NORTH DAKOTA BANKERS ASSOCIATION

# LEGAL UPDATE

A newsletter covering bank legal and compliance information.

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## BANKRUPTCY

### Creditors' Failure to Timely File Proofs of Claim did not Constitute Excusable Neglect [5TH CIR]

The creditors, former employees of the debtors, filed a putative class action lawsuit against the debtors in California state court, alleging various wage-related claims. The debtors removed the action to the United States District Court for the Central District of California and moved to compel arbitration pursuant to a company-wide arbitration agreement, which contained a class action waiver. The district court denied the motion, holding the arbitration agreement and its class action waiver were unenforceable. The debtors appealed the order to the United States Court of Appeals for the Ninth Circuit. While the appeal was pending, the debtors filed for voluntary Chapter 11 bankruptcy. The bankruptcy court issued an order setting a bar date, which is the date by which all creditors must file their proofs of claim to be treated as a creditor. In accordance with the bar-date order and notice, the creditors each filed a proof of claim as the representatives of the putative class. However, the Ninth Circuit's reversal of the district court's holding had the practical effect of requiring individual arbitration of all claims by the purported "class" members. While twenty-nine putative class members filed individual proofs of claim in the bankruptcy case, some creditors, among the remaining class members, did not do so. Consequently, the bankruptcy court informed the creditors that they could file a motion seeking leave to individually file late proofs of claim. The creditors did so, and the bankruptcy court denied the creditors' motion, holding that the creditors failed to meet their burden of showing "excusable neglect," the legal standard to allow creditors to file late claims. The creditors timely filed a notice of appeal in the United States District Court for the Southern District of Texas. Following a hearing, the district court reversed and remanded the case to the bankruptcy court for further proceedings. The bankruptcy court ruled in favor of the creditors. The debtors timely appealed.

In W. Wilmington Oil Field v. Nabors Corp. Servs., 27 F.4th 1105 (5th Cir. 2022), the court reversed the district court's and reinstated the bankruptcy court's judgment. The court examined whether the bankruptcy court had abused its discretion by denying the creditors' motion for leave to file late proofs of claim, the sole issue in this case. The court's review of "abuse of discretion" turned on whether the creditors established excusable neglect under four equally weighed factors: 1) the danger of prejudice to the debtor; 2) the length of the delay and its potential impact on judicial proceedings; 3) the reason for the delay, including whether it was within the reasonable control of the movant; and 4) whether the movant had acted in good faith. First, the bankruptcy court held that granting the creditors' motion would not prejudice the debtors, because the debtor's reorganization plan contained a disputed claims reserve, which mitigates risk that the debtors may face unexpected losses. Second, the impact of the delay on the judicial proceedings would be minimal. Third, however, the bankruptcy court had not abused its discretion because the reason for the delay was within the control of the creditors. Lastly, the creditors' failure to move the bankruptcy court to apply Federal Rules of Civil Procedure Rule 23 (relating to class actions) to their class of proof claim evinced both a lack of diligence and a misunderstanding of bankruptcy procedural rules, which contradicts a showing of good faith. Therefore, the circuit court ruled that the creditors had failed to show excusable neglect. By Elijah Benzvi elbenzvi@ttu.edu

### Creditor Fails to Produce Enough Evidence that Chapter 11 Debtor Acted in Bad Faith [D NV]

Two debtor companies filed "skeleton" Chapter 11 petitions. One of the companies owned all the shares of the other company, which owned and operated a winery (the "Lead Debtor"). After a law firm filed the petitions for each of the companies, the two companies filed separate emergency motions for an order directing joint administration of their Chapter 11 cases. A creditor sought to dismiss the jointly administered Chapter 11 cases for cause under 11 USCS § 1112(b) based on the debtors' alleged bad faith in seeking relief. The creditor also sought, in the alternative, relief from the automatic stay solely against the lead debtor in the case. In moving to lift the automatic stay, the creditor also asserted that the lead debtor lacked equity in its interest in the secondary debtor company and that the secondary company was unnecessary for an effective reorganization of the parent company.

