NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

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BANKRUPTCY

Strict Five-Year Deadline to Make Chapter 13 Payments [10TH CIR]

Debtor had a Chapter 13 bankruptcy plan which provided she would pay off her mortgage within the statutorily prescribed five-year deadline (11 U.S.C. § 1322(d)). She had from November 2013 to November 2018 to complete her plan. Unfortunately, in March 2018, she was in a car accident, and she missed two mortgage payments. After the November 2018 deadline passed, she made the missing payments and asked the bankruptcy court to grant her discharge. The bankruptcy court did not grant her discharge and dismissed her case, reasoning that because Debtor had not completed her payments within five years, it did not have discretion to grant her a discharge. On appeal, the United States Court of Appeals for the Tenth Circuit, determined that the issue was "whether the bankruptcy court could grant discharge."

In KINNEY v. HSBC BANK USA, N.A., 5 F.4th 1136 (10th Cir. 2021), the court focused on the Code's language and preformed a statutory interpretation analysis. The relevant bankruptcy code (the Code) provision is 11 U.S.C. § 1328(a) which provides that a "discharge is necessary upon the debtor's 'completion... of all payment under the plan.'" So, the court was tasked with determining whether Debtor's late payments were "under the plan." The court decided that the term "under" is ambiguous when it connects the terms "payments" and "plan." After referring to the most natural reading, case law, legislative intent, and recent legislation, the court eventually held that the phrase "under the plan" requires "that a plan remain in effect when the payments are made." While "under" can have more than one meaning, the natural reading of the term is "something 'subject to... or under the authority of the plan." The court cited several cases to back up this interpretation. Looking at the legislative history, the circuit court also determined that the Code's purpose was to give debtors a fresh start with strict deadlines (the House report had stated that strict deadlines are not good for every debtor but are good for debtors as a whole). Additionally, recent legislation recognizes that the Code prohibits "informal cures after expiration of the five-year period." Thus, the circuit court determined that Congress sought to strictly limit Chapter 13 payment plans to five years and because the Debtor did not make her payments within five years, she was not entitled to a discharge in bankruptcy court. By: Madison Pyle Madison.Pyle@ttu.edu.

Court Upholds LLC Agreement Requiring Approval From Priority Members Before Filing Bankruptcy Petition [BKR D NJ]

The debtor received a capital investment from a small group of investors. In exchange for the investment, the investors became members of the debtor as evidenced by an LLC agreement. In the agreement, the investors are each labeled as a "Preferred Member." The investors later extended a loan to the debtor. Subsequently, a putative creditor paid the investors for their preferred membership status, and also obtained an assignment of the loan that the investors had made to the debtor. The debtor then filed a voluntary Chapter 11 bankruptcy petition without receiving approval from the putative creditor. In response, the putative creditor filed a motion to dismiss the Chapter 11 case.

In IN RE 3P HIGHTSTOWN, LLC, 631 B.R. 205 (Bankr. D. N.J. 2021), the court dismissed the debtor's Chapter 11 case. Three issues were presented to the court: (1) whether the putative creditor had standing to move the court to dismiss the Chapter 11 case, (2) whether the debtors had authority to file the bankruptcy petition without the consent of the putative creditor, and (3) whether public policy weighed against limiting a debtor's ability to file for bankruptcy in an LLC agreement. First, the court addressed the standing requirement, holding that even if the putative creditor lacked standing, the bankruptcy court's authority permits dismissal of a bankruptcy petition for cause on the court's own motion under 11 U.S.C. § 1112. Further, case law indicates that a court must dismiss a petition when those who purport to have authority to file the petition lack such authority. Price v. Gurney, 324 U.S. 100, l06 (1945). Accordingly, the court moved on to determine whether the debtor could file for bankruptcy without permission of the putative creditor. The entity that maintains the "power of management" of an LLC holds the authority to file a bankruptcy case on behalf of the LLC. The LLC agreement provided that the debtor shall not commence a bankruptcy case unless it returned all capital to the holders of preferred units or preferred members approved of the proceedings. The debtor argued the investors failed to properly assign their interests sufficient to make the putative creditor a preferred member. As such, the bankruptcy case did not require the putative creditor's approval. However, the court determined that even if the putative creditor lacked preferred member status, the original investors retain that status; thus, the debtors still needed approval from the original investors. Because the debtor failed to obtain approval from either the putative creditor or the original investors, the debtor lacked appropriate authority under the LLC agreement to file a bankruptcy petition. Lastly, the court evaluated whether public policy would render the sections of the LLC agreement that restricted the debtor's ability to file bankruptcy petitions void. The court refused to hold that the limiting provisions of the LLC agreement were void because the parties, in drafting the contract, took advantage of the "wide latitude afforded to them by the [Delaware] LLC Act." Ultimately, the court dismissed the debtor's bankruptcy case because the debtor lacked the requisite authority to unilaterally file a bankruptcy petition. By Grant Coffey grant.coffey@ttu.edu.

