NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

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ARBITRATION

Arbitration Clauses Are Enforceable Against All Parties to a Contract [TX APP]

The creditor and the debtor entered into a litigation funding contract and security agreement under which the creditor would provide working capital to the firm in exchange for a security interest in future proceeds from cases. The contract contained an Arizona choice of law provision and an arbitration clause. Attached as Schedule E was a separate guaranty agreement in which the debtor's agent (the guarantor) agreed to personally guarantee the law firm's obligations under the contract. The agreement did not contain an arbitration provision, but the contract designated the attached schedules as part of the contract by reference. Alleging breach of contract, the creditor commenced arbitration against both the debtor and guarantor and was ultimately awarded damages. Two years later, the debtor filed a petition in Texas alleging violation of the Texas Deceptive Trade Practices Act and fraud. The creditor filed a motion to compel arbitration that was denied. The creditor then appealed.

In Pravati Cap. III Funding, LP v. Law Offs. of Phillippe & Assocs., No. 13-22-00168-CV, 2023 WL 3369106, 2023 Tex. App. LEXIS 3191 (Tex. App. Corpus Christ [13th Dist.], May 11, 2023) (unpublished opinion), the Texas Court of Appeals for the Thirteenth District held that the trial court had abused its discretion in denying the motion to compel arbitration. It therefore reversed the judgment and rendered an order compelling the parties to arbitrate their claims. The debtor did not dispute the fact that it was a party to the contract containing the arbitration provision or that its claims arose out of or were related to the contract, a requirement to compel arbitration. Therefore, a valid arbitration agreement existed between the creditor and the debtor. The security guaranty agreement was also incorporated by reference into the contract and bound the guarantor to the arbitration provision as well. While Arizona treats guaranty agreements as contracts separate from their related instruments, it can be made clear from the context that the agreements incorporate the terms of another by reference if it is "clear and unequivocable" and calls the attention of the other party to the contract with the arbitration clause. The security guaranty "clearly and unequivocally" referenced the contract, was attached to it, and both documents were executed "at the same time, by the same persons, and for the same purpose." Because there was a valid arbitration agreement, the debtor's claims fell under this agreement, and the motion to compel arbitration should have been granted.

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When Banking on Bankruptcy, Consider Collateral Estoppel [5TH CIR]

The awardee won an arbitration award (award) against the debtor. The debtor then filed for bankruptcy, attempting to avoid paying the award. The awardee objected under Bankruptcy Code § 523(a) and argued that based upon the arbitration award, the debt was not dischargeable. The awardee filed for summary judgment, insisting that the claims could not be discharged in bankruptcy, on the grounds that (1) based on the collateral estoppel doctrine, the award was entitled to preclusive effect, and (2) the award met all elements for nondischargeability required by 11 U.S.C. § 523(a). The bankruptcy court granted summary judgment for most of the award. The debtor argued that the arbitration award had contained a disclaimer (disclaimer) that should have barred the award from having collateral estoppel effect. The awardee argued that the disclaimer was not dispositive, and that the extensive arbitration hearing satisfied the requirements of collateral estoppel.

In Amerson v. McAllen (In re Amberson), 73 F.4th 348 (5th Cir. 2023), the court held that although the arbitration award included the disclaimer, it did not render collateral estoppel inappropriate. The Supreme Court had already ruled that issue

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preclusion applies to bankruptcy dischargeability proceedings, and an abundance of authority applies this rule to arbitration proceedings and awards. After reading the disclaimer, the court determined that the assertions set forth by the debtor were incorrect. The disclaimer referred to a "reasonable award" because that was what the parties had requested, and the arbitrator merely distinguished the award from the formal findings and conclusions that trial courts enter. The arbitrator also had provided assurances that his assessment resulted from a thorough analysis of all arguments, claims, and defenses given by both parties. Nowhere in the disclaimer did the arbitrator indicate any doubt as to his fact finding process or any "express instruction" to prevent future tribunals from granting the award preclusive effect.