In In re Quicker Liquor LLC, 2022 Bankr. LEXIS 1846 (Bank:r. D. Nev. June 22, 2022), the court denied both the creditor's motion to dismiss for bad faith and the creditor's motion in the alternative to terminate the automatic stay under 11 U.S.C. §§ 362(d)(l) and (d)(2). The court acknowledged that bad faith or its equivalent, a lack of good faith, may constitute cause for dismissal. The lead debtor had emphasized at the hearing that it had no ability outside of bankruptcy to restructure its obligation to the creditor and therefore, argued that it had acted in good faith in filing the bankruptcy petition. The creditor had not agreed to extending the repayment terms and the lead debtor had been left with no other option under state law to force a restructuring. While bankruptcy courts cannot infer a lack of good faith solely because the debtor is left without other options than pursuing Chapter 11 relief, it may also be true that seeking relief in the absence of alternative non-bankruptcy options is not determinative of a debtor having acted in good faith. After hearing the evidence, the court concluded there was insufficient evidence that the bankruptcy case, by either debtor, had been undertaken in bad faith. Moreover, the creditor was unable to provide enough evidence that the lead debtor's interest in the other debtor company had declined since the filing of the Chapter 11 petitions, which led to the creditor's alternative relief--terminating the automatic stay--to also be denied. By Ty Koether tkoether@ttu.edu.

## CIVIL PROCEDURE

### *Debtors' Untimely Claim Objection Leads to the Application of Res Judicata [5TH CIR]

Debtors owned a property known as the Crawford property. They had refinanced the property and received additional loans to finance a variety of construction projects. The bank had extended the debtors' notes maturity and payment terms, but the debtors could not even pay the interest-only payments on the notes. The bank accelerated the notes and posted foreclosure of the property, and the debtors filed for bankruptcy. The bank filed its lift-stay motion with the bankruptcy court, to allow it to proceed with the foreclosure, but the debtors objected to the motion. The bankruptcy court held a settlement conference, where the debtors and the bank signed an agreed order, agreeing to an amount owned by the debtors that could be amended by the bank. The bank filed its amended proof of claim, as contemplated by the agreed order, and the debtors did not file any objections to the amended proof of claim until over a year later. The bankruptcy court ruled that the debtors' motion objecting to the amended proof of claim was untimely and dismissed it. Before the objection, the debtors filed counterclaims against the bank. The bank moved for summary judgment, and in response the debtors filed a motion for leave to amend, which the bankruptcy court denied, applying the doctrine of res judicata. The debtors appealed to the circuit court.

In Snowden v. First Nat'l Bank of McGregor (In Re Matt/age-Thurmond), 2022 WL 3544393, 2022 U.S. App. LEXIS 23044 (5th Cir. August 18, 2022) (per curium), the court held that res judicata prevented the debtors from filing a late objection to the bank's amended proof of claim. The agreed order had provided that objections could be made only for 14 days after the bank's filing of an amended proof of claim. The debtors did not object to the amended claim until a year later. The court applied the 4-prong test of res judicata and looked to see if there were claims that should have been asserted earlier. The debtors conceded that the case involved the same parties, and that the bankruptcy court was a competent court, therefore conceding on the first two prongs. Next, the Fifth Circuit reaffirmed that any arrangement that is confirmed by a bankruptcy court has the same effect as a judgment rendered by a district court. Consequently, a bankruptcy court order allowing a proof of claim is a final judgment for res judicata purposes. Finally, the counterclaims alleged fraud and breach of contract against the bank, which necessarily revolve around the parties' lending and borrowing relationship. Thus, the debtors' counterclaims, the bank's claims, and the agreed order involved the same cause of action. The court determined that the untimely filing of the debtors' objections to the agreed order barred all subsequent claims from being raised. By Baylee Ballais baylee.ballais@ttu.edu.

### Resolved Billing Dispute Precludes Debtor From Reviving Legal Obligations Under Fair Credit Billing Act [D IN]

A bank made two loans to a debtor. The bank subsequently forgave the loans and refrained from penalizing the debtor, thereby ending the financial relationship between the two. Later, the debtor attempted to make payments for the old loan balance previously forgiven by the bank. The bank refused to accept the checks and the debtor subsequently sent a letter to the bank disputing the payment status of the loans. The debtor sent this letter within the Fair Credit Billing Act statutory timeline of 60 days and therefore created an obligation under the law for the bank to respond within 30 days. The bank responded within the 30- day window mandated by law and explained that the debts had been forgiven, and no action would be taken against the debtor's credit. The debtor sent a second letter to the bank nearly a year later, again inquiring into why the bank was not accepting payments; the bank never responded. The debtor sued the bank for violations under the Fair Credit

Billing Act, 15 U.S.C. § 1666(a) for the alleged failure to resolve the debtor's billing dispute within the statutory time frame of 30 days.