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

The debtor owned two residences which he used as rental properties, and the creditor planned to foreclose on one of the properties. The debtor then filed for Chapter 11 bankruptcy. The creditor filed a motion to appoint a Chapter 11 trustee or, in the alternative, to convert the case to Chapter 7 case. The debtor opposed this motion and amended his bankruptcy petition to elect small business treatment under subchapter V. The creditor opposed this election. After a hearing on these motions, the bankruptcy court entered an order granting the creditor's motion to convert and sustaining its objection to debtor's subchapter V election. The debtor then filed a motion for reconsideration. The bankruptcy court denied the motion for reconsideration and the debtor appealed to the district court.

In SABER v. JPMORGAN CHASE BANK, N.A. (IN RE SABER), 527 F. Supp. 3d 1196 (C.D. Cal. 2021), the district court upheld the bankruptcy court's decision to grant the bank's motion to convert the case, to sustain the bank's objection to subchapter V election, and to deny the debtor's motion for reconsideration. According to 11 U.S.C. § 1112(b)(1), upon request and after notice and hearing, the court can convert a Chapter 11 case to a Chapter 7 case for cause. In this case, the bankruptcy court gave two grounds for cause: diminution in value of the estate and the debtor's failure to comply with court orders. In the first instance, a "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation" is the standard for cause under section 1112(b)(4). The debtor argued that the bankruptcy court had ignored valuations of the estate. However, the district court determined that there had been an extensive record that reflected the bankruptcy court's thorough and comprehensive consideration of the valuations. For the second issue, the bankruptcy court determined that the debtor had failed to comply with the order compelling him to file a status report or plan. The district court determined that as to this issue the bankruptcy court had not abused its discretion. Next, as to debtor's election under subchapter V, the court reviewed whether the debtor qualified as a small business debtor under 11 U.S.C. § 101 (51D). A small business debtor was defined as: (l) a person engaged in commercial or business activities, (2) that has aggregated debts less than roughly $2.7 million, and (3) an entity whose debts arose from commercial or business activities. The debtor argued he qualified for subchapter V because he owned two rental properties. This issue became moot, however, because the bankruptcy court had not abused its discretion by converting the case to a Chapter 7 case. Finally, to grant a motion for reconsideration, the party must show mistake, inadvertence, surprise, or excusable neglect. The district court held, however, that the bankruptcy court acted within its discretion in rejecting the debtor's reconsideration motion because a motion to reconsider cannot be used to rehash the same arguments previously presented to the court. Thus, the district court affirmed the bankruptcy court's decision. By Jessica Longoria Jessica.longoria@ttu.edu

Bankruptcy Court Wrongfully Dismissed Claims Without Evidentiary Hearing [D MASS]

