NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

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BANKRUPTCY

*5th Circuit Punts on Deciding "Unsettled Questions in Bankruptcy Law." [5TH CIR]

During a bankruptcy case, a bankrupt company (the "debtor") sought to enforce a contract it believed to have been made with a leasing company. The alleged contract consisted of email communications discussing the potential sale of a property. The debtor was renting a property, and the lessor expressed interest in selling that property to the company. The owner of the debtor responded, reciprocating interest, but made no other communications. Years later, the debtor sought to enforce the contract in its bankruptcy case. The leasing company resisted, and the court agreed that the emails did not form a valid contract. On appeal, the district court affirmed the bankruptcy court's ruling. The debtor then appealed to the 5th Circuit, arguing the contract was valid. However, the bankruptcy court had dismissed the underlying bankruptcy case. The leasing company argued that "the relief sought by [the bankrupt company] require[d] remand to the bankruptcy court." Thus, the dismissal of the bankruptcy case made it "impossible for [the court] to grant relief." The leasing company based its argument on the "doctrine of equitable mootness," which the bankrupt company argued was inapplicable because the issue of a valid contract "involves a matter ancillary to the bankruptcy." Therefore, the circuit court had two issues to resolve. The first was whether the case before it was moot, and the second was whether the email communications constituted a valid contract.

In Texxon Petrochemicals, L.L.C. v. Getty Leasing, Inc. (In re Texxon Petrochemicals L.L.C.), 67 F.4th 259 (5th Cir. 2023), the Fifth Circuit declined to decide "unsettled questions in bankruptcy law," including whether the bankruptcy court should decide the "validity of the contract in the context of a motion to assume." The court stated that neither party had raised the issue, and because it could "affirm on the merits," a ruling on mootness was unnecessary. Concerning the contract's validity, the court upheld the district court's ruling that the emails did not constitute a contract because they failed to "demonstrate an offer and acceptance" and was unclear on the exact contractual tem1s, including the specific property that was the subject of the sale. The court noted that the mere interest expressed by both parties was insufficient. The Fifth Circuit affirmed the district court's ruling and reasoned that the Debtor had failed to carry its burden in establishing that the two companies had formed a contract.

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CFPB

Constitutional or Not? Banks Await Supreme Court's CFPB Decision [ED KY]

On March 30, 2023, the Consumer Financial Protection Bureau (the agency) issued the Small Business Lending Rule (the Rule). When Congress amended the Equal Credit Opportunity Act through Section 1071 of the Consumer Financial Protection Act, financial institutions were required to gather thirteen data points about their small business lending, some of which included the applied amount, how the application was submitted, annual revenue of the business, race, sex, and ethnicity of the principal business owner, and reasons for denial of the loan. The Rule was brought into effect on August 29, 2023. However, compliance is not required until the rule takes full effect on January 1, 2026. Seven Kentucky state-chartered banks, one national bank operating in Kentucky, and the Kentucky Bankers Association moved for a preliminary injunction to enjoin the agency from implementing and enforcing the Rule. The banks argued that the agency's funding structure violated the United States Constitution's separation of powers because the agency issued the Rule with funds obtained from "unconstitutional sources." Thus, because unconstitutional sources funded the Rule, the Rule itself must be unconstitutional.

In Monticello Banking Co. v. Consumer Fin. Prot. Bureau, No. 6:23-cv-00148-KKC, 2023 WL 5983829, 2023 U.S. Dist. LEXIS 163226, (E.D. Ky. Sept. 14, 2023) (opinion not yet

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released for publication), the United States District Court for the Eastern District of Kentucky granted the banks' motion fora preliminary injunction. The court looked at four factors: 1) the banks' likelihood of success on the merits; 2) irreparable harm to the banks without injunctive relief; 3) substantial harm to other banks resulting from an injunction; and 4) public interest. To address the first factor, the court weighed its decision by looking at the Appropriations Clause of the U.S. Constitution. The court considered whether the agency's funding comports with the Appropriations Clause by considering other courts' decisions on the merits. For example, the Fifth Circuit had held that the agency's methods were unconstitutional because it "receives funding directly from the Federal Reserve, which is itself outside the appropriateness process." In contrast, the Second Circuit had explicitly disagreed with the Fifth Circuit and held that the agency's funding method was constitutional under the Appropriations Clause. The Supreme Court is scheduled to resolve this circuit split by determining whether the Rules funding is constitutional by 2024.