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BANKRUPTCY

Dodging Fraud with Bankruptcy? Think Again [BKR ED CA]

The debtor and the creditor entered into a feeding/grazing contract in 2015. By 2017, the debtor had incurred outstanding debt to the creditor. In response, the debtor signed a promissory note to pay the creditor by December 2017. The debtor also signed a security agreement in which he pledged all his property to the creditor to secure the promissory note. Ultimately, the debtor did not make payment upon the promissory note's expiration. The parties met in February 2018 to consider renewing the promissory note. There, the debtor and the creditor's branch manager constructed a financial statement to clarify the debts owed by the debtor. Notably, the debtor failed to disclose all his outstanding debt, rendering the financial statement incorrect. The incorrect financial statement and a renewed promissory note were later sent to the debtor to sign. In May 2018, the debtor signed the renewed promissory note, which was payable by March 2019. However, the debtor never signed the financial statement.

By March 2019, the debtor again did not satisfy his obligations to the creditor. In May 2019, the creditor obtained a default judgment for $193 million in state court. The debtor never paid the judgment, and the creditor claimed the judgment had accrued interest of approximately $254,000. Consequently, in March 2021, the debtor filed this bankruptcy case. In response, the creditor asserted that the state court's judgment was a non-dischargeable debt due to claims of fraudulent transfer, non fraudulent transfer, and conversion. The central issue of this case focused on the analysis of 11 U.S.C. § 523(a)(2)(B), which "bars discharge of debts arising from a materially false statement respecting the debtor's financial condition if that statement is in writing."

In Producers Livestock Mktg. Ass'n v. Del Toro (In re Del Toro), No. 21-10753-B-7, 2023 WL 2700606, 2023 Bankr. LEXIS 777 (Bankr. E.D. Cal. Mar. 28, 2023) (unpublished opinion), The court noted that to "prevail on an exception to discharge claim under § 523(a)(2)(B), the creditor must show:

1. it provided the debtor with money, property, services, or credit based on a written representation of fact by the debtor as to the debtor's financial condition;

2. the representation was materially false;

3. the debtor knew the representation was false when made;

4. the debtor made the representation with the intention of deceiving the creditor;

5. the creditor relied on the representation;

6. the creditor's reliance was reasonable; and

7. damage proximately resulted from the representation."

The first element was not under dispute. The court next looked to see whether the financial statement was false. Given expert testimony and the omission of significant debt from the statement, the court concluded that factor two was satisfied. Third, the court looked at the debtor's non-denial of the hidden debt to satisfy whether he knew the representation was false. Fourth, the court determined that the debtor's efforts for a renewal of terms were also an attempt to receive additional funds and, thus, made false representations to deceive the creditor. Fifth, the creditor relied on the debtor's representation by extending the debtor a secured loan. Sixth, the creditor's reliance was reasonable because the creditor could not easily discover the hidden debt. Lastly, the court noted that though the debtor provided all his property as security, the collateral severely depreciated by the time of the agreement's expiration. Therefore; the court concluded that the debtor's misrepresentation of debt proximately caused the creditor's damages. Accordingly, the court held that the state court judgment was non-dischargeable.

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Does the Debt Have Merit? Take the Test. [BKR ND IA]

The Chapter 1l debtor-in-possession (the "DIP") requested that the court grant its Motion for Authority to Obtain Credit from the bank (the "DIP lender"). An unsecured creditor and the United States Trustee objected to the motion. In order to provide financial support for Chapter 11 debtors-inpossession, 11 U.S.C. § 364(b) may be used to authorize a DIP to incur unsecured debt outside of its normal scope of business while also allowing that debt to be considered an administrative expense, which is entitled to priority. Based on extensive analyses of the pleadings and the key facts of the case, the court found that it should grant the debtor's motion.