A fraudulent internet phone service company (Company), which was in essence a multibillion-dollar Ponzi scheme built upon a pyramid scheme, filed for Chapter 11 bankruptcy. During its operation, Company had swindled $1.8 billion from over a million participants (Participants) across the globe. After being recruited, Participants purchased memberships through triangular transactions (frequently made in cash) under which they could earn credits by participating in the pyramid scheme and redeem those credits for cash. Most of the time, Participants did not receive receipts for their purchases and cash outs. Participants often had two or more accounts in Company's database (each reflecting different transactions), which were not linked. During Company's bankruptcy case, Participants filed proofs of claim as creditors in an attempt to recover their lost funds. The bankruptcy court had Participants file electronic proofs of claim through an online portal and supply any evidence through that portal. Participants were only entitled to payout if the total amount they paid to Company outweighed what they gained from the scheme. Because a vast majority of the transactions were triangular and made in cash, Participants had slim to no evidence supporting their claims. The liquidating trustee (Trustee) objected to the proofs of claim, arguing that Participants did not supply adequate documentation required by the Federal Rules of Bankruptcy Procedure (the FRBP). Suspicious that Participants were cherry-picking information from their multiple accounts in order to make it look as though they lost more than they gained, Trustee hired an accountant (Accountant) to "develop an algorithm to identify the user accounts associated with a given participant" in an attempt to link Participants' multiple accounts. Accountant, who had no background in computer or data science and lacked experience in aggregating and analyzing large datasets, created an unreliable algorithm. While the bankruptcy court concluded that the method was insufficiently reliable, it allowed the parties to enter an affidavit and Omnibus Objection battle where Participants provided reasons for lack of documentation, and Trustee objected. In the end, the bankruptcy court's judgment favored Company. It reasoned that because "some documentation must be required to set out a prima facie basis for a claim," it could not allow the Participants to move forward without the supporting documentation. There was no evidentiary hearing. Participants came to this court, the United States District Court for the District of Massachusetts, requesting an evidentiary hearing.

In IATROU v. DARR, NO. 20-40112, 2022 U.S. DIST. LEXIS 12979, (D. Mass. Jan. 25, 2022), the court granted Participants' request. A proof of claim constitutes prima facie evidence of the validity and amount of the claim if it is filed in accordance with the FRBP. An objecting party may overcome this presumption if it provides substantial evidence to the contrary. If the objecting party can supply such evidence, the claimant has the burden to prove its claims by a preponderance of the evidence. The FRBP does not require claimants to submit specific documentation in support of its claim if the claims stem from oral transactions and unwritten obligations because, in those situations, documentation simply may not exist. Further, the FRBP "does not set forth any specific supporting documentation required of cash payments for which no receipts were provided." Here, Participants submitted claims through a bankruptcy court-mandated portal which this court assumed created prima facie valid claims. Trustee argued that the discrepancies between the information supplied by Accountant's algorithm and Participants' self-reported gains and losses constituted "substantial evidence" to overcome the validity presumption. The court disagreed but realized that because the bankruptcy court did not hold an evidentiary hearing to let Participants and Trustee explain their positions, the only remedy it could come up with was to remand the case with instructions on holding an evidentiary hearing. By Madison Pyle Madison.Pyle@ttu.edu

MORTGAGES

Failure to Return Unearned Private Mortgage Insurance Premiums Violates HPA [ND ILL]

Husband and wife (together, Couple) obtained a mortgage loan and contracted to pay private mortgage insurance under the condition that they would have the right to cancel it on or after the day the mortgage's principal balance "actually reaches 80% of the original value of the property." Couple paid all insurance premiums upfront. A few months later, Couple paid the mortgage in full and requested, in writing, the cancellation of their private mortgage insurance. Although Couple's principal balance was $0.00 (much less than 80% of their property's original value), their bank (Bank) denied the request, claiming "that a request for cancellation must be made before the loan is paid in full." Couple sued Bank under the Homeowner's Protection Act (the HPA), the Illinois Consumer Fraud Act (the ICFA), and for breach of contract. Couple's broad argument was that Bank is liable for refusing to refund their unearned insurance premiums. Bank argued that Couple failed to state a claim under the HPA and that their ICFA and breach of contract claims were state law claims preempted by the HPA, which, according to Bank, does not even apply to paid-off mortgages.