For the second factor, the court considered whether the banks would be harmed without an injunction. The banks were able to provide information that showed they had incurred unrecoverable expenses as a result of the Rule. Additionally, a previous Supreme Court case weighed in favor of the second factor because Justice Scalia had noted in that decision that unrecoverable incurred compliance costs almost always produce irreparable harm. The third and fourth factors carried little weight in the court's decision because the Rule had not yet taken full effect. The court reasoned that because banks did not have to comply with the Rule yet, the agency would not suffer harm for the time being, and the public would not lose any benefit by the court issuing a preliminary injunction. Meanwhile, while the banks await the Supreme Court's decision on whether the Rule is unconstitutional, the court acknowledged that the banks would have incurred unrecoverable expenses. Therefore, the district court granted the banks' motion for injunctive relief and enjoined the agency from enforcing the Small Business Lending Rule under the Supreme Court's ruling of whether the funding method is constitutional.

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FCRA

Maybe You Did Discharge the Debt [D.Ala.]

Plaintiff sued her lender, contending that her debt to the lender had been discharged but that nevertheless the debt was reported to a credit agency as not having been discharged. Plaintiff alleged that the lender had given it IRS Form 1099-C to supply to the IRS indicating that the debt had been discharged. Later, Plaintiff discovered that her credit report did not indicate that the debt had been discharged. For that reason, Plaintiff submitted a written dispute to a credit reporting agency and that dispute was forwarded to the lender, Plaintiff contended that, nevertheless, the lender failed to investigate its complaint that the reporting to the credit agencies was inaccurate. Accordingly, plaintiff commenced this action under 15 U.S.C. § 168ls-2(b) of the Fair Credit Reporting Act ("FCRA") against the lender and a credit reporting agency. The lender moved to dismiss the complaint.

In Hollingsworth v. Discover Bank, No. 23- 00184-KD-B, 2024 U.S. Dist. LEXIS 10975 (S.D. Ala. Jan. 22, 2024), adopted by Hollingsworth v Discover Bank, 2024 U.S. Dist. LEXIS 22183 (S.D. Ala. Feb.8.2024), the magistrate's recommendation was that the complaint should not be dismissed. The magistrate acknowledged that there were some cases that hold that the mere giving of IRS Form 1099-C to a debtor does not establish that the debt has been discharged. However, the magistrate concluded that at this early stage it was too soon to conclude that in fact the debt had been discharged, because Plaintiff had plausibly alleged that the debt had been discharged.

By the Editors.

LENDING

*Excuses... Excuses: Fear of a Potential Scam Does Not Justify Non-Payment [SD TX]

The debtors purchased a home and signed two mortgage notes to cover the cost of the house. The Senior Loan covered 85% of the total price of the home, and the Junior Loan covered 15% of the price. To grant security for the loans, the debtors executed a deed of trust. Later, another creditor purchased the Junior Loan. The new creditor "charged off" the loan, writing it off as a loss, and sold the debt to a collection agency. Multiple creditor companies bought and transferred the loans several times over several years. Subsequently, the debtors received notice that the current creditor had changed the loan status from "charged-off" to "accelerated." The loan began accruing interest, and the creditor created a payment schedule. However, the debtors did not pay,

believing the notices related to the Junior Loan were a scam. The debtors received notice of foreclosure on their property, with nonpayment cited as the reason. The creditors auctioned off the property; however, the debtors avoided the foreclosure by purchasing the foreclosure debt. The debtors sued the various creditors and holders of the mortgage note for statutory violations of the Texas Debt Collection Act (TDCA), Deceptive Trade Practices Act (DTPA), Texas Civil Practice & Remedies Code (TCPR), Truth of Lending Act (TILA), and fraud. The creditors moved both to dismiss the case and for judgment on the pleadings.

In Annor v. PHH Mortg. Servs., LLC., No. 4:22-CV-02202, 2023 WL 7926810, 2023 U.S. Dist. LEXIS 205206 (S.D. Tex. Nov. 16, 2023) (unpublished opinion), the court granted all motions in favor of the creditors. On the TDCA claim, the debtors argued the creditor both failed to disclose the identity of the assignee of the Junior Loan and misrepresented the extent or amount of that loan. However, the debtors failed to adequately plead fraudulent behavior on the part of the creditor, so the court dismissed the claim. Regarding the debtor's TCPR claim, the court dismissed it because the debtors lacked standing to challenge the assignment of the loan because they had not been parties to the assignment. The debtors argued they were "consumers" under the DTPA, but the court disagreed because the debtors failed to base their claim on the original transaction. The court dismissed the debtors' fraud claims due to the undisputed facts of the nonpayment, and the court characterized the debtors' reasons for ignoring the notices as "simply excuses." Finally, the court granted judgment on the pleadings for the TILA claim, noting that the creditor's statute of limitations argument was uncontested because the debtors had failed to challenge the creditor's motion.

