NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

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BANKRUPTCY

*Guarantors' Liability Could be Determined By Bankruptcy Court [5TH CIR]

The debtor was a limited liability company that had borrowed $3.5 million from a creditor. The guarantors of this loan included the debtor's owner. The debtor defaulted when over $3 million was outstanding and the creditor brought an action to hold the debtor and its guarantors liable. The creditor then commenced an involuntary bankruptcy case against the debtor. The creditor moved the state court action to federal court and sent notice to the guarantors to either object to or agree to the bankruptcy court hearing of the case. The guarantors failed to respond and participated in the bankruptcy proceeding by filing motions and amending pleadings. The court granted partial summary judgment for the creditor and found the debtor and its guarantors liable for over $3 million. The bankruptcy court entered a final judgment. On appeal, the guarantors asserted (1) the bankruptcy court did not have jurisdiction over the claims against them, (2) they had not consented to the issuance of a final judgment by the bankruptcy court, and (3) the creditor had forced the debtor into bankruptcy in bad faith.

In Ward v. Cross Keys Bank (In Re Karcredit, LLC), 2022 WL 4103265, 2022 U.S. App. LEXIS 25116 (5th Cir. Sept. 7, 2022) (unpublished opinion), in a per curiam opinion the court examined three issues. The first issue was whether the bankruptcy court had jurisdiction to decide the creditors' claims against the guarantors. The court held that the bankruptcy court had jurisdiction over the adversary's claims. The court noted that removal jurisdiction is assessed based on the facts as they stood at the time of removal. Although this case to hold the guarantors liable was not directly a Title 11 case, the adversary proceeding was "related to" the main bankruptcy case and fit within the statutory rules. The court rejected the guarantors' objection that the estate had no assets because of a fraudulent conveyance finding. The court also rejected the guarantors' argument there was only one creditor because the guarantors had conceded in bankruptcy court that there were multiple creditors. Secondly, the court looked at whether the guarantors consented to the bankruptcy court's issuance of a final judgment. The court held the guarantors had consented to the issuance of a final judgment. Nevertheless, on appeal, the guarantors asserted the bankruptcy court could only submit findings of fact and conclusions of law, arguing that only if a case constitutes a "core proceeding," may the bankruptcy courts enter final judgments. The key question the court analyzed was whether the guarantors had been made aware of their need to consent to the bankruptcy judge entering a final judgment, the right to refuse it, and nevertheless still voluntarily tried the case before the bankruptcy court. The court found the guarantors had received notice that gave them an opportunity to object to bankruptcy court jurisdiction and had failed to respond. However, because the guarantors continued to file and amend pleadings in the bankruptcy court, the guarantors voluntarily had appeared to try the case. The court found that even if the bankruptcy court had indicated that it planned not to enter a final judgment, the guarantors litigated the case without saying anything about the final judgment issue. Finally, the court examined whether the lower court had abused its discretion in holding the guarantors' bad-faith-filing argument had been forfeited. The court held the guarantors forfeited this argument by failing to properly raise the bad-faith-filing argument in the main bankruptcy case. Because the issue had not been properly raised, the appeals court then applied an abuse of discretion standard. The court rejected the guarantors' argument that a badfaith filing is a non-forfeitable jurisdictional issue and held that because bad-faith filing is governed by a permissive provision it is not· jurisdictional. Therefore, by not raising the issue, the guarantors had forfeited the argument.

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Litigate All Possible Issues Before Res Judicata Leaves You Stranded [6TH CIR]

In a previous bankruptcy case in March 2019, Central Processing Services, LLC (debtor) intended to reorganize as a debtor in possession under Chapter 11. Shafer & Weiner, PLLC had been appointed as legal counsel and Harmon Partners, LLC had been appointed as financial advisors (professionals). At that time, the debtor owed almost $6.9 million to its largest individual creditor, the IRS. During the bankruptcy case, the debtor had continued to operate and paid the professionals a total of $83,000 for their fees. The professionals thereafter held these fees in escrow pending the bankruptcy court's approval of their actual fees. In addition to continuing to operate, the debtor paid wages to its employees and withheld $286,878 in federal income tax from those wages without paying the withheld money to the IRS. In August 2019, the IRS moved the bankruptcy court to dismiss the case, alleging that the debtor had failed to pay post-petition taxes and that the reorganization was unlikely to succeed. The bankruptcy court granted the motion in September 2019 and dismissed the case. The IRS filed a post-dismissal motion demanding a pro rata share of the $83,000 in escrowed money and further requesting the court to order disgorgement because the professionals had possession of the funds. The court denied the motion because the dismissal of the case had re-vested the money in the debtor and disgorgement from the professionals to the IRS was impossible. Meanwhile, the professionals submitted fee applications to the bankruptcy court to approve their fees and, despite the IRS's objections, the bankruptcy court had approved the fees. The IRS appealed the two judgments, one denying the disgorgement motion and the other approving the fee applications, but later chose to dismiss both appeals voluntarily.

