NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

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GENERAL BANKING LITIGATION

PPP Loan Borrowers' Agent's Claim for Right of Payment Dismissed [SD TX]

Congress established the Paycheck Protection Program (PPP) loan program when it passed the CARES Act in response to the COVID-19 pandemic. A CPA completed several PPP loan applications on behalf of his clients. The accountant was not paid agent fees by the banks that approved those PPP loan applications. As a result, the CPA brought suit, requesting a declaration that the banks were required to pay him the agent fees. Additionally, the CPA alleged unjust enrichment, conversion, and the breach of an implied contract. The banks filed a joint motion to dismiss.

In SANCHEZ v. BANK OF S. TEX., F. Supp. 3d, 2020 WL 6060868, 2020 U.S. Dist. LEXIS 189858 (S.D. Tex. Oct. 14, 2020) (opinion not yet released for publication), the court granted the banks' motion to dismiss. The court began its analysis by noting that the CARES Act does not create a private cause of action for enforcement of agent fees. The CPA requested the court infer a cause of action because the act mentioned that agents are eligible to receive fees in 15 U.S.C. § 636(a)(36)(P)(ii). The court stated that mentioning a fee limitation is not the equivalent of a private right of action. The court then addressed the CPA's complaint for nonpayment. The court analyzed whether the Small Business Act (SBA) compensation agreement requirement for agent fees, detailed in 13 C.F.R. § 103.5(a) and implemented through Form 159, conflicted with the PPP regulations promulgated in the CARES Act. The court noted that Congress amended the SBA in several sections when it enacted the CARES Act, so it knew how to modify the act for the new PPP loan requirements. Because Congress did not change 13 C.F.R. § 103.5(a), or Form 159, the court determined that the agency's regulations regarding compensation agreement forms for agent fees remained. Additionally, Form 159 explicitly stated that it must be completed for an agent to be paid under the SBA. As the CPA and court both noted, the banks lacked notice of an agent's role unless the agent submitted Form 159. The court determined that an agent is only entitled to fees under the PPP if the agent submitted the required compensation agreement. Because the agent was not entitled to fees absent the compensation agreement, all state law claims the CPA had brought failed. *[By Melissa Clark Melissa.l.clark@ttu.edu Ed. Grant Coffey]*

Court Enforces Interest Rate Swaps Against Numerous Challenges [ND TX]

A corporate debtor sought to obtain a loan that it could draw down like a line of credit. It turned away offers from several banks until a creditor offered a variable rate loan contingent upon the debtor entering into an interest rate swap agreement. Under the agreement, the debtor would pay to the creditor a 5% fixed rate on the notional amount in exchange for the creditor's payment to the debtor of the London Inter Bank Offer Rate (LIBOR) plus 1.75% of the loan's principal. Under pressure from the creditor to sign quickly and without fully understanding its obligations under the swap agreement, the debtor agreed. The corporate debtor never drew the full amount of credit, and had a balance that was low enough that no interest would accumulate. At that time, the creditor demanded payment of the 5% of the notional amount, while offering to pay LIBOR and 1.75%. The debtor attempted to renegotiate its agreement with the creditor but the creditor insisted on enforcing the agreement as it stood. The debtor eventually stopped making payments under the agreement. The creditor initiated suit, and the debtor filed several counterclaims.

In TRUIST BANK v. NEPHSERV, LLC, No. 4:20-cv-00760-P, 2021 WL 164444, 2021 U.S. Dist. Lexis 10079 (N.D. Tex. Jan. 13, 2021), the court analyzed, and dismissed, each of the debtor's six counterclaims. The debtor first counterclaimed under common law fraud, but later withdrew the claim. Second, the debtor alleged unlawful banking practices under the Bank Holding Company Act. The debtor