In ABRUSCATO v. WELLS FARGO BANK, N.A., NO. 21-CV-00012, 2022 U.S. Dist. LEXIS 46553 (N.D. ILL. Mar. 16, 2022), the United State District Court for the Northern District of Illinois (Eastern Division) granted in part and denied in part Bank's motion to dismiss. As an initial matter, the court held that the HPA does apply to paid-off mortgages. Bank, through non-precedential case law and faulty statutory interpretation, was unable to convince the court otherwise. In fact, the court stated that to interpret the HPA to not apply to paid off mortgages would lead to these absurd results, which the court refused to read into the HPA's language. "Under [Bank's] reading of the HPA, a homeowner who wanted to pay her mortgage off in full, ahead of schedule, would have to stop short of paying off the entire mortgage (she could pay 99% of the balance), write a letter to the bank to cancel [the private mortgage insurance], and then pay off the remaining amount (a separate payment of the remaining 1%), or be out thousands of dollars in [private mortgage insurance] refunds," the court reasoned. With that out of the way, the court determined that under the HPA, a bank is required to cancel private mortgage insurance on the cancellation date or when the mortgagor submits a cancellation request in writing, has a good payment history, and is current on payments. Here, Couple met those requirements because they submitted their request in writing, never made a payment thirty days past due, and had finished making mortgage payments. Therefore, the court dismissed Bank's motion to dismiss that claim. The court did the opposite for Couple's state law claims. The HPA has an express preemption clause that explicitly preempts state law claims that directly relate to the HPA's requirement and depend on a defendant's purported violation of the HPA. Here, the ICFA claim alleged that Bank "engaged in unfair acts and practices... by failing to comply with the [HPA]." According to the court, that allegation was practically identical to the Couple's HPA violation claim. The court determined the same for the breach of contract claim, which alleged that Bank breached its contract with Couple when it refused to pay the unearned private mortgage insurance premiums. That claim was wholly indistinguishable from the HPA claim. Thus, the court granted Bank's motion to dismiss Couple's state law claims. By Madison Pyle Madison.Pyle@ttu.edu.

SECURITY INTERESTS

*Engagement Letter Granted Counsel an Unavoidable Security Interest [BKR SD TX]

The debtor filed a subchapter V petition under Chapter 11 and a Disclosure of Compensation of Attorney for Debtor ("Disclosure") on October 16, 2020. An engagement letter by the debtor's bankruptcy counsel ("counsel"), dated one day before, provided that the debtor agreed to deposit an additional retainer for fees and costs associated with representation, and that the counsel would hold these funds in trust. Further, the engagement letter provided that "[a]s of the petition date, any unused portion of the retainer [would] convert into a retainer securing payment of any post-petition fees approved by the bankruptcy court." After the bankruptcy filing, a Retention Order by the court authorized the counsel to submit interim fee statements monthly and to draw down on the retainer, subject to final approval by the court through a fee application every 120 days. In connection with filing his first fee application, counsel sought compensation for services rendered and for reimbursement of out-of-pocket expenses, including pre-petition unbilled time. In response, a creditor asserted that counsel only had the rights of a general unsecured creditor.

In IN RE OZCELEBI, 631 B.R. 629 (Bankr. S.D. Tex. 2021), the court considered whether the attorney has a right to be paid his pre-petition unpaid fees (which were less than $10,000) from the retainer. The creditor argued that the counsel's application and supporting affidavit failed to provide notice of the purported security interest. Additionally, the engagement letter had failed to attach and perfect the purported security interest. The debtor's counsel asserted, however, that under 9.203(a) of the Texas Business and Commercial Code, its security interest attached at the time the collateral came into its possession in accordance with the engagement letter. Thus, the debtor's counsel argued that upon court approval of the fees, it could apply the retainer to its approved fees. Regarding the creditor's notice argument, the court found that the creditor had notice because "classic retainers" are commonplace in Chapter 11 cases, and the retainer had been paid prepetition. Next, focusing on whether the counsel's security interest in the retainer had been attached and perfected, the court looked to § 9.203(a). Under § 9.203(a), a security interest attaches once a secured party takes possession of the collateral pursuant to an agreement, gives value, and the debtor has rights in the collateral. Asserting the engagement letter failed to "properly and unavoidably attach or perfect a lien," the creditor argued that because the engagement letter expressly delayed the creation of the security retainer until the date of the debtor's bankruptcy petition, it had not created a perfected security interest. The court rejected that argument, however, and allowed the counsel to be paid from the retained for its prepetition unpaid fees. In so doing, the court noted that the case was a subchapter V Chapter 11 case, and in those cases counsel is not disqualified for being a creditor if its claim is no more than $10,000. By Brooke Allen brooke.n.allen@ttu.edu.