In In re BDC Group, Inc., No. 23-00484, 2023 WL4111476, 2023 Bankr. LEXIS 1610 (Bankr. N.D. Iowa 2023) (opinion not yet released for publication), the bankruptcy court applied a three-part test under 11 U.S.C.S. § 364(c) to assess the merits of a debtor's motion to obtain financing: (I) whether the debtor cannot obtain unsecured credit under § 364(c), (2) whether the credit transaction is required to preserve the estate's assets, and (3) whether the transaction terms are reasonable, fair, and adequate considering the circumstances of the debtor and the lender. The debtor could have failed the first element of the test because it did not shop around; however, the statute does not require that a debtor seek credit from every possible outlet before finding that credit is unavailable. A debtor only needs to show that it reasonably tried but failed to obtain such credit. Therefore, the debtor met the first element. Under the second element, the debtor could use DIP financing to reorganize and pay the prepetition wages, which is oftentimes necessary to keep employees from leaving, consequently meeting the second element. Finally, the court found the terms of each transaction to be reasonable, considering the collateral offered to the DIP lender was the debtor's only possible available collateral, thus meeting all three test elements. Based on the debtor meeting the three-element test under 11 U.S.C.S. § 364(c), the court adopted and approved the debtor's interim order for DIP financing.

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Motions for Summary Judgment for Matters of Fraudulent Intent of a Debtor [BKR WD OK]

The debtor's business obtained two loans from the bank, personally guaranteed by the debtor and secured by a first priority security interest in the business's inventory, accounts, general intangibles, and equipment. The bank alleged that the debtor represented that the bank would have a first priority security interest on the business's collateral (after the debtor used the loans obtained to pay off all outstanding loans owed to another bank (the creditor)). However, the debtor provided the creditor with personal financial statements that failed to disclose pre-existing liabilities. As a result of the fraudulent disclosures, the bank could only secure a lower-priority lien on the business's collateral. During the debtor's bankruptcy case, the bank filed an adversary proceeding claiming the debtor could not discharge the bank's loans because the debtor obtained them on false pretenses. The debtor filed a motion for summary judgment (the motion) in which he sought an order dismissing the bank's complaint. In the motion, the debtor asserted that his debt was dischargeable. Moreover, the debtor denied that he had committed fraud to obtain the loan and asserted that he had made no financial misrepresentations. The bank failed to file a response to the debtor's motion.

In First Nat'l Bank & Tr. Co. Weatherford v. Hobbs (In Re Hobbs), No. 22-10330-JDL, 2023 WL 368932, 2023 Bankr. LEXIS 1396 (Bankr. W.D. Okla. May 26, 2023) (opinion not yet released for publication), the court denied the debtor's motion. The court explained that section 523(a)(2)(A) of the Bankruptcy Code provides that a debtor may not be discharged from any debt if the debtor obtained that debt through the intentional use of a written statement that falsely represents the debtor's financial situation to a creditor. Here, the debtor failed to demonstrate that he was legally entitled to summary judgment because he only provided conclusory opinions in his motion. Further, the court clarified that for issues of intent-in this case fraudulent intent-summary judgment is generally not a sufficient resolution because it involves questions regarding a party's intent or state of mind which are issues best left for a fact finder. While the debtor provided statements denying fraudulent intent to support his motion, the court clarified that these statements were not equivalent to affidavits, and it could not consider them when ruling for summary judgment.

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GENERAL BANKING

No Cause of Action for Negligent Lending in Wyoming [WY]

The borrower was a longtime owner and operator of a cattle ranching operation in Wyoming. Amid rebuilding the operation following financial trouble, the borrower accumulated unpaid bills. To pay the bills, the borrower had applied for an agricultural loan from the lender, offering cattle as collateral. The lender originally denied her loan application due to the unpredictability of the cattle market. The borrower applied again and offered a house as additional collateral. The lender accepted her application and provided the borrower two loans to use to operate and grow her cattle ranch. Upon the lender's approval, the borrower acquired additional loans that she also used in her ranching operation. The borrower's business ultimately failed, and she consequently defaulted on her loans. The lender foreclosed on the cattle that the borrower had pledged as collateral. The borrower filed suit against the lender alleging negligent lending and advising, breach of good faith and fair dealing, and breach of fiduciary duty. The lender filed a counterclaim alleging breach of contract and moved for summary judgment. The district court granted the lender's summary judgment motion and entered judgment in favor of the lender. The borrower appealed.

