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SYLVESTER & STAMELMAN LLP

BANKING ALERT

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Divided United States Supreme Court Affirms Eighth Circuit Decision on Definition of "Applicant" Under ECOA

In its first decision since the death of Justice Antonin Scalia, an equally-divided United States Supreme Court affirmed the lower court decision in *Hawkins v. Community Bank of Raymore*, 761 F.3d 937 (8th Cir. 2014). In *Hawkins*, the United States Court of Appeals for the Eighth Circuit held that a spouse, who was a co-guarantor of a loan given to her husband by the defendant bank, could not maintain a claim against the defendant bank under the Equal Opportunity Credit Act, 15 U.S.C. § 1691 ("ECOA"). Specifically, the Eighth Circuit found that a co-guarantor of a loan does not qualify as an "applicant" under ECOA and, as a result, does not have standing to pursue a claim in her own right under the statute.

The Eighth Circuit's decision is at variance with other courts that have ruled on the issue. Most recently, the Sixth Circuit held that ECOA did extend protection to guarantors. Relying on the regulatory definition of "applicant" promulgated by the Federal Reserve Bank, 12 C.F.R. § 202(e), the Sixth Circuit joined the Third and First Circuits as recognizing a broader definition of "applicant" for the purposes of determining whether a guarantor can proceed with a claim under ECOA.

While the United States Supreme Court affirmed the decision in *Hawkins*, the single sentence opinion of the divided court has no precedential value and does not resolve what has become a growing circuit split over which parties have standing to pursue a claim under ECOA.

New York Supreme Court Finds Party Did Not Perfect Its Security Interest in Creditor's Bank Account

In *In re 140 W. 57th St. Bldg. LLC*, the New York Supreme Court decided a dispute over priority with respect to bank account. Petitioner 140 W. 57th Street Building LLC ("140") sought to enforce a $2,156,165.17 Judgement (the "Judgment"), entered in its favor against non-party Kate's Paperie, LLC, Kate's Paperie Ltd. and K.P. LLC (collectively, "Kate's"). In aid of enforcement of the Judgment, 140 delivered to the Marshall an Execution and directed the Marshall to levy upon and conduct a sale of Kate's assets, and served a Restraining Notice, Information Subpoena and Execution upon respondent TD Bank. In response to the Marshall's levy

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Office Locations

New Jersey
210 Park Avenue
2nd Floor
Florham Park NJ 07932
973.302.9700

New York
54 W. 40th Street
New York NY 10018
212.763.6464

Follow Sherman Wells on
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on Kate's assets, Russ Teddy Bear Investments LLC ("Russ") commenced a related special proceeding, pursuant to CPLR 5239, for an order vacating the Marshall's levy and declaring that Russ has a priority interest over 140 with respect to Kate's collateral. Russ's claim was premised upon a security interest granted by Kate's in April 2012 and a UCC-1 Financing Statement that Russ filed against Kate's on May 23, 2012. The Court denied Russ' motion for a preliminary injunction finding there was a question of fact on the issue of priority.

TD Bank Responded to 140's Information Subpoena and advised that it held a deposit account in Kate's name, with a balance of $40,147.22. TD Bank placed a restraint on that account. 140 commenced the special proceeding for an order, pursuant to CPLR 5225 and 5227, directing TD Bank to turnover the funds in the account and extend priority to 140's Judgment. Russ intervened and argued that it has a perfected security interest in Kate's collateral and that the funds in the TD Bank account are "identifiable proceeds from the sale" of such collateral, thereby giving Russ priority over the account. In support, Russ submitted an affidavit stating that Russ had a perfected security interest in Kate's collateral to secure payment of over $5 million in loans prior to the entry of the Judgment and the Marshall's levy, and that Kate's, at the direction of Russ, had liquidated the collateral and deposited the funds in Kate's TD Bank account. 140 argued in reply that Russ did not have a perfected security interest in the account because it did not take possession and control of the account as required by UCC §§104 and 314.

Citing UCC §9-314(a), which provides that a security interest in a deposit account "may be perfected by control," the Court found that Russ did not perfect its security interest: (1) Russ is not the bank; (2) it did not offer an "authenticated record" between itself, Kate's and TD Bank evidencing Kate's consent to Russ's disposition of the funds in the account; and (3) it failed to offer any other evidence showing that it exercised control over the account.