Sale Found Free and Clear of Liens When Purchaser's Lack of Good Faith Was Not Established [BKR PA]

Debtor, a Pennsylvania limited liability company that bought and leased cars, operated under two contractual agreements. The first was a "floor financing plan" under which Debtor bought cars at auction and used Defendant-Creditor (another limited liability company) to finance Debtor's purchases and take a properly-perfected security interest on Debtor's inventory. Under the second

contract, Debtor would sell the cars and associated lease agreements to Plaintiff-Creditor (yet another limited liability company), which would "service the lease agreement and retake possession of the vehicle upon termination of the lease." Concerning five particular cars, Debtor did not satisfy Defendant-Creditor's security interests and did not arrange for title to be conveyed to Plaintiff-Creditor as required by the second contract. A few months later, Debtor filed for Chapter 7 bankruptcy, after which Plaintiff-Creditor sought a declaratory judgment that it had purchased the five cars at issue free and clear of Defendant Creditor's perfected liens.

AUTO TRAKK, LLC v. E. SHORE AUTO, INC. (IN RE E. SHORE AUTO, INC.), NO. 20-BK-02164, 2022 Bankr. LEXIS 634 (Bankr. M.D. P.A. Mar. 11, 2022) demonstrates that in Pennsylvania, a good-faith purchaser that buys a good in the ordinary course of the seller's 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." Under that rule, DefendantCreditor argued that Plaintiff-Creditor did not qualify as a "good faith purchaser," so the five cars were not bought in the ordinary course of business. For that reason, Defendant-Creditor argued, Plaintiff- Creditor's purchase of the cars was subject to the security interests. Defendant-Creditor claimed that Plaintiff-Creditor did not purchase the five cars in good faith because it did not perform due diligence that would have put it on notice of Defendant-Creditor's position. According to the United States Bankruptcy Court for the Middle District of Pennsylvania, however, "it simply does not matter." The court concluded: Plaintiff Creditor showed that it bought the five cars in good faith, without knowledge that the sale violated any of Defendant-Creditor's rights, and in the ordinary course of Debtor's business (a business that sold leased cars and lease agreements). For that reason, Plaintiff Creditor took the cars free and clear of Defendant-Creditor's liens.Ed. Note: This case reflects a general rule under Article 9 of the U.C.C. By Madison Pyle Madison.Pyle@ttu.edu.

Because Fishing Rights Are Appurtenances of Vessels, Bank Had Security Interest in Those Fishing Rights [WD WASH]

Debtors defaulted on a loan that was secured by their vessel and their fishing rights according to the security agreement. On this appeal to the United States District Court for the Western District of Washington, the relevant issue was whether Debtors' fishing rights qualified as "appurtenances" of the Debtors' fishing rights defined in the parties' security agreement. In the end, the court answered this question in the affirmative.

In FIRST BANK v. EXODUS, NO. 21-CV-05412, 2022 U.S. DIST. LEXIS 51011 (W.D. WASH. Mar. 22, 2022), Debtors argued that "their fishing rights are not 'appurtenances' of [their vessel] and therefore should not be foreclosed upon with the vessel." According to applicable case law, maritime liens attach to a ship's "usual equipment and appurtenances." Appurtenances are defined as something "that belongs or is attached to something else." In the context of a vessel, courts consider an item an "appurtenance if it is "essential to the ship's navigation, operation, or mission." An examination of the case law persuaded the court that "intangible assets such as fishing rights can qualify as appurtenances in the maritime context." Therefore, the court agreed with Bank and held it had a security interest in the Debtors' fishing rights. By Madison Pyle Madison.Pyle@ttu.edu.

Debtor Entitled to Discovery Regarding Bank's Expense Reimbursement Request [BKR NM]

A homeowner (Debtor) secured a promissory note with a mortgage. Her bank (Bank) holds the note and owns the mortgage. After losing her job, Debtor never returned to work, and her income (unemployment insurance, social security, and money from family members) was not enough to cover her living expenses and also pay her mortgage. Consequently, she stopped paying her mortgage and entered into a decade-long financial struggle consisting of five bankruptcy cases and three scheduled and rescheduled foreclosure sales. Debtor evaded the third scheduled foreclosure sale by filing this current bankruptcy case three days before the sale. One month after the Debtor filed for bankruptcy, Bank filed a secured proof of claim for about $225,000. The claim contained ten pages of payment history that listed, among other things, categorical descriptions of all expenses. Debtor objected to the amount under "prepetition expenses" (an amount over $30,000), arguing that the fees were excessive and that Bank did not provide a detailed description of the fees.