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Pro Se Plaintiff Fails to State a Claim Under the Federal Reserve Act [ED TX]

The applicant applied for a car loan and a credit card from the bank. The bank denied both applications, and the applicant sued believing the bank had no legitimate reason to deny the loan. The applicant, proceeding pro se, argued the court had federal question jurisdiction under the Federal Reserve Act (the Act). Alternatively, the applicant argued the court had diversity jurisdiction and provided the court with a California address of the bank. The applicant also requested to proceed in forma pauperis under 28 U.S.C. § 1915(e).

In Mims v. Bank of Am., No. 6:23-cv-581- JDK-JDL, 2023 WL 8804324, 2023 U.S. Dist. LEXIS 226577 (E.D. Tex. Dec. 20, 2023) (unpublished opinion), the district court ruled against the applicant. First, the court held the applicant had failed to establish federal question jurisdiction under the Act because (1) the applicant was an individual rather than a banking institution, and (2) the applicant grounded his suit in provisions of the Act that do not create a private right of action. Second, the court held the applicant had improperly pled diversity jurisdiction. Although the applicant alleged $300,000 was the amount in controversy, he failed to plead why he would be entitled to that amount. The applicant based the $300,000 figure off a calculation of 1% per day interest of an asset owned by the bank, yet he failed to identify the asset. Therefore, the applicant had failed to state a claim upon which relief could be granted, and the court rejected his in forma pauperis request on that basis. The court refused to allow the applicant to amend his complaint and dismissed the applicant's claims without prejudice.

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Can Creditors Discriminate Based on DACA Status? [ND CA]

A credit union filed a motion to dismiss a loan applicant's (the applicant) suit, which challenged the credit union's denial of a loan application based on immigration status. The applicant had applied for a loan with the credit union and had been pre-approved. However, the credit union then requested that the applicant provide documentation showing either her visa holder, permanent resident, or naturalized citizen status. When the applicant informed the credit union of her DACA status, the credit union responded that it does "not lend on DACA status." The applicant then received notice that her application had been denied, which indicated that she had been denied solely due to her immigration status. The applicant filed a lawsuit alleging that the denial was alienage discrimination under 42 U.S.C. § 1981 and violated the Unruh Civil Rights Act (Unruh Act) under Cal. Civ. Code § 51. In its motion to dismiss, the credit union argued that (1) the Equal Credit Opportunity Act (ECOA) and Regulation B displaced the Section 1981 action for credit discrimination; (2) the ECOA preempted the Unruh Act; and (3) the complaint failed to state a claim under both Section 198 l and the Unruh Act.

In Camacho v. Alliant Credit Union, No. 22-cv-01690-BLF, 2023 WL 149999, 2023 U.S. Dist. LEXIS 4322 (N.D. Cal. Jan. 10, 2023) (opinion not yet released for publication), the U.S. District Court for the Northern District of California denied the credit union's motion to dismiss. First, the court found that

the ECOA and Regulation B did not displace a Section 1981 action. The court followed the holdings of the courts in both Juarez and Perez, which stated that the rule is to give effect to both acts - Section 1981 prohibits creditor discrimination on the basis of alienage, and the ECOA prohibits creditor discrimination on additional grounds. Juarez v. Soc. Fin., Inc., No. 20-cv-03386-HSG, 2021 WL 1375868, 2021 U.S. Dist. LEXIS 70430 (N.D. Cal. Apr. 12, 2021); Perez v. Wells Fargo & Co., No. l 7-cv-00454-MMC, 2017 WL 3314797, 2017 U.S. Dist. LEXIS 122772 (N.D. Cal. Aug. 3, 2017). Further, the court reasoned that the legislative purpose of the ECOA was not to repeal Section 1981. Next, the court held that the ECOA did not preempt the Unruh Act for primarily the same reason that it did not displace Section 198 l: the two can exist simultaneously. Despite alienage and residency status not being listed in the ECOA, the court found that it did not authorize creditors to discriminate on such grounds. Applicants are still protected against any discrimination afforded under other statutes, such as alienage and residency status under the Unruh Act. Finally, the court held that the applicant had not failed to state a claim under Section 1981 or the Unruh Act.

