBA General Counsel

Role of NDBA General Counsel

NDBA's general counsel serves as the attorney for the association. Although Tracy is pleased to be able to serve as a resource for NDBA members in responding to their questions, she is providing general information, not legal advice. Banks must obtain legal advice from counsel who has been retained by the bank to represent the bank's interests in a specific matter.

To contact Tracy Kennedy, NDBA General Counsel, call 701.772.8111 or email at tracy@ndba.com.