NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

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SET OFF

Pre-petition Agreement Allowing Non Mutual Post-Petition Setoff By Creditor Unenforceable Because Post-petition Setoff Requires Mutuality [3RD CIR]

A debtor filed for Chapter 11 relief. Before the Chapter 11 case was filed, the debtor and a creditor had entered into a contractual agreement that provided that both parties could set off debts owed to each other. In addition, the creditor's subsidiary agreed with the debtor that it could set off debts the debtor owed the creditor's parent. When the debtor filed for bankruptcy, it owed the parent and the subsidiary money. The creditor-parent company moved to set off the debt owed to the subsidiary and apply it to the creditor's debt owed to the debtor. The court held this would ultimately end up in a triangular set off rather than a mutual set off. This appeal followed.

In IN RE OREXIGEN THERAPEUTICS, INC., 990 F.3d 748 (3rd Cir. 2021), the Third Circuit evaluated the claim of the parent company that the set off agreement permitted set offs in this context because the contractual agreement provided that the potential set offs mutual. The court rejected the idea that section 553 of the bankruptcy code imposes no independent mutuality limitation. The court held that Congress intended for mutuality to exist only between two parties whose obligations were in fact mutual. Section 553 therefore does not allow a triangular set offs. As a policy matter, the court noted that allowing parties to shoehorn multiple debts into section 553 would result in less disclosure of securitized claims, diminishing the effectiveness of the purpose of the commercial code. For these reasons, the Third Circuit court affirmed the order of the bankruptcy court denying the set off of the debts between the three parties. [By Jimmy D. Vaughn jimmy.d.vaughn@ttu.edu]

FDCPA

Threatening Time · Barred Lawsuit Violates FDCPA but A Defense of Mistake is Applicable [9TH CIR]

A borrower purchased a car under a retail installment sales contract. The borrower defaulted on the payments, so the lender repossessed the car and sold it, failing to recover the balance on the loan. The borrower failed to pay the remaining amount due. Many years later, the lender retained counsel to recover the remaining balance on the unpaid date. Counsel's law firm sent a letter to the debtor informing him that the creditor had retained the law firm and given it the authority to file a lawsuit against him. It also demanded payment of the outstanding debt. The debtor then filed a putative class action against the creditor claiming that the Fair Debt Collection Practices Act (FDCPA) prohibited collection letters and filing lawsuits on time-barred debts. The creditor filed a motion to dismiss, which the district court granted, and this appeal followed.

In KAISER v. CASCADE CAPITAL, LLC, 989 F.3d 1127 (9th Cir. 2021), the Ninth Circuit evaluated the debtor's FDCPA claims in connection with the motion to dismiss. The court first turned to Oregon commercial law to determine whether collection of the debt was time barred under the applicable statute. The Ninth Circuit concluded that the Oregon Supreme Court would find that the four-year statute of limitations would apply to the debt. Therefore, the suit was time barred. Next, the court evaluated whether the FDCPA prohibited threatening to collect on time barred debts. The court held that attempts to sue to collect on a time-barred debt were "unfair, misleading, and threats to sue on time-barred debts are at the least misleading." The court noted that the FDCPA makes debt collectors strictly liable for misleading and unfair debt collection. The court noted this policy by cited to the Consumer Financial Protection Bureau's (CFPB's) guidance, which had adopted a strict liability policy as well. However,

the court stated that it was possible for the creditor to make a bona fide error defense under the statute's narrow exception to liability. The court concluded that mistakes about the time-barred nature of a debt may constitute a bona fide error. The court remanded the case, noting that the debtor stated a claim for relief under the FDCPA that survived a motion to dismiss. Additionally, the court stated that the creditor may raise the bona fide error defense but declined to discuss its likelihood to succeed on the merits of the case. [By Jimmy D. Vaughn jimmy.d.vaughn@ttu.edu]

CHECKING ACCOUNTS

Right of Survivorship Allows Ex-Wife to Legally Close Account After Ex Husband's Death [KY APP]

The putative beneficiary of an estate filed a complaint against its executrixes to recover a $70,000 check from her deceased son and ex-wife's joint bank account and jointly owned real property. She claimed she had an interest in it as a result of her son's holographic will, which was in dispute at the time of this suit. The executrixes were the exwife of putative beneficiary's son and the estate. The trial court dismissed the ex-wife as a party, but on appeal, the ex-wife was reinstated as a party. The court also dismissed the estate and the executrixes, focusing this appeal on whether the ex-wife had been properly dismissed at the trial level. The exwife and putative beneficiary's son had divorced in 2017; their final decree had provided that they divided their joint bank accounts to their mutual satisfaction, and the home in dispute had been awarded to the son on the condition that he paid his ex-wife $100,000. After the death of the son, authorities found a check payable to the putative beneficiary, but the ex-wife had closed the account before it could be drawn on. The ex-wife argued she was the surviving owner of the checking account and residence, and thus she had lawfully closed the account.