In Walton v. FirstMerchs. Bank Corp., 2022 WL 3999965, 2022 U.S. App. LEXIS 24716 (D. IN. Feb. 17, 2022) (opinion not yet released for publication), the court dismissed the debtor's appeal as frivolous. The court considered whether the bank had any legal obligation to respond to any of the debtor's letters and found that only the first letter created such an obligation. The first letter disputed a transaction regarding refused checks that were sent as payments and had occurred within 60-days of the letter being sent, and therefore within the window authorized by 15 U.S.C. § 1666(a). Under § 1666(a)(3)(A), (B) this letter of dispute created an obligation for the bank to respond to the debtor's letter. The court found that the bank responded in time and resolved the issue of dispute, satisfying its obligation under the statute. The court addressed whether the subsequent letters sent to the bank created any legal obligation to respond. The court held that the subsequent letters were not only disputing transactions that were more than 60-days old and therefore created no obligation to respond, but in addition the transaction being disputed had already been resolved by the bank and could not be repeatedly used to establish a legal obligation to respond. By Levi J.Bowmanlev.bowma@ttu.edu.

# CONTRACTS

## Breach of Trust Agreement and Contractual Email Agreement Can Lead to Big Trouble for Bank [SD TX]

A petroleum company (company) acquired an existing petroleum company which had previously established a rabbi trust holding stocks and money to pay compensation to high level executives, which allowed for favorable tax treatments. The bank (bank) acted as the trustee of the trust and assigned a team of three (team) to manage and maintain the trust for the company. The company requested that the bank diversify its trust holdings and sell the company's shares on specific dates in January 2020. After this request was sent in a series of emails between the company and the bank, the bank responded by accepting the recommendations made by the company, The bank began selling the stock in January 2020, but a member of the team realized that bank did not hold all the shares in its Depository Trust Company account, nor did the bank have control over all shares in the trust. Rather, the shares were held in a Direct Registration System by a transfer agent (agent). Because of the team's inexperience, the team did not know that it could transfer the shares from the agent, and the team did not tell the company it would not be selling those shares. The bank failed to follow its own standard position to move all assets eligible for its Depository Trust Company account held from agent as soon as available to move, thus preventing the sale of the shares until March 2020. Because the market took a tum from the Covid-19 pandemic, the shares sold at a dramatically decreased amount compared to the shares that had been sold in January 2020. The bank argued it was not liable for the delay in the sales. Nevertheless, the company sued the bank for breach of the initial trust agreement, breach of the email contract entered into by bank with the company, and the company sought damages.

In Occidental Petro. Corp. v. Wells Fargo Bank, N.A., 2022 WL 3566939, 2022 U.S. Dist. LEXIS 147906 (S.D. Tex. Aug. 18, 2022) (opinion not yet released for publication), the court held that, under the trust agreement, the bank needed to execute the trade of shares prudently and competently on the dates specified at the market price to ensure that the company's shares were liquidated as agreed by both the company and the bank. Because the bank did not satisfy its obligation to trade the shares by the dates specified, the bank breached the obligation set forth in the trust agreement. In addition, the bank breached the contract it had entered into in the emails with the company. The court found that an offer, acceptance, and consideration existed in the emails, indicating a contract had been created. The affirmative response to the email by the bank to the company accepting its recommendations to sell the stock on specified dates and the performance in selling some of the shares on the specified dates indicated that bank was attempting to meet the requirements of the contract it had entered into with the company. By failing to complete the actions set forth in the emails, the court found that the team had breached its requirements. Finally, the court found the company was entitled to loss of profit damages due to the breach of the contract, resulting from the in loss of value in the shares when they were eventually sold later then contractually agreed. By Melissa Hightower mehighto@ttu.edu.