In IN RE SHERMAN, NO. 21-11-67, 2022 BANKR. LEXIS 533 (Bankr. D. NM March. 1, 2022), after reviewing Bank's "proof of claim, the dockets in this and Debtor's prior cases, and the claim objection and response," the United States Bankruptcy Court for the District of New Mexico decided to hold a preliminary hearing to hear from Debtor about whether or how she wished to proceed. Proofs of claims are statements that set forth a creditor's rights that assist debtors in determining to what portions of the claim to object. A properly filed proof of claim that itemizes "categories and subtotals for principal, interest, charges, and collection costs" is entitled to an evidentiary presumption of prima facie validity and is deemed allowed unless a party objects. Here, Bank used a standard form to organize its proof of claim and broke down the prepetition expenses into specific categories. According to Debtor, Bank did not correctly itemize the expenses. She argued that Bank should have given a detailed description of the fees rather than a broad categorization of the expenses. The court disagreed with Debtor's argument. Payment histories attached to proofs of claim are not required to supply comprehensive details about itemized expenses because their purpose is merely to provide enough information to a debtor for the debtor to determine, during discovery, any questions the debtor may have. Therefore, the court held that Bank's "itemization and expense categories [were] more than sufficient to comply with the applicable Rules." Nevertheless, the court concluded that the Debtor was entitled to discovery to determine the reasonableness of some of the expenses that Bank listed and set a hearing date for the Debtor to say if she would like to go forward with discovery. By Madison Pyle Madison.Pyle@ttu.edu.

Perfected Fixture Security Interest Takes Precedence Over a Subsequent Judgment Lien [D HAW]

A broadband services company (the Company) entered into a series of loans and promissory notes with the United States (the U.S.) from 1997 to 200 I. In 1998, the U.S. entered into a Mortgage Security Agreement and filed a Financing Statement, which pledged, among other things, the Company's fixtures to the U.S. Later, the U.S. obtained a judgment of nearly $140 million against the Company. Around the same time, a bankruptcy trustee (the Trustee) of a cable company that was going through a Chapter 11 bankruptcy obtained a $250 million judgment against the Company in accordance with a bankruptcy court decision. The Trustee's judgment was recorded one month before the U.S.'s judgment but two years after the U.S. had perfected its security interest. After the Trustee assigned his judgment (to the Assignee), the bankruptcy court directed the U.S. Marshal to levy the Company's fixtures to satisfy the Trustee's judgment. The U.S. filed a motion to quash because it wanted its judgment satisfied first. The U.S. argued that its lien was superior because it had been perfected for years. The Assignee argued that the U.S. did not perfect its security interest because "the great majority of [the Company's] real estate interests and any fixtures affixed to them" were acquired after the U.S. perfected its security interest.

In KATZENSTEIN v. SANDWICH ISLES COMMUNICATIONS, INC. (IN RE PANIOLO CABLE CO., LLC), NO. 21- 00499, 2022 U.S. Dist. LEXIS 37404 (D. HAW. MAR. 3, 2022), the United States District Court for the District of Hawaii granted the U.S.'s motion to quash. In Hawaii, the priority of security interests is governed by Sections 490:9-334 and 490:9-604 of the Hawaii Revised Statutes (the Statutes). Those sections provide that a "security interest in fixtures is perfected when a financing statement is filed." Here, the U.S. filed a Mortgage Security Agreement and Financing Statement two years before any court entered any judgment against the Company-that was when it perfected. The Statutes also describe several situations where a perfected security interest in fixtures has priority over conflicting interests. According to this court, the U.S. had priority over the Assignee in at least two of the enumerated situations. First, a perfected security interest has priority over a conflicting interest when the party with the perfected security interest files a financing statement of a transmitted utility which is a fixture filing. Second, a perfected security interest has priority over a conflicting interest when the "conflicting interest is a lien on the real property obtained by legal or equitable proceedings after the security interest was perfected by any method." The U.S. satisfied the first situation when it filled the Mortgage Security Agreement and Financing Statement two years before the judgment was entered. The U.S. satisfied the second situation because the Trustee obtained his judgment after the U.S. perfected its security interest. Thus, the U.S.'s interest in the Company's fixtures held higher priority than the Trustee's judgment. By Madison Pyle Madison.Pyle@ ttu.edu.