In WHEELER v. LAYTON, 617 S.W.3d 830 (Ky. Ct. App. 2021), the court upheld the lower court's dismissal of the claims against the ex-wife. The putative beneficiary primarily argued that her son's holographic will entitled her to the check and residence, in addition to claiming that ex wife had violated the divorce settlement. Because the putative beneficiary did not raise the issue in the lower court and because she was not a party to the divorce settlement, the court declined to review the divorce settlement arguments. The court also declined to review claims against the holographic will, because it was in dispute. As for the putative beneficiary's claims regarding the check, the court held that because the joint bank account was created with survivorship rights, the ex-wife was legally allowed to close the account and withdraw the funds. This conclusion was also supported by the fact that there was no evidence that the son was indebted to her at the time of his death, so the check was seen as having been an incomplete gift. As for the residence, the putative beneficiary's son and ex-wife acquired the house during their marriage and it had held it as a tenancy by the entirety, meaning the ex-wife obtained title to the home in fee simple absolute upon her exhusband's death. At no point did the putative beneficiary hold an actual interest in the disputed property, leading the court to affirm the lower court's judgment. [By Jessica Longoria jessica.longoria@ttu.edu]

CREDIT AGREEMENTS

Bankruptcy Court Holds Subordination and Release Are Different Concepts. [BKR SD OHIO]

The borrower, a coal producer that had acquired an interest in a group of coal companies, sought to extend the maturity date governing term loans. However, the original contract prohibited extensions from consenting term loan lenders unless it also gave an extension to the lenders that did not consent to the agreement. To overcome this problem, the lender entered into a "Third Amendment Agreement," to remove any provisions that prohibited a lender from favoring extending lenders over nonextending lenders. Next, the borrower used "modified Dutch auctions" to repurchase term loans on a non-pro rata basis from any lenders that agreed to new loans with a 2022 maturity date. Lastly, the borrower entered into a "Superiority Credit Agreement" governing the new loans provided by the extending lenders and leaving the nonlenders with their existing but newly subordinated loans. The administrative agent for the Term Loan Lenders claimed that the "modified Dutch auctions" actually represented a "Specified Auction." Additionally, the administrative agent claimed that the "Third Amendment" never became effective and therefore failed to remove certain provisions of the original loan agreement and that this violation triggered a default under the Credit Agreement, rendering the Third Amendment ineffective. The borrower contended as a matter of law that the Specified Auction was conducted in accordance with the modified-Dutch-auction provision of the Credit Agreement and the court can determine the consents required for the Third Amended agreement.

In IN RE MURRAY ENERGY HOLDINGS CO., 616 B.R. 84 (Bankr. S.D. Ohio 2020), the bankruptcy court evaluated the default claim of the administrative agent by starting with the contract language. Discussing whether ambiguity was within the four corners of the contract, the court turned its

eye to language "modified Dutch auction," stating that, the parties will receive an opportunity to provide evidence that the specified auction would be considered a modified-Dutch-auction as the term in the finance industry is understood. If the specified auction failed to operate as a modified-Dutch-auction, then a default under the Credit Agreement had occurred. Turning to the second issue, the court rejected the claim that the Superiority Lenders lacked authority to enter into the "Third Amendment agreement" because they committed to selling their loans back to the borrower. The Third Amendment was entered before the specified auction was conducted. Therefore, the super-priority lenders entered into the amendment before the former notes were repurchased and cancelled. The bankruptcy court rejected this "zombified votes" argument. Additionally, the court evaluated the contract provision that required the written amendment to occur for a release of substantially all of the collateral. Because the Third Amendment subordination and release provisions are different concepts, the court rejected the contention that a default had occurred because the Third Amendment required consent of all parties. The bankruptcy court also examined the argument that the other lenders needed to consent because the contract required the consent of all adversely affected lenders, not just the lenders whose principal amounts were reduced. The court rejected this argument, stating that the term loan lenders were not affected by the reduction of the principal amount of loans of the super priority lenders. The court also rejected the claim that the superpriority loans were extended loans. Lastly the court rejected the administrative agent's argument that the term loan lenders have priority over super-priority lenders. If the agreement violated the contract, then they are back on equal footing because the specified auction did not cancel the original loans. Therefore, it dismissed those complaints. The court ultimately dismissed all claims of relief except the challenge to the modified Dutch auction." [By Jimmy Vaughn jimmy.d.vaughn@ttu.edu]