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argued that the Fifth Circuit's controlling case misstated the unlawful banking practice elements under the Act. The court disagreed, however, holding that the debtor failed to meet the Act's first element, which requires that the practice at issue be unusual in the banking industry. Because banks and corporations commonly swap interest rates, the debtor failed to meet the Act's first element, so the court dismissed the claim. Next, the debtor counterclaimed under the Texas Securities Act (TSA), which prohibits the sale of securities by an untrue statement. The TSA broadly defines "security" as "any . . . instrument commonly known as a security, whether similar to those [listed in the Act] or not." The court rejected the debtor's claim that the TSA's definition of a security included interest rate swaps. The Fifth Circuit had previously held that interest rate swaps were not securities, which the debtor did not dispute. The debtor argued that the federal definition of security had since changed under the Dodd-Frank Act to include "security-based swaps." But the Dodd-Frank Act securities law distinguished interest rate swaps from security-based swaps, so the court relied on the Fifth Circuit's precedent and dismissed the debtor's claim with prejudice. Fourth, the debtor counterclaimed that the creditor had violated Texas usury laws. The court held that because the payments under the swap agreement are not interest, usury law does not apply. Payments under the swap agreement did not constitute interest for three reasons: (1) the swap agreement was supported by consideration separate from the loan agreement, (2) applicable law did not allow interest rates to be contingent upon outside forces like LIBOR, and (3) the agreement was formed under New York law, which exempts interest rate swaps from usury protections. The debtor argued that it did not matter under which state's law the agreement was formed because the federal National Bank Act applied. However, the court held that the creditor, a bank, was chartered under Texas law, and the National Bank Act therefore did not apply. The court therefore dismissed with the debtor's usury claims. The fifth and sixth claims for offset, recoupment, unfair competition, and equitable recission were dismissed because both claims relied on the survival of the other counterclaims , which had been dismissed. *[By Will Watson will.watson@ttu.edu Ed. Grant Coffey]*

Waiver of Statute of Limitations in Promissory Note is Enforceable [KS APP]

The debtors obtained a loan from a bank, and in exchange signed a twenty-year promissory note. The bank received a commercial real estate mortgage on the debtors' property as security for the loan. The promissory note contained a waiver of the statute of limitations, and an acceleration clause. The debtors failed to make any required payments in the first year, and the creditor sent a letter demanding payment in full. The debtors failed to respond, and the creditor sent another letter threatening legal action. However, the creditor did not file a foreclosure suit until more than seven years later, at which point the debtors asserted a statute of limitations defense. The applicable statute of limitations was five years.

In FIRST SECURITY BANK v. BUEHNE, No. 121,765, 2020 WL 5580498, 2020 Kan. App. Unpub. LEXIS 643 (Kan. Ct. App. Sep. 18, 2020) (unpublished opinion), the court held that the waiver of the statute of limitations in a promissory note was enforceable and did not violate public policy. "The paramount public policy is that freedom to contract will not be interfered with lightly." The U.S. Supreme Court has held that an otherwise legal contract provision will be void only if it would violate an explicit public policy. There is no explicit public policy preventing a waiver of the statute of limitations, and previous Kansas cases had enforced contractual provisions extending it. Furthermore, the purpose of a statute of limitations is to prevent stale claims - this claim was not stale because the promissory note had not even reached its maturity date. Therefore, the debtors had waived their statute of limitations defense. *[By Luke Herbig luke.herbig@ttu.edu Ed. Grant Coffey]*

UCC

Banks' Motion to Dismiss Debtors' Conversion Claim Denied [SD NY]

The debtors brought a lawsuit against two banks for negligence, conversion, and violation of the New York UCC § 3-419 after one of the debtors' former employees fraudulently cashed checks made out to and issued by the debtors. The debtors claimed that the former employee intercepted both inbound checks payable to them and outbound checks payable to third parties. They also claimed that the signature on the checks did not match the authorized signature on record with the bank for the debtors, but the banks had still allowed payment to go through. The complaint stated that after the banks discovered the fraud, the money was still not returned to the debtors' account. The debtors filed suit in the New York Supreme Court, but the case was removed to the Southern District of New York. The banks filed motions to dismiss. The District Court referred the case to a magistrate judge for a report and recommendation. The magistrate judge directed the parties to file supplement briefs on a few issues, including "whether plaintiffs had adequately pled that defendants had failed to act in accordance with reasonable commercial standards under § 3-419." The magistrate judge released the report and each party made objections to the report.