In United States v. Schafer & Weiner, PLLC, 2022 WL 3151809, 2022 U.S. App. LEXIS 21929 (6th Cir. Aug. 8, 2022) (opinion not yet released for publication), the IRS sued the professionals directly regarding the escrowed money and demanded its "return." The professionals moved to dismiss the suit and the court agreed, finding the IRS barred by res judicata because the IRS could have raised its claims in the bankruptcy case that led to this appeal. Res judicata "prevents parties from raising issues that could have been raised and decided in a prior action - even if they were not actually litigated." The professionals argued that the IRS had the opportunity to bring these claims during the previous case and that these claims arose out of the same operative facts. The IRS responded that the court had refused to establish jurisdiction over the funds placed in escrow and that it therefore could not litigate that issue. However, the appeals court rejected the argument on the basis that the IRS had not "abstained from exercising jurisdiction" over the funds. In order to satisfy res judicata, there are four elements: "(1) a final decision on the merits by a court of competent jurisdiction; (2)...the same parties or their privies; (3) an issue [that] was litigated or which [c]ould have been litigated in the prior action; and (4) an identity of the causes of action." The IRS claimed that the third element was not met because the bankruptcy court did not establish jurisdiction over the funds and it therefore could not bring its claim. The court ruled again that the IRS had time to raise its claims despite the dismissal of the original lawsuit, especially because it had moved for dismissal of the case. Furthermore, the professionals had petitioned the bankruptcy court to approve their fees, the funds in question, and the IRS had failed to challenge those applications or appeal the judgement. Res judicata applies "to prohibit a claim or defense that would attack a previously decided claim." Accordingly, the court held that res judicata barred the IRS's claims against the professionals that arose from the previous bankruptcy.

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Requirements to Prove Violation of the Automatic Stay [11TH CIR]

The debtor owned property that was subject to a foreclosure sale by their bank due to nonpayment of the mortgage. The debtor filed for Chapter 13 bankruptcy to prevent the sale. The filing imposed the automatic stay with respect to the debtor's estate under 11U.S.C. § 362(a). The sale went forward and the bank sold the property to the buyer, an LLC. The debtor claimed that she had faxed evidence of the bankruptcy petition to the bank on the sale date but did not allege that the buyer knew of the bankruptcy case or automatic stay prior to the sale. The buyer later posted an eviction notice on the property at which point the debtor informed the buyer of the bankruptcy petition and automatic stay. Ultimately, the bank executed a foreclosure deed to the buyer.

In Baker v. Oksana Sepich, Najarian Capital, LLC, 2022 U.S. App. LEXIS 27432 (11th Cir. Sept. 30, 2022) (opinion not yet released for publication), the debtor filed suit against the bank and the buyer for willful violation of the automatic stay. The district court granted the buyer's motion to dismiss because the debtor failed to plead that the buyer had violated the stay after learning of the automatic stay. On appeal, the court held the debtor was required to allege that the buyer knew of the existence of the bankruptcy stay, and that the buyer had acted intentionally in a manner prohibited by Bankruptcy Code § 362(a) after becoming aware of the stay. Actions prohibited under the section include intentional "acts to obtain possession of property of the estate," as well as "acts to create, perfect, or enforce any lien against property of the estate." In this

situation, the buyer had waited until the stay was lifted to enforce its purchase of the property and had not attempted to take control of the property until after the bankruptcy case had been terminated. The court therefore concluded that the buyer had not violated the automatic stay. Ruling affirmed.