ELECTRONIC DEPOSITS

Electronic Deposit Effective Even Though Check Was Unendorsed [NJ APP]

A hairstyling school that served as a pass through for federal funds given to students attending its program gave a check to a student. The same day the student received the check, it was cashed twice, once via electronic deposit and later at a check cashing business. The student had not endorsed the check that she deposited electronically. The student's depository bank presented the check to the issuing bank and the check was honored. The check paid by the check cashing business was not honored because it was a duplicate presentment. An individual (the assignee) obtained an assignment of the rights of the check cashing business and sued, claiming that the check presented by the check cashing business should have been honored and not the electronically deposited check. The assignee lost, moved for reconsideration, and lost again. The assignee filed an appeal as a result of the holding.

In TRIFFIN v. SHS GROUP, LLC, 247 A.3d 7 (N.J. Super. Ct. App. Div. 2021), the court reviewed the assignee's argument that under N.J.S.A. 12A:3-308(b) the depositor had the burden of establishing the assignor's right to payment, by proving the check had been paid by the bank before the check cashing company presented it for payment. The court rejected the assignee's claim that the trial court's holding on this matter amounted to prejudicial error. The key here was N.J.S.A. 12A:4-205, which allows the customer of a depository bank to deposit a check without endorsing the check. Accordingly, the moment the check had been deposited into the account, valid transfer and negotiation of the instrument had occurred because the depositor was a customer of the depository bank. The indorsement on the check presented to the cash checking service made it clear that the transaction with the cash checking service had occurred after the electronic deposit. Using this reasoning, the court affirmed the decision of the lower court. [By Jimmy Vaughn jimmy.d.vaughn@ttu.edu]

INTERVENTION

Holder of Perfected Security Interest in a Claim Against Reorganized Debtor Entitled to Intervention When Debtor Moves to Disallow, Subordinate or Recharacterize Claims [BKR WD KY]

A reorganized debtor brought a claim against several creditors to recharacterize, disallow and equitably subordinate the creditors' claims. The reorganized debtor also sought an award of damages against an individual in connection with the suit. A creditor that held a perfected interest in the creditors' claims against the reorganized debtor filed a motion to intervene as an interested party under F.R.C.P. 24 and pursuant to Rule 7024 of the Federal Rules of Bankruptcy Procedure. The secured creditor filed the motion to intervene a month after the reorganized debtor filed its suit.

In IN RE INSIGHT TERMINAL SOLUTIONS, LLC, 2021 WL 2258294, 2021 Bankr. LEXIS 1493 (Bankr. W.D. Ky. June 2, 2021), the bankruptcy court evaluated the motion to intervene by the secured creditor. Looking at the three-prong test of F.R.C.P. 24(a)(2), the court held that under the first prong the secured creditor's motion to intervene was timely. When evaluating the second prong, the court held that, under the Colorado UCC, a secured party is permitted to settle and compromise claims against the account debtor. Therefore, the secured creditor has a substantial interest that satisfies the second prong. The court similarly held that the legal interest of the secured creditor may be impaired if it were not allowed to intervene because the account debtor may not defend the secured creditor adequately. These four requirements weighed in favor of allowing intervention. Using this reasoning, the bankruptcy court permitted the secured creditor to intervene in the suit brought by the reorganized debtor. [By Jimmy D. Vaughn jimmy.d.vaughn@ttu.edu]

SECURED TRANSACTIONS

Failing to Include Debtor's Entire Middle Name on Financing Statement May be Seriously Misleading And Result in Lack of Perfection [BKR MD GA]

A debtor filed for Chapter 12 (family farmer) bankruptcy relief. The holder of an allegedly secured claim filed a motion for adequate protection or, in the alternative, for lifting the automatic stay to allow the creditor to foreclosure. For either of those types of relief to be granted, the creditor had to have a perfected security interest in the relevant collateral. The chapter 12 trustee objected to the motions, claiming the creditor's claim was unsecured because the financing statement the creditor had filed was insufficient. There are two versions of 9-503 of Article 9 of the Uniform Commercial Code. Under the version adopted in Georgia, the name of the debtor as set forth in a validly issues driver's license must be set forth in full on the financing statement. Here, the name on the financing statement was Darren E. Bryant, but the name on the driver's license was Darren Eugene Bryant. In other words, the financing statement was filed under the name of the debtor with the middle initial abbreviated.