# FORECLOSURES

## Abandonment of Accelerations by Lenders: A Make-or-Break Case [5TH CJR]

A debtor defaulted on his loan payment regarding a tract of land located in Houston, Texas. In April 20I 0, the mortgage servicer sent the debtor a notice of default, demand to cure, and gave a notice of intent to accelerate the loan. At that time, the debtor filed suit in state court alleging fraud-related claims arising from certain tax assessments and charges on his property. The debtor did not cure his default. The debtor received his first notice of acceleration in June 2010, to which he did not respond, and the lender accelerated the loan, declaring the total amount to be due. The debtor received five more notices of acceleration but failed to cure his defaults. This continued after the loan was transferred from the original lender to another lender, and then eventually to the final lender. At this time, the parties involved in the fraud claim settled, to which the court entered final judgment on the agreement and dismissed all the claims asserted with prejudice. On July 2, 2019, the lender sent its first notice of foreclosure to the debtor. The following day, four years after accelerating the refinanced loans, the lenders filed an action seeking declarations that the statute of limitations did not prevent enforcement of the loan agreement, claim preclusion barred the debtor from asserting any claims against enforcement of the agreement, and that the agreement may be enforced by foreclosure. On appeal, the court answered the following questions: "Is the debtor claim precluded from asserting his statute of limitations defense?" and "whether the plaintiffs provided sufficient notice to the debtor intent to abandon the previous acceleration of the loan?"

In U.S. Bank Nat'l Ass'n v. Lamell, 2022 U.S. App. LEXIS 15251, 2022 WL 1800860 (5th Cir. June 2, 2022) (opinion not yet released for publication), the court held that the lender failed to abandon an acceleration of a defaulted loan when the only notice given to the borrower was a monthly statement purporting to demand less than the full amount of the loan. Precedent showed that to adequately abandon a prior acceleration, a lender must demonstrate an unequivocal manifestation of intent to no longer accelerate the loan. The lenders argued that it gave the borrower adequate notice by demanding less than the full accelerated amount. However, the court rejected this argument. The court stated that the demand letter alone-without any language that would allow the borrower to conclude the loan had not yet been accelerated--did not constitute sufficient notice. From this reasoning, the court concluded that the lender did not abandon the acceleration, and therefore, there existed a genuine dispute of material fact that constituted a reversal and remand. The issue of whether the 2010 acceleration was abandoned was to be outcome determinative because under Texas law an entity must bring suit for foreclosure of real property not later than four years after the cause of action accrues, which is deemed to be at the time of acceleration. By Sabrina Urso sabrina.urso@ttu.edu.

## Automatic Stay Provision Violated by Foreclosure Sale When Debtor Named [2D CIR]

The debtor stopped making payments on a mortgage. The creditor obtained a judgment in the foreclosure action against the debtor. The sale of the property was scheduled, but the debtor filed for Chapter 7 bankruptcy. The debtor's counsel notified the creditor that the continued sale of the property would violate the automatic stay of actions to collect on debts that had been triggered by the petition. Nevertheless, the creditor proceeded as scheduled and the property was sold. The debtor moved for damages, alleging that the creditor violated the Bankruptcy Code's automatic stay provisions, 11 U.S.C. § 362(a)(l) and (a)(2) by completing a foreclosure on their property while knowing that the debtor had filed a bankruptcy petition.

In Bayview Loan Servicing LLC v. Fogarty (In re Fogarty), 39 F.4th 62 (2nd Cir. 2022) the circuit court affirmed the order to award actual damages and consider punitive damages for the creditor's violation of the automatic stay. The automatic stay was violated because the debtor was a named defendant in the Foreclosure Action even if the debtor's direct interest in the property was only possessory. The creditor had willfully violated the automatic stay by selling the property while knowing that a bankruptcy petition had been filed. Under the plain language of the bankruptcy statute, the sale of the property violated the automatic stay. Precedent established that a possessory interest in real property, even without any legal interest, is sufficient to trigger protection of the automatic stay. Accordingly, the ruling was affirmed by the circuit court and remanded so the bankruptcy court. By Brian Phan briphan@ttu.edu.