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Bank was Party in Interest with Standing to Seek Relief from Bankruptcy Automatic Stay [11TH CIR]

The debtor filed for Chapter 7 bankruptcy. The debtor appealed the district court's order affirming the bankruptcy court's order granting the bank's motion for relief from the automatic stay. First, the debtor claimed that the bank lacked standing to request relief from the automatic stay because it was not a party in interest. It was not a party in interest, the debtor claimed, because it had not filed a proof of claim in the bankruptcy case. Next, the debtor alleged that the lower courts erred by not considering whether the bank's claim was fraudulent. Lastly, the debtor argued that the bank could not seek relief from the automatic stay if the court found that the bankruptcy filing petition was part of a scheme to delay, hinder, or defraud creditors.

In Ohlsson v. U.S. Bank N.A. (In re Ohlsson), 2022 WL 695929, U.S. App. LEXIS 28345, (11th Cir. Oct. 12, 2022) (opinion not yet released for publication), the court held that neither the bankruptcy court nor the district court erred in concluding that a bank was a party in interest with standing to seek relief from an automatic stay, because the bank had received a judgment of foreclosure in its favor relating to the real property at issue. Further, the debtor's Chapter 7 bankruptcy case was a "no asset" bankruptcy, so the bank had no duty to file a proof of claim because such claims are pointless in "no asset" cases. Additionally, the court rejected the debtor's RookerFeldman claim. Under the Rooker-Feldman doctrine, a federal district court lacks jurisdiction to review, reverse, or invalidate a final state court decision. The court affirmed the district court's conclusion that the Rooker-Feldman doctrine precluded the bankruptcy court's consideration of the debtor's challenge to the bank's right to foreclose on the real property at issue pursuant to the state court's final foreclosure judgment. Lastly, the court found that the debtor's final argument did not challenge the statute authorizing the bank's requested relief from automatic stay; therefore, the court did not have a basis for reversal of the lower courts' granting the bank's request relief. Thus, the lower court's ruling was affirmed.

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Court Grants Motion for Summary Judgment to Creditor, Denying Discharge of Debt in Bankruptcy Case [BAP WD OK]

The creditor had security interests in real estate assets of a debtor that were held by an LLC. The debtor had transferred the interests in the LLC to their children but maintained control and financial benefit over the assets of the LLC. The debtor filed for bankruptcy, seeking a discharge of debts owed to creditors in the bankruptcy case. The creditor commenced an adversary proceedings to hold the debt to be nondischargeable and moved for summary judgment, arguing that the debtor had made transfers of assets with the intent to conceal them from the creditor under 11 U.S.C. § 727(a)(2)(a). The debtor cross moved for summary judgment, arguing that the transfer was well outside the one-year statutory look-back requirement.

In SE Prop. Holdings, LLC v. Stewart, 2022 LEXIS 2172 (BAP W.D. Okla. 2022), the court granted the creditor's motion for summary judgment, denying the debtor the discharge of the debt. The court considered whether the transfer that had occurred over a year before the commencement of the bankruptcy case fell within the scope of the "continuous concealment doctrine," which would overcome the statute of limitations problem the creditor faced as a potential bar to success. The court determined that although the debtor had transferred its membership interest over a year before filing for bankruptcy, the debtors still had been receiving a financial benefit from the company. The debtors represented that they held a l00% ownership interest in the company in their tax returns that had been filed the same year as the bankruptcy case. The court ruled that a transfer of legal title along with retention of benefits that had been concealed up until the year before filing for bankruptcy could give rise to a nondischargeable debt.

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Warning to Creditors: Accurately Report Arrearage Amount in Bankruptcy Cases or Pay Damages [BKR D SC]

A debtor filed for Chapter 13 bankruptcy in March 2022. The debtor had previously received a discharge on its Chapter 13 bankruptcy filed in 2016. In the 2022 Chapter 13 filing, the debtor had filed schedules and statements listing debtor's residential property and the creditor, which had a secured claim to the property. The debtor also had filed a Chapter 13 plan which had included the installment payments to the creditor

and the pre-petition arrearage owed to the creditor. The creditor had been given notice by the court to file proof of claims against the debtor. The creditor filed a proof of claim listing the amount necessary to cure any default and attached a payment history. The amounts filed by the creditor and the debtor did not align. The debtor filed an objection to the creditor's claim because the form did not accurately account for payments (2016-2018 payments) the debtor had made in the previous Chapter 13 bankruptcy case. In response, the creditor filed an amended 410A. The debtor then filed an amended objection, stating that creditor had failed to accurately include the 2016-2018 payments and the 2019-2021 payments received by the creditor. The debtor requested the court to determine the accurate portion of arrearage to the creditor and grant relief to the debtor.