In IN RE BRYANT, 2021 WL 2326336, 2021 Bankr. LEXIS 1528 (Bankr. M.D. Ga. June 7, 2021), the bankruptcy court evaluated the claim of the chapter 12 trustee that the financing statement filed by the creditor was seriously misleading. The court held that under the Georgia UCC (or O.C.G.A. § 11-9-503(a)(4)) the financing statement must provide the full name of the individual indicated on the debtor's driver license. However, mistakes alone fail to make the claim unsecured. A financing statement can be adequate even though it does contain errors so long as it is not "seriously misleading." The court held the claim was unsecured because under the standard search logic a search for the financing statement under the correct name failed to pull up the financing statement filed under the abbreviated name. The court only addressed the arguments on the merits of the motion for adequate for protection. The court declined to make a final judgment on the status of the creditor's security interest, suggesting that the issue should be determined in an adversary proceeding. Additionally, the court rejected a res judicata argument made by the creditor. The court reasoned that res judicata only bars relitigating claims among the same individuals or their privies. Accordingly, any agreements entered into by a chapter 11 trustee or debtor in possession would not be binding on the chapter 12 trustee.

Ultimately, the bankruptcy court held that the creditor was not entitled to adequate protection or relief from the stay. The court reasoned that ultimately the validity of the creditor's security interest would have to be determined in an adversary proceeding. [By Jimmy D. Vaughn jimmy.d.vaughn@ttu.edu]

ACCORD AND SATISFACTION

Despite Bank Having Cashed Check, No Accord and Satisfaction Because Parties Had No Bona Fide Dispute Regarding Debt [WD WASH]

A debtor secured a loan with a deed of trust. A bank was the beneficiary of the deed of trust, as well as the servicer of the loan. The bank sent a statement to the debtor informing him of his outstanding balance. In response, the debtor sent the bank a qualified written request under the Real Estate Settlement Procedures Act (RESPA). The questionnaire contained detailed questions about every aspect of the loan. The bank responded with the minimum requirements of information, with an explanation that the other questions were outside the statutory requirements of RESPA. The bank also sent a form letter to the debtor encouraging him to apply for assistance or loss mitigation. The debtor then sent the bank a response that it was in default for its failure to respond to the other questions contained in the qualified written request (QWR). The debtor then sent the bank a letter with a settlement offer, which contained two checks. Contained in the letter and on the checks were statements that informed the bank that cashing any check constituted an acceptance of the settlement on the remaining balance of the loan. The letter also stated that the bank's failure to acknowledge receipt of the checks also constituted a settlement agreement of the remaining balance. The bank cashed the checks and applied them to the outstanding balance. After learning the bank had cashed the checks, the debtor sued to quiet title.

In SCHNOENBERGER v. PNC BANK, 2021 WL 1516180, 2021 U.S. Dist. LEXIS 74048 W.D. Wash. April 16, 2021), the district court evaluated the debtors quiet title claim. The court denied the debtor's motion for summary judgment on the quiet title claim. The Washington UCC requires that both parties believe in good faith that there is a bonafide dispute on the amount in dispute in order for there to be an accord and satisfaction of a dispute. The district court noted that the bank never offered to accept pennies on the dollar for the loan but instead invited the debtor to apply for assistance. The bank also communicated its letter in response to the QWR that it affirmed the validity of the debt, would continue to service the debt and would continue collection and foreclosure efforts. Therefore, the debtor lacked the good faith belief that a bonafide dispute existed. Additionally, the parties did not have a genuine dispute regarding the amount of the debt, causing the quiet title action to fail the bonafide dispute requirement under the Washington State UCC. Using this reasoning, the court voided the appointment of a successor trustee and the full reconveyance of deed of trust recorded because the appointment of a trustee was unauthorized. Ultimately, the court denied both parties' motions for summary judgment by both parties. [By Jimmy D. Vaughn jimmy.d.vaughn@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.