In Wilcox v. Sec. State Bank, 523 P.3d 277 (Wyo. 2023), the Supreme Court of Wyoming affirmed the district court and declined to recognize negligent lending or negligent advising as causes of action because they had not previously been recognized by the court. The court determined that the recognition of a negligent advising claim would result in the imposition of a non-contractual duty on the lender when advising clients. The Wyoming Banker's Association urged the court not to recognize the cause of action because of the negative effects that it would have on lenders and borrowers. Further, the court affirmed the district court's decision to grant summary judgment in favor of the lender on the good faith and fair dealing claim because the borrower failed to identify conduct or contractual text which would have indicated there was an "interference or failure to cooperate" by the lender. Although the court has recognized that a "lender can incur additional duties by conduct that creates a special or fiduciary relationship," the borrower failed to establish the extraordinary circumstances required to impose a fiduciary duty on the lender. Because the borrower clearly admitted that she owed the lender money and was not able to establish "any clear and definite promise" to loan her additional money, the court also affirmed the district court's determination that equitable defenses did not preclude the district court from granting summary judgment on the lender's breach of contract counterclaim.

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GENERAL LENDING

No Contractual Duty of Notice or Good Faith if the Accused Party is a Contract Beneficiary, But Not a Party to the Contract [BKR D CT]

Two debtors experienced massive pasta sales and, to increase production of pasta, secured a loan from the lenders to pay a construction company to build a state-of-the-art facility. The debtors and the lenders executed a credit agreement to this effect, and a mortgage on the debtors' properties secured the loan. However, due to the loss of a $30 million dollar contract and COVID-19, the debtors defaulted both on their loan and in paying the construction company. The construction company executed a mechanics lien for the debt owed. One of the debtors and the construction company executed a consent agreement which subordinated the mechanics lien to the lenders' mortgage. The two debtors entered into bankruptcy under Chapter 11. The construction company sued the lenders to establish its priority in the proceeds from the judicial sale of the debtors' properties. In cross motions for summary judgment, the parties disputed whether the lenders were required to give the construction company notice of the debtors' default on the loan. The construction company contended that the subordination of the mechanic's lien was unenforceable without this notice. In contrast, the lenders argued that the mechanics lien was invalid because the construction company did not give notice that the debtors defaulted under the construction contract.

In Dennis Eng'g Grp., LLC v. People's United Bank, NA (In re Old CP, Inc.), No. 21-20111 (JJT), 2023 WL 108132, 2023 Bankr. LEXIS 4 (Bankr. D. Conn. Jan. 4, 2023) (unpublished opinion), supplemented, No. 21-20111 (JJT), 2023 WL 2333276, 2023 Bankr. LEXIS 546 (Bankr. D. Conn. Mar. 2, 2023) (unpublished opinion), the bankruptcy court found that the lenders were not parties to the consent agreement subordinating the construction company's mechanics lien to the lender's mortgage. Therefore, the consent agreement failed to bind the lenders. Even if the lenders had been bound by it, the court found that a plain reading of the credit agreement showed it did not require the lenders to give notice of default to the

construction company. The court made clear that a non-party to a contract cannot be bound by it. In addition, the court rejected the construction company's claim that the lenders breached a duty of good faith and fair dealing because no such obligation could exist absent a contract. Further, the court rejected the construction company's claim that the lenders committed fraud, explaining there was no misrepresentation because the credit agreement made clear the lenders did not need to give notice. After dispensing with a standing issue, the court granted summary judgment in the lenders' favor on the validity of the subordination agreement because the construction company did not contest it. In a supplemental opinion, the bankruptcy court granted summary judgment in the lenders' favor regarding the validity of the mechanic's lien.