In LESSER v. TD BANK, N.A., 463 F. Supp. 3d 438 (S.D.N.Y. 2020), the court found no clear error in the magistrate judge's report and held that claims for conversion with respect to the inbound checks under Article 3 of the New York UCC were adequately pled by the debtors. The banks objected to the debtors' conversion claim on the basis that a common-law conversion claim required a greater showing by the debtors than a claim under UCC § 3-419. The court stated that a claim that arose under § 3-419 had the same attributes as a common law claim for conversion. The creditors also suggested that common-law conversion may be precluded by § 3-4 I9. First, the court stated that it has long been held that § 3-419 adopted the common law view that forged indorsements represent conversion. Here, the debtors sufficiently stated a claim under § 3-419, which sufficiently plead a claim of common law conversion. While principles of common law can supplement provisions of the UCC, they cannot be used to supplant those provisions. However, because the court was unable to determine whether the UCC precluded a plausible claim of conversion, the conversion claim was not dismissed merely because the debtor also plead a claim under § 3-419. Accordingly, the court adopted the magistrate judge's report and denied a defendant's motion to dismiss with respect to conversion and UCC § 3-419, although it did dismiss other claims, including negligence claims, without prejudice. *[By Grant Rodgers Grant.rodgers@ttu.edu Ed. Melissa Clark]*

Under UCC 3-309, Note Can be Enforced When Agent Has Possession of the Note Before It Was Lost [MA LAND COURT]

A debtor defaulted on her mortgage, and the assignee of the mortgage sought to foreclose on the property and sell it. The assignee faced one big problem however: the note was lost. The assignee therefore argued that it was entitled to enforce the note under Article 3 of the UCC as adopted in Massachusetts, which provides when the previous holder of a lost note can enforce the note. Specifically, UCC 3-309 as adopted in Massachusetts provides that in situations in which note is lost, destroyed or stolen, the person not in possession of the note is "entitled to enforce it if (i) the person was in possession of the instrument and entitled to enforce it when loss of possession occurred, (ii) the loss of possession was not the result of a transfer by the person or a lawful seizure, and (iii) the person cannot reasonably obtain possession of the instrument because the instrument was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person." The maker of the note claimed, among other defenses to foreclosure, that UCC 3-309 did not apply here because the assignee's agent rather than the assignee had possession of the note before it was lost. The facts established that the note had passed through the hands of a number of loan servicers, and that the last servicer had possessed the note, but, after a diligent search could not locate it.

In BISHAY v. U.S. BANK, NAT'L ASS' N, No. 18 SBQ 15269 05-001 (RBF), 2020 Mass. LCR LEXIS 195 (Land Ct. Oct. 27, 2020), the court held that the Article 3 of the UCC did not displace the common law of agency. Because the assignee's agent had held the note when it was lost, the assignee could enforce the note. The court's reasoning was buttressed by a United States District Court decision that had also held that the loss of a note by an agent satisfies the requirements of UCC 3-309.

BANKRUPTCY

Creditor's Releases of Liability to Non Debtor Found to Lack Intent [BKR D DE]

A debtor that produced raw materials for the oil and gas industry defaulted on two long-term secured operating capital loans. The company initially attempted a private restructuring, hiring reorganization professionals and creating a general restructuring committee. A natural disaster impacted the ability of the company's signature processing facility to produce at its peak levels, and although a business interruption insurance claim was submitted to insurance, the company continued to struggle due to what the court described as a "market...crowded with...suppliers." Because of these difficult market conditions the out-of-court restructuring negotiation ultimately failed, and the company filed for chapter 11 reorganization. The debtor proposed a plan that received objections from the unsecured creditors committee and other creditors. The objections were that the plan was not fair and equitable under § 1129(b)(1) of the Bankruptcy Code because the noteholders were to receive more than that to which they were entitled and the plan violated the best interests of creditors test of Bankruptcy Code § 1129(a)(7) because the value of the debtor's unencumbered assets would be paid to unsecured creditors in a hypothetical chapter 7 liquidation. In addition, the unsecured creditors' committee alleged that the plan's third-party releases of liability violated the requirement of Bankruptcy Code§ l 129(a)(3) that a plan be filed in good faith.

In IN RE EMERGE ENERGY SERVS., LP, No. 19-11563, 2019 Bankr. LEXIS 3717, 2019 WL 7634308 (Bankr. D. Del.

2019), the court first addressed the fair and equitable argument of one of the lower classes of creditors that had rejected the plan as a class. Those creditors argued that the debtor's total enterprise value exceeded the value of the debt owed to senior classes of creditors, and thus a cramdown of the plan over the junior creditors' objections was inappropriate. The court hosted a battle of the experts to value the total enterprise, and while the court found that both experts "testified credibly," it chose to accept the debtor's discounted cash flow analysis over the valuation of the creditors' expert. Next, the court considered the best interests test and determined that the creditors objecting to the plan would not have received anything under a hypothetical chapter 7 liquidation. In so doing, the court did not credit the objection of the unsecured creditors committee that the debtor's proposed liquidation analysis used low estimates and assumptions of value. Finally, the court addressed the contention that the plan's requirement that creditors release claims they held against non-debtor third parties was improper. The process to obtain the releases from certain classes of creditors required an affirmative opt-out, requiring the creditor to take a separate action to opt out of the third-party releases. The court determined this type of system did not demonstrate that the creditor intended to release claims against third-parties, and denied confirmation of the plan until the release process was amended. *[By Kurt Brown kurt.brown@ttu.edu Ed. Grant Coffey]*