In In Re Simmons, 643 B.R. 565 (Bankr. D. S.C. 2022), the court held that it is essential to the bankruptcy process that a creditor ensure its proof of claim contain accurate information. The burden of establishing a valid amount and proof of claim shifts between the creditor and the debtor. If the creditor meets the requirements of Fed. R. Bankr. P. 300l(c), the proof of claim is valid and the burden lies with the debtor, however, if the requirements are not met, the burden shifts to the creditor to establish the validity and amount of the claim. The debtor must only file an objection to satisfy its burden, shifting the burden to the creditor. Here, the debtor had filed an objection, thus the creditor's claim was no longer deemed allowed and the court was required to determine the amount and validity of the claim. The court noted that the creditor did meet its burden to prove the payment history in the claim for the 2019-2021 payments; however, the claim did not reflect the disbursements the creditor had previously received by the debtor for the 2016-2018 payments. The court determined the correct arrearage owed by the debtor requiring the creditor to file a revised proof of claim reflecting the corrected amount. In addition, because the creditor failed to attach an accurate claim originally, the court granted relief to the debtor, awarding reasonable attorney fees and costs to be paid by the creditor.

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CONTRACTS

Word's Plain Meaning Controls if the Contract is Unambiguous [4TH CIR]

A Texas insurance company (Grantor) and a South Carolina insurance company (Beneficiary) entered into a fronted reinsurance program. This program allowed the Grantor to sell insurance policies in the Beneficiary's home state in exchange for a portion of plan premiums. Under the terms of the contract, Beneficiary would bear liability if Grantor became insolvent. To mitigate their potential losses, Beneficiary set up a trust fund to hold collateral from Grantor and named a bank (Trustee) as the fund's trustee. Ultimately, the reinsurance program failed, and Beneficiary sued Trustee. The main issue hinged upon the definition of undefined key words in the trust fund contract. After examining the contract, the district court relied on extrinsic expert witness testimony to deduce the meaning of the words and entered judgment in favor of the Trustee. Beneficiary appealed, claiming the district court erred in its interpretation of the keywords.

In Accident Ins. Co. v. U.S. Bank Nat'/ Ass'n., 2022 WL 3713512, 2022 U.S. App. LEXIS 24287 (4th Cir. Aug. 29, 2022) (opinion not yet released for publication), the court of appeals vacated and remanded the district court's judgment. The court started its analysis by noting that Delaware's law governs the contract. Under Delaware law, courts must use an objective approach when construing contracts. Therefore, a contract's language must be taken at face value, as a "reasonable third party" would. Only when a contract's language is ambiguous may extrinsic evidence be introduced. Upon examination, the appeal's court found that the keywords at issue ("negotiate" and "accept") had clear and unambiguous meanings consistent throughout legal and financial dictionaries. Thus, the district court had erred in relying on extrinsic evidence in the face of clear and unambiguous terms.

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EMPLOYMENT

*Texas Employee Defeats Summary Judgment in Age Discrimination Case [5TH CIR]

The employee worked for the bank as a Senior Vice President ("SVP") on a team that included three other SVPs. The employee was the oldest SVP on the team. The team manager left the bank, and the employee began reporting to the bank's Head of Energy. The employee's performance review scores began to fall once this change happened, but the bank conceded that the Head of Energy was "broadly satisfied" with the employee's performance. The bank began looking for a new team manager and an email between executives stated that the bank would consider terminating the employee once a new manager was found. According to the bank, one SVP needed to be terminated to make room in the budget for the new manager. The Head of Energy performed an informal ranking of the SVPs to determine who to terminate and the older employee was ranked last. The employee was terminated before a new manager was found and a much younger employee

with a limited record of performance reviews was promoted to SVP the same day. The employee sued the bank alleging that he had been fired because of his age in violation of the Texas Labor Code. The district court granted summary judgment finding that the employee failed to establish a prima facie case of age discrimination and failed to demonstrate that the bank's proffered reason for the employee's termination was pretextual. The employee appealed.

