

NIGHTMARE ON MAIN STREET WHAT KEEPS LENDERS UP AT NIGHT

ABA Section of Business Law
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**SELECTED RECENT CASES CHALLENGING OR
LIMITING LENDERS' ACTIONS AND CONDUCT**

1. Attempted Temporary Restraining Order

**Edgewater Growth Capital Partners, L.P. and Edgewater Private Equity Fund III, L.P. v.
H.I.G. Capital, LLC, Bayside Capital, LLC**

Court of Chancery of the State of Delaware, Civil Action No. 3601-VCS

Edgewater and certain affiliates (the “Plaintiffs”) brought a motion for a temporary restraining order in the Court of Chancery of the State of Delaware to enjoin an auction and sale of the assets of a Company in which the Plaintiffs were both junior debtholders and equity sponsors, which auction and sale was orchestrated by the Company’s senior lenders (the “Defendants”). Plaintiffs had been in control of the company until it began to experience liquidity problems. After the liquidity problems arose, Plaintiffs ceded control of the Company and the Defendant lenders (who had been the only parties willing to provide funding) thereafter entered into a Foreclosure Agreement with the Company setting forth sale and auction procedures.

At the time the Foreclosure Agreement was executed, the Defendants were owed approximately \$92 Million and there was approximately \$43 Million in Junior Debt. In addition to its junior debt and equity positions, Plaintiffs also executed a \$4 Million Deficiency Guaranty in favor of the Defendants.

Plaintiffs’ primary argument to support the temporary restraining order was that the auction and sale process was not commercially reasonable under the UCC. Plaintiffs claimed that there was insufficient time to solicit bids or perform due diligence, improper notice was given of the sale, and as a result of the inadequate sale procedures, there may have been potential strategic buyers that were not given the opportunity to make a bid. Plaintiffs also argued that the insufficient procedures allowed the Defendants to create an artificially deflated price to purchase the Company themselves. Plaintiffs alleged there was a potential \$118 Million bid that would have paid off the senior debt in whole but the court noted such bid was not in writing and very little information was provided by Plaintiffs to support such a bid. The Court made a point of emphasizing that Plaintiffs did not attempt to make any bid or put together a syndicate to make a

bid for the assets of the Company despite Plaintiffs' contentions that their equity and junior debt had value.

Below is an excerpt from Judge Strine's opinion rejecting Plaintiffs' motion on the grounds it was untimely and did not present a colorable claim:

“But in terms of the colorability of it, what is a reasonable sale process takes into account a lot of things. One, Edgewater was in control of this company until autumn. What did Edgewater do to market the company? If Edgewater had been a responsible fiduciary, it was doubtlessly trying to maximize value, contacting the marketplace, letting people know about the opportunity to come in and make a bid that would make everyone happy, seeking strategic partners, looking for equity, looking for debt. I have to assume Edgewater, the Edgewater plaintiffs, were, in their fiduciary capacities, ringing the chimes pretty well, and that they only very reluctantly turned over the keys to the board room, because there were no other viable options than to get stop-gap financing from the people who owned the senior debt....

I also have a record where it appears a lot of people were given access to confidential information. Others had the opportunity to do it. I also look at Allied Capital and Edgewater's incentives to put together their own club deal, especially with a president of the company who appears to have made a guarantee. To top this bid, the junior debtholders simply have to pay out, essentially, the senior debt what it's due, plus the opportunity costs associated with the senior debtholder keeping the company afloat.

As I understand it, Allied Capital is not keeping the company afloat right now. Nor is Edgewater. Allied Capital and Edgewater, with the president of the company, basically pay the strike price of paying off the senior debt, paying the termination fee, and they have all the assets, and they can make this thing sing, and if they wish – if they believe there are other buyers out there, Hyson, other folks who, with enough time, would buy it, they would be in a position to run an orderly and as long a process as they want...

My strong intuition – I make no finding, but it is an application, and I have to make preliminary findings. My strong intuition is that Edgewater and Allied do not believe that this company has any equity value, they don't really believe that the junior debt is worth anything, or certainly not worth paying off the senior debt. And see, here is the thing about Delaware and contracts. The senior debt is the senior debt. The junior debt is not entitled to anything until the senior debt is paid off...