Debtor's Failure to Comply with Court Order Led to Discharge of his Bankruptcy Case, Making Appeal Moot [7THCIR]

The debtor filed for chapter 13 for bankruptcy relief, and failed to disclose a worker's compensation action on his schedules. When the debtor received the award years later, the trustee filed a motion to compel the debtor to disclose it. After the debtor complied, the trustee filed a motion to compel the debtor to file an amended plan providing for the debtor's award to fund distributions to debtor's unsecured creditors. The bankruptcy court ordered the debtor to pay in full the amount owed to the unsecured creditors. The debtor filed an amended plan but failed to make the payments required by the plan. The debtor moved to stay proceedings without posting an appeal bond. The bankruptcy court denied this motion, requiring the debtor to file a bond in the amount owed to the unsecured creditors. Rather than complying with this requirement, the debtor filed two amendments to the reorganization plan. The debtor had also filed an adversary proceeding, seeking a declaratory judgment that he did not have to tum over the proceeds of the worker's compensation claim to his creditors. On appeal to the district court, the trustee moved to dismiss the case as moot on grounds that the debtor could not challenge the order directing him to amend his reorganization plan once he had voluntarily complied with the order, and the order depended entirely on the underlying bankruptcy case, which had been dismissed. The district court agreed, and the debtor appealed.

In IN RE BULLOCK, 963 F.3d 733 (7th Cir. 2021), the circuit court began with a determination of the legal issue of mootness on appeal to be reviewed de novo. The court first considered the debtor's failure to comply with the order requiring the debtor to amend the reorganization plan. That order, the court concluded, did not render the debtor's amended plan coerced. A coercion argument only survives if the debtor lacked alternative means to properly present his challenge in court. In this circumstance, the debtor could have amended his plan and objected to its confirmation. Rather, the debtor stood back while the court confirmed the modified plan. The opportunity to object to the modified plan had passed by the time the debtor moved to alter the order, and the debtor failed to even challenge the dismissal of the bankruptcy case. The debtor also had the opportunity to post a supersedeas bond to secure a stay but had failed to do so. Secondly, the court held, the dismissal of the debtor's underlying bankruptcy case mooted debtor's appeal. Because the district court lacked the ability to fashion any sort of meaningful relief for the debtor, any resolution of the issue regarding the plan could not affect the now-dismissed bankruptcy case. Therefore, the district court correctly relied on the general rule that the dismissal of a bankruptcy case results in the dismissal of related proceedings. In short, the Seventh Circuit held that debtor's appeal was moot, thereby affirming the judgment of the district court. *[By Jimmy D. Vaughn jimmy.d.vaughn@ttu.edu]*reorganization had passed, the debtor moved for an extension of that deadline. The debtor pointed to only two reasons the court should grant an extension: a general reference to the pressures of the pandemic and the distraction of the holidays.

In IN RE ONLINE KING LLC, No. 1-20-42591-las, 2021 Bankr. LEXIS 198 (Bankr. E.D.N.Y. Jan. 19, 2021) the court denied the extension. It reasoned that it had two issues to address: (1) whether it could enter relief on a nunc pro tunc

basis and whether the reasons for the extension were sufficient under the Bankruptcy Code. To answer both of these questions, the court took a hard look at the statutory language. First, the court concluded, nothing required that the extension order be sought or entered before the expiration of the 90-day period. However, the debtor had failed to demonstrate adequate grounds for an extension of the time period. 11 U.S.C. § 1189(b) requires that the need for an extension is "attributable to circumstances for which the debtor should not justly be held accountable." Here, vague references to the pandemic and the high holy days were insufficient justification. The specificity of the statutory language required that the debtor put forth good reasons that the deadline could not be met. Indeed, here there was no showing that the debtor did not understand that the deadline was approaching or that the debtor had made progress m negotiating a reorganization plan. *[By Kurt Brown kurt.brown@ttu.edu]*

Tracy Kennedy
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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.

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