In Sears v. Zions Bancorporation NA, 2022 U.S. App. LEXIS 15255 (5th Cir. June 2, 2022) (unpublished opinion), the court reversed and remanded the decision of the district court. The court first reviewed the case to determine if the employee had established a prima facie case of age discrimination and specifically looked at whether a jury might find that the employee was treated differently from other similarly situated employees. The court found that there was a question for the jury because a younger SVP with a limited record of performance reviews was promoted the same day that the employee was fired. The court then reviewed the case to determine if there was evidence that the reason proffered for the employee's termination was pretextual. The employee presented evidence that the bank deviated from its own established policies for reviewing and providing feedback to the employee by conducting the informal SVP ranking. The court found that this was sufficient evidence to defeat summary judgment. The court also found that the informal ranking was a questionable reason for termination because the executives discussed terminating the employee by email before the ranking was conducted. After review, the court determined that the employee had provided sufficient evidence to survive summary judgment because a jury could find that age was the reason for the employee's termination.

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GENERAL BANKING

State Rule Preempted by National Banking Law [2D CIR]

A New York law required federal mortgage lenders to pay a 2% minimum interest rate on mortgage escrow accounts. The mortgagers residing in New York sued the bank for refusing to pay interest on the mortgagers' money in escrow accounts held by the bank. The main issue was whether several different federal banking law statutes preempted the New York law. To resolve this preemption issue, the district court attempted to "divine the general legislative purpose" of the various federal banking statutes and compare their objectives to the New York law's objectives. Ultimately, the district court found "little incompatibility" between the goals of each statute and ruled that federal law did not preempt and therefore void the New York statute. The bank appealed.

In Cantero v. Bank of Am., 49 F.4th 121 (2d Cir. 2022), the court of appeals reversed and remanded the district court's judgment on the preemption issue. In its opinion, the appeals court noted that the district court incorrectly applied legal principles of statutory interpretation. Rather than divine Congress's goals, the district court should have used a two-part analysis: (1) "read the plain language" of the relevant state statute; (2) ask whether the state law in question purports to control the exercise of a national bank's powers. In determining "(2)," courts must examine the "nature of an invasion into a national bank's operations, not the magnitude of its effects." Notably, a state law with a sizeable monetary effect on a bank may not be preempted, while a state law with a slight financial impact might be void. In this case, the Second Circuit Court of Appeals found that the New York statute forced the bank to pay its customers when exercising a power granted by the federal government. Thus, the state law effectively exerted control over the bank's exercise of that federal power. Accordingly, the federal banking statutes preempted the New York law and the decision below was affirmed.

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Bank Obtains Higher Interest Rate in Subchapter V Chapter 11 Plan [BKR ED CA]

A bank, a secured creditor, and a debtor in possession worked towards confirmation of a subchapter V Chapter 11 Plan. The bank objected to confirmation because it claimed the plan was not fair and equitable. It had multiple reasons for this assertion, but the court focused on the bank's issue with the interest rate proposed and dismissed the other concerns. The bank wanted its contractual interest rate of 7.5% to be awarded under the plan instead of the 3.5% prime rate adjusted up to 4.5% that was provided for in the plan.

In In re Twisted Oak Winery, LLC, 2022 WL 5264708, 2022 Bankr. Lexis 2840 (Bankr. E.D. Cal. 2022) (unpublished opinion), the court granted a higher interest rate of 5.75%. The court explained the debtor did not have to award the contractual interest rate of 7.5% in the plan, and that the interest rate would be determined according to the Bankruptcy Code and the case law construing it. The court decided that the current prime interest rate of 4.75% would be adjusted up by 1% according to the factors set forth in Till v. SCS Credit Corp., 541 U.S. 465 (2004). The court dismissed the bank's argument that a low interest rate posed a high risk and reasoned that the increase of 1% over the prime interest rate is

appropriate under the circumstances, and that the bank would be able to enforce its rights against the debtor if it defaulted and failed to cure.

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Debtor Fails When He Objects to Claim He Had Listed as Undisputed [D NV]

The debtor was issued a credit card and did not dispute owing $9,212.00 to a financial institution in an account ending in 6619. The financial institution's counterparty bank timely filed a claim in the debtor's bankruptcy case. While the debtor had listed the claim as being undisputed, the debtor contended that the bank had failed to produce authenticated evidence of the debtor's liability and the claim amount. The bank, as the creditor, met the authentication requirements for credit card debt. The debtor nevertheless argued that that bank was required to comply with the evidentiary requirements for an action to collect a debt owed to an issuer. The statute requires a credit card issuer to establish the debtor's contractual liability and the amount of that debt. In this case, the bank did not initiate an action against the debtor to collect its debt. Rather, the debtor had filed for bankruptcy and listed the undisputed debt owed to the bank. The bank, in response, filed its proof of claim and attached the required account summary.