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NEGOTIABLE INSTRUMENTS

Claim on Note Barred by Statute of Limitations [VA APP]

A bank loaned a borrower a sum of money in exchange for a promissory note, set to mature five years after the loan was given. The terms of the note included acceleration if the borrower failed to pay principal or interest and if representations concerning the borrower's finances were incorrect or incomplete. When the borrower failed to make the monthly payments, the bank notified him the due date had been accelerated. In an attempt to discharge his obligation under the accelerated note, the borrower filed for bankruptcy. The bank then filed a complaint objecting to the borrower's discharge. The bankruptcy court denied the borrower's request for a bankruptcy discharge. The bank obtained a confession of judgment, provided in the note documents, and refiled its case in the circuit court. The borrower responded by filing a plea asserting the statute of limitations had expired and sought dismissal of the action. The trial court found that the statute of limitations had not expired. The borrower appealed, claiming the trial court (1) applied an incorrect statute of limitations; (2) erred in its calculation of the date of accrual; and (3) erred in its calculation of the tolling period of the statute of limitations.

In Evans v. TruistBank, 884 S.E.2d 818 (Va. Ct. App. 2023), the Court of Appeals of Virginia affirmed the lower court's decision, in favor of the bank, finding no error. First, the court applied VA. Code Ann. § 8.3A-118, which states that "an action to enforce the obligation of a party to pay a note payable at a definite time must be commenced within six years after the due date or dates stated in the note or, if a due date is accelerated, within six years after the acceleration due date." The borrower entered into an agreement which was made payable at a definite time on a specific date, which was later accelerated due to the borrower's default. Therefore, the circuit court did not err in its application of the six-year statute of limitations. Next, the court discussed the timeline of when accrual begins. The court relied on VA. Code Ann. § 8.01-230, which states that the statute of limitations shall accrue from the date of the breach of contract. Therefore, the trial court did not err in its calculation of the date of accrual. Finally, the court reviewed whether the tolling period of the statute of limitations had been properly calculated. The bankruptcy case tolled the statute of limitations for four hundred ninety-one days. Having allowed the bankruptcy case to conclude before re-commencing the statute of limitation period, the court properly calculated the tolling period.

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No Indorsement, No Enforcement: Requirements for Enforcement of Lost Mortgage Notes [BKR PR]

The debtor filed a bankruptcy petition, listing the creditor as a secured claimant. The debtor proposed a Chapter 13 plan to pay the arrears on the creditors' claim. In response, the creditor filed an amended proof of claim for a secured mortgage and attached two lost note affidavits. The affidavits disclosed that the creditor had previously purchased the mortgage notes but did not have physical possession of the notes, despite its efforts to locate them. The debtor argued that because the creditor had no indorsed notes, the creditor was not a holder in due course of the notes, and therefore was not entitled to payment in the case. The creditor then filed a motion for summary judgment as to the debtors' proposed treatment of its claim and claimed that the lost note affidavits were sufficient ownership of the notes.

In In re Pagan, No. 21-02951, 2023 WL 2435680, 2023 Bankr. LEXIS 611 (Bankr. P.R. March 9, 2023) (opinion not yet released for publication), the bankruptcy court denied the creditor's summary judgment motion. The court found that the copies of the lost notes submitted by the creditor did not contain an indorsement by the transferor to the order of the creditor, meaning that the mortgage notes appeared not to have been negotiated to the creditor. Applying Puerto Rico law, the court ultimately held that because the creditor did not have possession of the mortgage notes, was not a holder in due course of the notes, and because of the missing indorsements, the creditor was not entitled to enforce the mortgage notes.