The Court also noted that a security interest in a deposit account may also arise where a secured interest in collateral has attached, and the secured party shows that such deposit account contains "identifiable proceeds of [such] collateral." The Court found, however, that Russ failed to demonstrate that the TD Bank account contained identifiable proceeds of the sale of such collateral. Ultimately, the Court found that 140 could attach the TD Bank account in partial satisfaction of its Judgment and ordered a turnover of the funds to 140. The Court declined to issue a blanket order on any other TD Bank accounts until Russ had the opportunity to demonstrate that the account contained identifiable proceeds of the sale of Kate's collateral.

Bankruptcy Appellate Panel Finds Release In Forbearance Agreement Provide Bank With Complete Defense

In *MERV Properties, L.L.C. v. Forcht Bancorp., Inc.* 2015 WL 5827775, 61 BCD 170 (Bankr. 6th Cir. 2015), the 6th U.S. Circuit Bankruptcy Appellate Panel (BAP) affirmed summary judgment entered by the bankruptcy court for the Eastern District of Kentucky in favor of defendant bank on plaintiff borrower's fraud and collusion claims.

In *MERV Properties, L.L.C.*, plaintiff, a limited liability company, obtained a loan from the bank for the purpose of purchasing and renovating a mall. The loan was guaranteed by four guarantors: two individual members of plaintiff LLC, a corporate member of the LLC and a nonmember spouse. After plaintiff purchased the mall, it defaulted on the loan, and the bank filed a foreclosure action. During the foreclosure proceedings, the parties entered into a forbearance agreement that contained a broad release by plaintiff and the guarantors in favor of the bank. The sole shareholder of the corporate guarantor signed the forbearance agreement on behalf of plaintiff as borrower and on the corporate guarantor's behalf. The other three guarantors also signed the forbearance agreement. Plaintiff later

filed for Chapter 11 bankruptcy. The bankruptcy court confirmed plaintiff's plan, but plaintiff defaulted on its obligations to the bank under the plan. The bank subsequently foreclosed on the mall. Following the foreclosure, plaintiff commenced an adversary proceeding against the bank, the sole shareholder of the corporate member and one of the individual guarantors, alleging fraud and collusion. The bank moved to dismiss.

In granting summary judgment in favor of the bank, the bankruptcy court ruled that the release was valid and enforceable. On appeal, plaintiff argued that there were genuine issues of material fact regarding the validity of the forbearance agreement and the release contained therein. In particular, plaintiff claimed that the forbearance agreement was not properly authorized by plaintiff, that it was induced by fraud, and that it was unconscionable.

In addressing the merits of plaintiff's arguments, the BAP explained that absent a recognized exception, such as fraud or unconscionability, the release in the forbearance agreement was a valid contract between the bank and plaintiff. The BAP found that the bank met its initial burden of showing that the forbearance agreement on its face appeared to be a valid contract between the parties, supported by adequate consideration. The BAP noted that the forbearance agreement was signed by three members of plaintiff and ruled that the bank reasonably relied on the members' apparent authority to execute the agreement on plaintiff's behalf.

The BAP rejected plaintiff's argument that the members of plaintiff could not bind plaintiff to the forbearance agreement because they had "adverse interests" to plaintiff. The BAP explained that the adverse interest exception did not apply because the forbearance agreement benefitted plaintiff. Further, the record did not show that the bank facilitated or colluded with any fraud or theft by members of plaintiff. In addition, the BAP noted that the only evidence of the bank's role in any fraud or collusion were vague allegations that the bank failed to follow reasonable banking practices.

Finally, the BAP found that there was no support in the record for plaintiff's claim that the forbearance agreement was unconscionable. Accordingly, the BAP affirmed summary judgment in favor of the bank and further ruled that the release in the forbearance agreement covered any and all claims.

If you have any questions about this Alert:

Attorney Contact Information

Anthony J. Sylvester
Partner
973.302.9713
asylvester@shermanwells.com

Craig L. Steinfeld
Partner
973.302.9697
csteinfeld@shermanwells.com

Caitlin T. Shadek
Associate
973.302.9672
cshadek@shermanwells.com

Arjun Shah
Associate
973.302.9698
ashah@shermanwells.com

Anthony C. Valenziano
Associate
973.302.9696
avalenziano@shermanwells.com