In In re Robles, 2022 WL 4486724, 2022 Bankr. LEXIS 2690 (Bankr. D. Nev. September 27, 2022) (unpublished opinion), the court did not sustain the debtor's objection because the debtor did not dispute the debt owed to the claimant. The debtor neither amended his schedules nor presented any evidence to dispute the debt. Instead, the debtor sought to require the creditor bank to produce documents from a debt he had already acknowledged in his sworn schedules. The debtor asserted that under Nevada law, the claim must be disallowed. In this case, the debtor misunderstood the creditor's requirements to establish the debtor's liability. A credit card issuer "may" establish the cardholder liable for the debt by submitting either the cardholder's written application for the credit card or evidence that the cardholder incurred charges on the account. The creditor "may" establish the amount owed by showing photocopies of the periodic billing statements provided by the issuer or by information stored on a computer, microfilm, microfiche, or optical disc which indicates the amount owed. These provisions use the word "may," which demonstrates that they are permissive and inclusive means of establishing liability rather than, for example, mandatory and exclusive had the word "shall" been used. When the debtor, as in this case, objected to a creditor's proof of claim that did not conform with the statute by including copies of the documentation on which the claim was based, the bankruptcy court may properly consider as admissions or evidence any information contained in the debtor's bankruptcy schedules. Because the debtor never refuted his liability for the amounts stated in his schedules to the bank, there was no real dispute over his liability to the bank. The claim was allowed.

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LENDING

Deceptive Practices Can Lead to Big Penalties [9TH CIR]

A loan company (company) made unsecured, high interest loans to consumers throughout the United States. The company attracted regulators attention by attempting to avoid state usuary and licensing laws by operating on a Native American reservation. The company entered into an assignment and a service agreement with a limited liability company (LLC). The company agreed both to purchase all loans made by the LLC within days after the LLC made such loans to borrowers and to indemnify it for any expenses associated with legal or regulatory action. The loan agreements between the LLC and its borrowers included a choice-of law provision calling for tribal law to govern in order for the LLC and the company to avoid accountability under state law. Unlike the tribal law, state law prohibited each of the loans. The Consumer Financial Protection Bureau brought an action against the company under the Consumer Financial Protection Act (CFPA), alleging that it committed an unfair, deceptive, or abusive act or practice by demanding payment from consumers under the hoax that loans invalid under state law constituted legally enforceable obligations. The company argued in response that the loans were valid because they were under the tribal law.

In Consumer Fin. Prot. Bureau v. CashCall, Inc., 35 F. 4th 734 (9th Cir. 2022), the court held the choice of law provisions unenforceable because the Native American reservation lacked a substantial relationship to both the parties and the transactions. The company conducted all of the loan transactions, not the LLC. The LLC was organized under South Dakota law, not tribal law and was not operated by the Tribe. The court concluded that the only reason for the parties' choice of tribal law was to further CashCall's scheme to avoid state usury and licensing laws. CashCall, in an attempt to expand outside of California to make a profit, had encountered significant regulatory scrutiny. After receiving cautionary legal advice, CashCall continued to collect on existing loans, collecting fees, and interest. The court deemed this to be grounds for a tier-two civil penalty instead of a tier-one penalty because the defendant had engaged in reckless behavior in

continuing the practice. Furthermore, the court concluded that the CEO's actions of relying on advice from counsel did not present a valid defense and continuing to collect on loans had been reckless, making himself personally liable. In addition, the court restated the Supreme Court's holding in CFPB v. Seila Law LLC, 997 F.3d 837, 846 (9th Cir. 2021), that actions taken by an officer unconstitutionally insulated from removal nevertheless as valid. Accordingly, the Consumer Financial Protection Bureau did not lack the authority to pursue an action against CashCall, Inc. Finally, the court remanded the decision of back to the district court.