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Changes in Loan Servicers Does Not Diminish Entitlement to Enforce [OH APP]

A man (mortgagor) purchased a residential property financed by a loan from a bank (bank l). Bank l initially acted as both owner and servicer of the loan. One year later, the mortgagor refinanced the property. Subsequently, mortgage service corporation became the new owner and servicer of the mortgagor's loan. The mortgagor defaulted on the loan. The mortgage service corporation sent the mortgagor a notice of intent to foreclose after a month had elapsed without payment. The mortgagor ceased his scheduled monthly payments. The ownership of the mortgagor's loan sold to another bank (bank 2), with the mortgage service corporation retaining its servicing responsibility. Bank l endorsed the note and left it in possession of the custodial bank of the mortgage service corporation. Three monthslater, the mortgage service corporation filed a foreclosure complaint against the mortgagor. During this time of constant loan transfers, the mortgagor claimed that the mortgage service corporation continually gave him incorrect information regarding his loan, leaving him confused and unable to pay it. However, the court granted summary judgment and a decree to foreclose to the mortgage service corporation on the grounds that the mortgagor signed the note and failed to make his payments as stipulated. The mortgagor appealed, claiming that (1) the custodial bank of the mortgage service corporation, not the mortgage service corporation possessed the note, therefore the mortgage service corporation could not enforce the note and (2) that the entry of judgment and decree to foreclose were inequitable because the mortgage service corporation sent him conflicting and inaccurate information regarding the status of his loan.

In Carrington Mortg. Servs., LLC v. McClain, 2023-Ohio-22 l l (Ohio Ct. App. 2023), the court affirmed the summary judgment and decree to foreclose. First, the court stated that an entity must be in possession of a note to enforce it, but Ohio's Uniform Commercial Code (UCC) failed to specifically define "possession." The court reasoned that possession included constructive possession. The court determined that because the custodian bank of the mortgage service corporation possessed the note, the mortgage service corporation was authorized to enforce it. Because the mortgagor provided no evidence that a genuine issue of material fact existed, the trial court did not err in granting summary judgment. The court also found that while the mortgage service corporation sent inaccurate information regarding the loan, the entry of judgment and decree to foreclose were equitable because the mortgage service corporation immediately corrected most of its mistakes and mailed corrected documents.

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Statute of Limitations: Acceleration is the Standard [OK]

A mortgagor initially obtained an installment loan from a bank. A mortgage secured the promissory note. Ten years later, the bank filed a petition to foreclose the mortgage, alleging that the mortgagor had defaulted on the loan. The bank asserted it had elected to accelerate the debt and declared the full balance due. The bank later voluntarily dismissed the action. After several transfers, an investment group became the holder of the note and sent the mortgagor a notice of intent to foreclose. The investment group then brought an action against the mortgagor for defaulting on the loan and the investment group accelerated the loan. The investment group and the mortgagor filed motions for summary judgment. The mortgagor argued the statute of limitations barred the investment group's claim because the bank had accelerated the debt more than six years earlier. The investment group argued that because the bank had dismissed its foreclosure action, the note decelerated as a matter of law.

In MTGLQ Inv., L.P. v. Witherspoon, 532 P.3d 21 (Okla. 2023), the Supreme Court of Oklahoma held that for installment loans, the statute of limitations begins against each installment on the day following maturity. Acceleration clauses give the mortgagee an option to accelerate a loan, making the loan due immediately. The statute of limitations, therefore, begins to run on the date the acceleration option is exercised. Specifically, the statute of limitations runs for six years after the accelerated due date of the loan, not six years after the mortgagor's default. The bank had accelerated the loan when it filed the petition to foreclose. The court held that the statute of limitations therefore had not expired on the foreclosure action. The court then determined that the bank had decelerated the loan upon its voluntary dismissal of the foreclosure action. The court the rejected mortgagor's assertion that a deceleration clause is necessary to decelerate. To decelerate, the mortgagee is required to make an affirmative act that indicates an intent to decelerate. The bank's voluntary dismissal of its foreclosure action was the affirmative act necessary to indicate intent to decelerate. Notice of the dismissal is notice of deceleration. Because the bank's first foreclosure action served as sufficient notice that the loan had been accelerated, the notice of dismissal of the action served as sufficient notice of deceleration. The mortgagor was put on notice of the dismissal. Therefore, the statute of limitations did not bar the investment group's action for foreclosure.