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SECURITY INTEREST

*You Better Pay the Assignee! [TX APP]

An investigation and security company (the company) provided security services for a debtor in Houston, Texas. Later, a factoring company (the purchaser) acquired accounts that owed payments to the company. One of the accounts acquired reflected obligations of the debtor. The debtor, in accordance with a factoring agreement between the company and the purchaser, was to make payments directly to the purchaser instead of to the company. Although the original term was for one year, the "term" of the factoring agreement was continuous and renewed for successive one-year periods unless either party gave notice of termination. Initially, the debtor made direct payments to the purchaser because the company had provided the debtor with a notice of assignment. The notice indicated that the company assigned the purchaser the right to collect payment on "present and future account receivables existing between [the debtor] and [the company] and that future payment should be directed to [the purchaser] ... [and would] remain in effect until [the purchaser] provided written notification withdrawing the notice." Upon the company's request, the debtor stopped making payments to the purchaser and resumed. payments to the company. The purchaser sued the debtor for breach of contract to recover the amount unpaid invoices and filed a motion for summary judgment. The debtor also filed a motion for summary judgment stating the purchaser had no security interest in the unassigned invoices from the company and that the notice was not a binding obligation with respect to other invoices that had not been assigned. The debtor further argued that a written agreement, entered by the purchaser and the company, allowed payment to be made to either party. The purchaser claimed, however, that UCC § 9.406(a) applied, requiring the debtor to pay its invoices to the purchaser, and that the notice of assignment included a security interest. The trial court denied the purchaser's motion, granted the debtor's motion for summary judgment, and dismissed the purchaser's claim against the debtor with prejudice. The purchaser appealed.

In lnterflow Factors Corp. v. Hilton Holdings, LLC, No.·09-22 00376-CV, 2023 WL 6631907, 2023 Tex: App. LEXIS 7797 (Tex. App.--Beaumont Oct. 12, 2023) (opinion not yet released for publication), the court reversed the trial court's summary judgment in favor of the debtor, approved the purchaser's summary judgment motion, rendered judgment in favor of the purchaser, and remanded the case to the trial court to determine necessary fees· and costs. The debtor claimed that "the agreement did not qualify as a security agreement or sufficiently identify the collateral securing the loan." The agreement included a section titled "Security," which provided that the debtor agreed to any future indebtedness or obligation. The agreement also listed a continuing security interest in the "Collateral," which included all the present and future accounts. Therefore, the court concluded that a security agreement and collateral had been established. The debtor also claimed that the notice did not obligate payment on unassigned invoices and that "UCC § 9.406(a) did not apply to the purchaser's claimed lien on unassigned accounts." The court concluded that the debtor's second and third claims were not entitled to judgment as a matter of law because the UCC explained that "assignment" included the transfer of rights to liens and other security interests." Regarding the written agreement, the court concluded it was immaterial because the debtor was not a party to the agreement nor a third-party beneficiary of the agreement. The court stated the debtor made payments to the servicer "at its own peril and failed to discharge its debt" to the purchaser. Furthermore, the debtor was aware of the notice and payment demands from the purchaser.

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Criminal Liability for False Financing Statement (Even Against a Pseudonym) [4THCIR]

The debtor owed a substantial amount to the Internal Revenue Service (IRS) in past-due taxes. After exhausting ordinary collection remedies, the IRS agent assigned to the case, operating under a pseudonym, tried to contact the debtor. When that failed, the agent instructed the debtor's employer to garnish his wages. After learning of this, the debtor filed a fraudulent lien documentation against the agent, but he filed the financing statement and other documents using the agent's pseudonym. In a later investigation, the debtor admitted the fraudulent lien was the only way he could "get the IRS to leave him alone" and knew of the potential detrimental effect on the agent's credit score. The debtor was charged with attempting to file a false lien against a federal employee in violation of 18 U.S.C. § 1521 as well as attempting to interfere with the administration of internal revenue laws in violation of 26 U.S.C. § 7212. The debtor appealed, contesting the sufficiency of evidence supporting both convictions along with the sentencing enhancements.