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The Importance of Reliance in Proving Fraud [BKR ND MS]

The debtor purchased a 2020 Dodge Challenger by entering into a loan agreement. The agreement provided that the vehicle would be collateral for the loan. Page one of the loan agreement had a space for the debtor to mark whether the vehicle would be used for consumer or business use. The debtor checked neither. The document also prohibited the debtor from leasing the collateral. At the time the debtor signed the document, the debtor planned to rent out the vehicle, and did not reveal this information to the lender. The lender disregarded page one of the agreement and instead relied upon the borrower's credit history, occupation, the collateral's value, state lien laws, and the location of the collateral at the time of the loan. The debtor rented out the vehicle until the default date. The debtor later defaulted on the loan, and the lender auctioned off the vehicle, leaving behind a deficiency balance. In the debtor's chapter 7 case, the lender contended that the deficiency balance should not be discharged because the debtor obtained the loan through false pretenses specifically, that the lender would not have entered into the agreement if it had known the debtor's intention was to rent the car to others.

In Huntington Nat'l Bank v. Mosby, (In re Mosby), 2022 WL 4003615 (Bankr. N.D. Miss. Sep. 1, 2022) (opinion not yet released for publication), the court held that the bank failed to prove the element of reliance necessary to preclude the discharge of the debt. The court construed section 523(a)(2)(A) of the Bankruptcy Code, which provides an exception from a discharge of debt obtained by false pretenses or actual fraud. The lender must prove: (1) the debtor made representations; (2) which the debtor knew were false; (3) the debtor intended to deceive the creditor; (4) the creditor relied on such representations; and (5) the creditor sustained losses as a proximate result of the representations. Additionally, the elements for false pretenses are as follows: (l) a knowing and fraudulent falsehood; (2) describing past or current facts; (3) that was relied upon by the other party. The court concluded that because the lender relied on information other than the purpose of the vehicle when granting the loan, the requisite reliance necessary for both actual fraud and false pretenses was missing.

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Mortgage Assignee Denied Standing in Foreclosure Action Because of Fishy Note [2ND APP NY]

Two mortgagors executed a note from a lender. To secure the note, the mortgagors executed a mortgage encumbering real property. The mortgagors allegedly defaulted on their obligations under the note and mortgage by failing to make payments. The original lender then assigned the mortgage to the assignee. The assignee of the mortgage brought a foreclosure action against the mortgagors, but discontinued it. Thereafter, the assignee assigned the mortgage to a subsequent assignee. The subsequent assignee then brought its foreclosure action against the mortgagors. The mortgagors asserted the defense that the subsequent assignee lacked standing. The subsequent assignee moved for summary judgment to strike the mortgagor's defense that it lacked standing.

In U.S. Bank N.A. v. Rozo-Castellanos, 20 l A.D.3d 995, 162 N.Y.S3d 125 (App. Div. 2d Dep't 2022), the court denied the subsequent assignee's motion for summary judgment and foreclosure action because there was a genuine issue of material fact as to whether the note possessed by the subsequent assignee was the same note as that submitted in the earlier foreclosure action. The court first evaluated the subsequent assignee's argument that it had standing because it had possession of the note before the commencement of the action, which was endorsed in blank by the original lender, and the mortgagor's argument that the copies of the note that were produced in the earlier court proceedings had inconsistent endorsements. Specifically, in the prior foreclosure action, the original signee submitted a note that contained a special endorsement by the lender to the original assignee. Here, the note submitted by the subsequent assignee was endorsed in blank by the lender. The court rejected the subsequent assignee's argument, even though its version of the note without the endorsement was not necessarily inconsistent with the note endorsed in blank. However, because the note in the prior foreclosure action contained the special endorsement by the lender to the original assignee, the note produced by the subsequent assignee was not consistent with the endorsement in blank by the lender. The court reasoned that under UCC § 3-202[1] and 3-204[l], if the note had been specially endorsed to the original assignee,

it would have had to have been specially endorsed to the subsequent assignee or endorsed in blank to the original assignee in order for the subsequent assignee to enforce it.

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SECURITY INTERESTS

Security Interest in Deposit Account does not Attach to Funds Transferred out of Account Absent Collusion [SD OH]

An Ohio banking corporation (the creditor) entered into a series of security agreements with different debtors (the debtors). Under the agreements, the creditor took a first priority security interest in the debtors' deposit accounts, accounts receivables, and other collateral. The debtors ultimately defaulted on their obligations, and the creditor moved to seize the collateral; however, the creditor discovered that the debtors had entered into a factoring agreement with a third party. The factoring agreement allowed the debtors to sell or pledge their accounts receivable to the third party in exchange for upfront cash. This factoring agreement violated the creditor's security interest in the accounts receivable. The creditor then sued the third party (the defendant), alleging conversion of the receivables that were subject to the creditor's security interest. The defendant countered with a motion to dismiss, claiming the creditor failed to state a claim for conversion because "there is no conversion where the subject of the claim is money or funds transferred from a deposit account."