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SECURITY INTERESTS

Cross Your T(s), Dot Your I(s), and File Security Interest Notices in the State of Title [BKR D KS]

The creditor obtained a security interest in a vehicle with a California title owned by the debtor. The creditor filed a notice of security interest in Kansas, where the debtor resided, but never filed a title transfer application in California, not did the debtor attempt to have the vehicle titled in Kansas. Later, the debtor declared Chapter 7 bankruptcy, and the creditor attempted to have its security interest in the vehicle recognized in the bankruptcy case. The Chapter 7 trustee (the trustee) filed an adversary proceeding against the creditor, attempting to avoid the security interest under 11 U.S.C. § 544(a)(1), which gives the trustee power to "avoid any security interest that would be voidable by a creditor who obtained a judicial lien on the petition date." The rights of the creditor are determined under state law. The trustee subsequently filed a motion for summary judgment on his claim.

In Hamilton v. Glob. Lending Servs., LLC (In Re Williams), Nos. 22-06041, 21-21115, 2023 Bankr. LEXIS 1194 (Bankr. D. Kan. Apr. 28, 2023) (opinion not yet released for publication), the Bankruptcy Court ruled in favor of the trustee, granting the motion for summary judgment to avoid the creditor's secured interest in the vehicle. Citing a Kansas statute to determine the law to apply, the court determined the local law of the title state controls the perfection of the security interest. Because the title state of the vehicle was California, § 6301 of the California Vehicle Code (the CVC) ultimately "governs perfection, the effect of perfection..., and the priority of security interests in this dispute." The CVC dictates that the creditor must record its vehicle security interest in California to perfect its security interest. Because the creditor recorded the interest in Kansas, and not in California, the security interest in the vehicle was unperfected. Finally, the California Commercial Code dictates that an "unperfected security interest is subordinate to the rights of a [trustee]," giving the trustee power to avoid the creditor's security interest on behalf of the bankruptcy estate.

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Incorrect Filing Results in Unperfected Security Interest [BKR D KS]

In a Chapter 7 Bankruptcy, the bankruptcy trustee started an avoidance action against the bank. The trustee claimed the bank's security interest in the debtor's car was unperfected. The issue arose because the debtor financed the original car purchase with a first creditor and then refinanced with the bank. After the bank refinanced the auto loan, it submitted a security interest application and paid an associated $2.50 fee through the Kansas Department of Revenue's (KOOR) electronic lien system, giving notice of security interest. On the KOOR E-lien system, the bank had the option to file a lien by submitting one of three options: (1) a security interest application, (2) a secured title application, and (3) a refinance secured title application. The bank needed to file the third option with its associated $10.00 fee to properly secure perfection of the refinanced loan but failed to do so.

In Williamson v. Southwind Bank (In re Anstaett), 651 B.R. 911 (Bankr. D. Kan. 2023), the bank sought summary judgment on the trustee's avoidance claim. The court denied the bank's motion and asserted that it did not properly perfect its security interest. The court determined that the Kansas Motor Vehicle Registration Act indicates three elements for proper perfection: (l) delivery of the surrendered title, (2) application submission, and (3) tender of the required fee. It includes the language, "A lien in violation of this provision is void." So, the bank's filing of the inapplicable electronic security interest application and then paying the incorrect fee failed to comply. Failure to follow the above provisions made the lien void. In its defense, the bank invoked the substantial compliance doctrine, which says a court can "recognize a security interest as perfected despite failure to strictly comply with the requirements of state law, so long as the creditor's interest is adequately noticed." Typically, the court will apply this doctrine in cases where a creditor files a correct application that contains an error. The court declined to extend the doctrine here, where the creditor filed an entirely incorrect application. Due to the plain language of the Kansas Statute, the court held that the bank in no way complied with the necessary elements for perfecting the security interest.

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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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