AUTOMATIC STAY

Holding the Stay Violator in Contempt - the Only Option for a Corporate Debtor [SD OH]

Before filing its Chapter 11 petition, the debtor sold substantially all its assets to a subsidiary. The documentation provided for several calculation and adjustments post sale, in exchange for a preferred membership interest (PMI) in the parent company. After the debtor filed its Chapter 11 petition, the parent company sent the debtor two letters with reports of its post-closing calculations. The first letter informed the debtor of a significant shortfall in the working capital and contended that the working capital was below the contractually required minimum. As a result, the parent company demanded payment for the alleged breach. In response, the debtor stated it had filed for bankruptcy. The parent company subsequently informed the debtor in a second letter that the debtor did not have the PMI. After this second letter, the parent company filed a lawsuit against the debtor's principals. The trustee responded by filing an adversary proceeding against the parent company, arguing it had violated the automatic stay associated with bankruptcy. The parent company moved to dismiss the adversary proceeding, suggesting that the debtor join the state court action.

In HARKER v. EASTPORT HOLDINGS, LLC (IN RE GYPC, INC.), 634 B.R. 983 (Bankr. S.D. Ohio 2021), the court held that the parent company violated the automatic stay. The automatic stay helps to preserve what remains of a debtor's estate and allows for a systematic and equitable liquidation process for all creditors, Here, a third party actor had sought payment from the debtor in violation of the automatic stay. In response, the bankruptcy trustee had pursued an action against this party, asserting that its stay violation had been willful. The applicable standard provides that a willful violation of the stay under § 362(k) occurs once a creditor knows of the automatic stay and violates it through an intentional act, even if the creditor did not specifically intend to violate the stay. The defendant in this case attempted to circumvent the automatic stay in the bankruptcy case by naming only the principals of the debtor in a state court action and did not include the corporate entity that was a Chapter 11 debtor. "The automatic stay covers nearly every type of action taken against the debtor, the debtor's property, or the estate property but generally provides no protection to third parties, such as the debtor's affiliates, officers, and shareholders." The trustee here, being trustee of a corporate entity, did not have the benefit of a statutory private right of action for a stay violation, so it had to proceed under 11 U.S.C. § 105, asserting civil contempt. By Marilyn Lorraine Haithcock marilyn.haithcock@ttu.edu.

ARBITRATION

The Court Will Not Compel Unagreed to Arbitration [CA APP]]

The bank loaned the borrower funds for the purchase of a commercial aircraft. The parties executed seven loan documents, and, seven weeks later, executed an eighth- the aircraft usage agreement (Agreement). Once the borrower defaulted on the loan, the bank filed suit alleging multiple breaches of the loan documents, including the Agreement. In response, the borrower petitioned the court to compel arbitration based on an arbitration clause in the Agreement. None of the other documents contained such a clause. The language in the clause in the Usage Agreement required arbitration of "any dispute or controversy between the parties relating to this agreement." The bank voluntarily dismissed the claims pertaining to the agreement, maintaining its claims for breaches of the original seven documents. The trial court issued a tentative ruling denying the petition to compel arbitration. However, after the filing of supplemental briefs, the court granted the petition to compel arbitration as to the issue of whether causes of action pertaining to the breach of the other loan documents had become governed by the arbitration clause included in the Usage Agreement. The bank challenged the trial court's order compelling arbitration.

In BANC OF CALIFORNIA, NAT'L ASS'N. v. SUPERIOR COURT, 69 Cal. App. 5th 357 (Cal. Ct. App. 2021), the court held determination of the existence of an arbitration agreement is for the court to decide, not an arbiter. The court recognized the question was whether an arbitration agreement existed at all. Two key considerations noted by the court involved the delay in execution of the Usage Agreement from the other documents and that the arbitration language was narrowly drafted to refer to disputes arising solely from that particular agreement. In contrast, five of the seven other documents contained prov1s10ns specifying which courts would have jurisdiction of disputes between the parties. The party moving to compel arbitration had the burden to show that the parties had "clearly and unmistakably" agreed to arbitrate. Because the borrower did not meet this burden, the trial court erred in granting the petition to compel. By Morgan Walton Morgan.R.Walton@ttu.edu.

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.

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