In First Fin. Bank v. Fox Cap. Grp., Inc., No. l:21cv691,2022 WL 4622687, 2022 U.S. Dist. LEXIS 180347 (S.D. Ohio Sept. 30, 2022), the district court held that the creditor had no security interest in the money transferred to the defendant. In its analysis, the court looked to a controlling opinion recently decided by the Ohio appeals court on the same issue. The appeals court held that a security interest in an account is the "equivalent of exchanging the funds for a promise to pay." Thus, an account does not contain funds. Instead, the funds are "transformed to a right to payment […] to which the security interest attaches." Absent collusion, the security interest will not attach to funds paid out of the account. Applying the appeals court's reasoning, the district court held that funds transferred from the debtors' account to the defendant were free of the creditor's security interest. Accordingly, the district court granted the defendant's motion to dismiss.

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FRAUDULENT TRANSFER

Debtor's Property Transfer was Fraudulent and did not Qualify for Safe Harbor Provision. *[5TH CIR]

The debtor owned a property encumbered by multiple liens. He erased one of the liens by purchasing a senior lien and foreclosing on the property. The property in question suffered setbacks, and the tenant leasing the property defaulted on and then abandoned its lease. As a result, the debtor's company ran out of cash, so the debtor continued to pay the bills for the property with money from his other business ventures. Meanwhile, the debtor formed a new company, similar to his previous company, and convinced one of the lien holders to sell its lien to the debtor's new company. Knowing that the lienholder wanted a buyer with the time and resources to maintain the property, the debtor lied and said he had a prospective buyer. The debtor then foreclosed on the property. The foreclosure extinguished a junior judgment lien held by the creditor. The creditor did not find out about the foreclosure until more than a month after it happened. When the creditor found out about the foreclosure, it amended its pleadings to add claims against the debtor under the Texas Uniform Fraudulent Transfer Act (TUFTA). In response, the debtor filed a Chapter 11 bankruptcy petition. The central issue before the court was whether the creditor whose lien was erased could avoid an involuntary transfer in a bankruptcy case. The bankruptcy court ruled in favor of the creditor, and the debtor appealed.

In Morash v. Valley Ridge Rooking & Constr., L.L.C. (In Re Silver State Holdings), 2022 WL 3755778, 2022 U.S. App. LEXIS 24587 (5th Cir. August 30, 2022) (unpublished opinion), the bankruptcy court held that the creditor could avoid the foreclosure because the court found (1) an actual fraudulent transfer under Bankruptcy Code § 548, (2) a preferential transfer under Bankruptcy Code§ 547 of the c, (3) an actual fraudulent transfer under section 24.005(a)(l) of Texas Uniform Fraudulent Conveyance Act (TUFTA) (through Bankruptcy Code § 544), and (4) a constructively fraudulent transfer under section 24.006(b) of TUFTA. First, the debtor argued that the transfer of the property to the creditor was not "made by a debtor" as TUFTA requires but instead was a transfer made by a third party. The court used TUFTA's expansive definition of "transfer," which makes no distinction between voluntary transfers made by a debtor and involuntary transfers made by third parties. Therefore, TUFTA's broad language defeated the debtor's first argument. Second, the debtor contended that the foreclosure was not a transfer because the property that the debtor foreclosed on was not an "asset." Under TUFTA, the transfer must be of "an asset or an interest in an asset." Tex. Bus. & Com. Code § 24.002(12). The court determined that

a property is considered an asset when the property's value exceeds valid liens encumbering the property. Accordingly, the court rejected this argument because the property was classified as an asset. Next, the debtor argued that a transfer is fraudulent only if it was made in exchange for insider debt. However, TUFTA's language has no insider requirement. The debt must only exist before a debtor's transfer of an interest in the property. The debtor's debt existed before the foreclosure took place, so the court deemed the debtor's third argument invalid. Lastly, the debtor argued that the TUFTA safeharbor provision applies, and he was entitled to the value of the lien on which he foreclosed, but the court held the safe-harbor provision solely applies to good faith transferees. The debtor was not considered a good faith transferee because he lied and misled the creditor about the foreclosure of the property. Thus, the court concluded that the debtor does not qualify for the safe harbor provision and affirmed the lower court's ruling.

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