In U.S. v. Reed, 75 F.4th 396 (4th Cir. 2023), the court upheld the conviction of the debtor because substantial evidence supported the jury's verdict. First, the debtor claimed his conviction for attempting to file the false lien was invalid because he had filed the lien against the agent's pseudonym. He alleged 18 U.S.C. § 1521 did not apply to fictitious persons and that the pseudonym was not an "individual" as defined in the statute. The court rejected this argument, explaining that the agent was still a real person, thus satisfying the definition of "individual" in the statute. Second, the debtor argued he had not violated the Omnibus Clause of 26 U.S.C. § 7212(a) because the agent's investigation did not qualify as "targeted administrative action." The court disagreed, pointing to evidence that the agent's enforcement efforts qualified as more than the routine work of the IRS. Significantly, the debtor admitted he tried to interfere with the agent's federal tax law administration only after he had failed to stop normal collection attempts. The court found no clear error in the district court's sentencing enhancements due to the debtor's intent to obstruct the administration of justice by carrying out his threats. Both the debtor's actions and statements justified the enhancements. Thus, the Court of Appeals affirmed the conviction of the debtor on both counts with all sentencing enhancements.

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Verbal Objections Do Not Rise to Breach of Peace Claim [2D CIR]

The debtor failed to make the necessary payments for her vehicle, leading the creditor to engage a towing company for repossession. On the day in question, the debtor encountered the towing company's vehicle blocking her car when she was at the mail. An employee of the towing company informed the debtor that he was repossessing the car, and she verbally objected to the repossession. The employee then called for a tow truck, and while awaiting the tow truck, the debtor verbally objected once again, stating that she needed to get to the hospital for her son's treatment. The employee permitted her to take her son to the hospital. However, he told her that if she attempted to flee, he would call the authorities. When she reached the hospital, the debtor verbally objected to repossession for the third time. The employee informed her that if she refused to relinquish the keys to her vehicle, the company would fine her.: The debtor relinquished her keys, and the company repossessed the vehicle. The debtor sued the towing company, alleging breach of peace under Section 1692f(6) of the Fair Debt Collection Practices Act (FDCPA). The District Court of New York granted the towing company's 12(b)(6) motion, dismissing the debtor's complaint with prejudice for failure to make a claim. The debtor appealed.

In Labadie v. NU Era Towing & Serv., Inc., No. 22-2064-cv, 2023 WL 8708421, 2023 U.S. App. LEXIS 33407 (2d Cir. Dec. 18, 2023) (unpublished opinion), the United States Court of Appeals for the Second Circuit affirmed the decision of the District Court of New York, dismissing the debtor's complaint for failure to state a claim. Section 1692f(6) of the FDCPA prohibits debt collectors from employing "unfair or unconscionable means to collect or attempt to collect any debt," which includes "taking or threatening to take any nonjudicial action to effect dispossession or disablement of property." Yet, under New York law, a secured party can repossess collateral without judicial process, provided it does not breach the peace. The New York Court of Appeals defines breach of the peace as "disturbance of public order by an act of violence, or an act likely to produce violence... causing alarm, disturbing the peace and quiet of the community." The debtor's grounds for supporting her claim rested upon her verbal objections, which the employee had ignored, and that the employee had mentioned the possibility of involving the police if she attempted to flee. Legal precedent in New York provides that the absence of consent to repossession does not amount to a breach of peace. Consequently, the Court of Appeals upheld the ruling of the New York District Court, because the debtor's claim lacked legal merit.

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TILA

Too Bad You Didn't Get the Loan [ED Mo.]

Plaintiff brought an action pro se complaining that the bank failed to give him an automobile loan. He moved for an order allowing him to proceed without prepaying the filing fee. The court noted that under 28 U.S.C. § 1915(e)(2) a court must "dismiss a complaint filed in forma pauperis i[it is frivolous, malicious, or fails to state a claim upon which relief may be granted." The court noted that, under Neitzke v. Williams, 490 U.S. 319, 328 (1989), an action is considered to be frivolous when it "lacks an arguable basis in either law or fact."

In Garrison v. .IP Morgan Chase, No. 4:23- CV-1521 PLC, 2024 U.S. Dist. LEXIS 10794 (E.D. Mo. Jan. 22, 2024) the court granted the motion to proceed in forma pauperis and then, having reviewed the complaint, dismissed the action. The court noted that the pro se plaintiff had been unclear as to what statute or statutes he was claiming had been violated, but the court concluded that he most likely was claiming that the Equal Credit Opportunity Act, 15 U.S.C. § 1691, and the Truth in Lending Act ("TILA") had been violated. Having so concluded, the court noted that the plaintiff had only made a generalized complaint and had not met the requirements of the Equal Credit Opportunity Act. Moreover, he had failed to indicate under what section of TILA he was bringing the action. Case law indicates that a TILA complaint may be dismissed when it fails to specify the sections of TILA that have been violated. Accordingly, the court also dismissed the complaint.

By the editors.

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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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