# SECURITY INTERESTS

## Financing Statement With Incorrect Name is Ineffective [FL]

The debtor's two loans were purported to be secured by a blanket lien on all of its assets. In an attempt to perfect its claimed security interests, the creditor submitted two UCC-1 financing statements to the Florida Secured Transaction Registry (Registry). However, on the UCC-l's, the creditor improperly named the debtor. In 2019, the debtor filed voluntary petitions for reorganization under Chapter 11 of the United States Bankruptcy Code. When its manager conducted a search of the Registry, the creditor's financing statements did not appear on the first page of results from the Registry; the financing statements did, however, appear on the immediately preceding page. The debtor filed a complaint in bankruptcy court claiming that the creditor's failure to properly name the debtor on the financing statements was "seriously misleading" under section 679.5061(2) of the State's adopted UCC, and therefore the perfection of the security interests was ineffective. The creditor argued that the statements were not "seriously misleading" because the financing statements were located so close to where they should have been located. Both parties filed a motion for summary judgment, and the bankruptcy court ruled in favor of the creditor, saying that the statements fell within the state's safe harbor laws and therefore were effective. The debtor appealed to the federal district court, which affirmed the bankruptcy court's decision. The debtor then appealed to the Eleventh Circuit, which certified three related questions related to the "safe harbor" to the Supreme Court of Florida to determine the state law.

In 1944 Beach Boulevard, LCC v. Live Oak Banking Co., 2022 WL 3650803, 2022 Fla. LEXIS 1298 (Fla. Aug. 25, 2022) (opinion not yet released for publication), the court held that it did not need to answer the questions posed to it by the Eleventh Circuit. Here, the court looked at the statute that governed this dispute-section 679.5061-and the language used there to determine what 'standard search logic' means. Section 679.5061(1) says that a financing statement with minor errors remains effective, unless the errors make the statement "seriously misleading." Section 679.5061(2), however, creates a zero-tolerance rule, where when a filing statement fails to correctly name the debtor's name, the document is seriously misleading and therefore ineffective. The safe harbor provision is in 679.5061(3); it states that the statement will be effective even if it fails to correctly name the debtor, and "a search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic, if any, would disclose" the statement. However, as the Eleventh Circuit pointed out, the statute does not define what the standard search logic is in Florida. However, the term is well understood in the industry as it is used in Article 9 of the UCC, which Florida has adopted. Under this, "standard search logic" is understood to mean any process that identifies the financing statements on file that produces hits. The key fact was that in Florida, the Registry allows its records to be searched but does not implement a "standard search logic." Therefore, because the Registry lacks this standard search logic, the search mentioned in 679.5061(3) is not possible. Accordingly, under the zero tolerance rule of 679.5061(2), which meant the security interests were unperfected. By Kate Settle kathryn.settle@ttu.edu.

## WHAT IS FTX?

FTX is a cryptocurrency exchange, which facilitated the buying and selling of cryptocurrency assets. Prior to filing for bankruptcy, FTX processed a majority of cryptocurrency trades and transactions around the world.

## WHAT HAPPENED TO FTX?

Cryptocurrency exchanges often create their own token to facilitate transactions on their network. FTX followed suit by creating its own token "FTT". However, a recent article published by coindesk, alleged that Alameda, a hedge fund owned and operated by FTX's founder Sam Bankman-Fried, held a substantial amount of the FTT token, an ownership stake which equaled billions of dollars. The article further alleged that Alemeda was using its stake in the FTT token as collateral for over 2.2 billion dollars' worth of loans, and that FTX had loaned more than $10 billion worth of customer funds to Alameda allowing them to use those funds for investment.

After the abovementioned article was published, a major holder of the FTT token, Binance, sold its stake in FTX which was worth more than $500 million, resulting in a dramatic decrease in the FTT token price. This prompted a mass exodus of users from the FTX network, triggering the withdrawal of roughly $6 billion worth of cryptocurrency from the platform. The sudden crash of the FTT token price, and the quick exit of many users, forced FTX to momentarily shut down withdrawals from their network, and subsequently file for Chapter 11 bankruptcy. FTX's resulting bankruptcy marks the third crypto company to seek bankruptcy protection under Chapter 11, following Voyager Digital and Celsius Network.

**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.

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