This appears to be largely a case about the fact that Edgewater doesn't like the fact that it has a contractual obligation to go deeper into the hole because things haven't panned out the way it wished. Again,

when you think about the economics of this, if it was really the case that Edgewater believed in good faith, and not for its own litigation posturing purposes, that these assets were worth more than the senior debt, it would pay off the senior debt...

I also think you have to look at the reasonableness. If the senior lenders could have foreclosed on the assets right away and agreed to provide stop-gap funding to the company and give everybody a chance, including Edgewater and Allied and management, and Edgewater and Allied in combination with management, then that all speaks to the reasonableness of the process...

So I have to say, if there is color here, it's very, very nonvivid. And in terms of irreparable injury, I don't believe there actually is irreparable injury. I think this is essentially a claim by a plaintiff to try to be relieved of its own contractual obligation to make a monetary payment. And, in fact, you know, there is a real argument that the plaintiffs shouldn't even be in court until it's sued on its guarantee, and it should be the defendant, because it strikes me Edgewater is mostly about not having to go deeper into the hole.

I will finish with the balance of harms. At the risk of – how would I ever enter an injunction – at the risk of a well-heeled, sophisticated investor that controlled the company up until autumn of last year, refused to infuse capital in the company itself and take further risk, did not find a strategic partner to buy the company itself, even though it controlled the board, has had the opportunity, along with another well-heeled investor, to make a bid that simply requires them to take out the senior debtholders, has enjoyed the benefit of the senior debtholders propping up the company and engaging in a strategic search for buyers, all the while allowing the plaintiff and Allied to try to make a deal in combination with another thing – how would I ever throw down an injunction flag in favor of that party and at the risk of injuring the senior debtholders and the other interests affected by a corporation like this?...

And I really do take seriously here that Edgewater controlled this company. It's had years to form strategic partnerships and find other ways to make it happen.

2. Alleged Fraudulent Transfer

In re Mervyn's Holdings, LLC, et al.,

Case No. 08-11586 In the United States Bankruptcy Court for the District of Delaware

On September 2, 2008, Mervyn's Holdings, LLC and its affiliates (the "Debtors") filed an adversary proceeding in the Bankruptcy Court for the District of Delaware against numerous Private Equity Sponsors, Private Equity Owners, Bankruptcy Remote Real Estate Holding

Companies (“RE Holding Companies”), Real Estate Secured Lenders and the Target Corporation, as the selling shareholder, (“Target”) asserting that numerous transactions occurring in August, 2004 involving the sale of the Debtors by Target to the Private Equity Sponsors, Private Equity Owners and the RE Holding Companies and the granting of liens to the Real Estate Secured Lenders constituted a fraudulent transfer. The only pleading filed to date is the Complaint - thereafter, the factual summary below is based on Plaintiff’s allegations in the Complaint.

The 2004 transaction that formed the basis of the Debtor’s claim was essentially a LBO structured as a stock purchase and, among other reasons, allegedly structured in a manner to avoid any claims that creditors might have against the real estate assets of the Debtors.

The first step taken by the Defendants was to form the RE Holding Companies as special purpose bankruptcy remote entities to take ownership of all of the Debtors’ real estate assets and hold all of the Debtors’ leases. The RE Holding Companies would then lease the real property to the Debtors under three Unitary Leases. The Unitary Leases were marked to market and the rents being paid by the Debtors subsequent to the acquisition were substantially greater than what the Debtors had paid prior to the transactions. The rental payments under the Unitary Leases were allegedly structured to cover the debt service owing to the secured lenders. In addition to increased rents, because certain leases could not be assigned to the RE Holding Companies, the Private Equity Sponsors and Private Equity Owners amended the operating agreement of the Debtor to include a provision that required the Debtors to make distributions to the Private Equity Sponsors in an amount that was intended to reflect the rent mark-up that would have been imposed had those restricted leases been assigned to the RE Holding Companies. The Private Equity Sponsors in turn would pay such distributions to the Secured Lenders. As a result of the assignment and transfer of all real property and leaseholds to the RE Holding Companies and the lease back to the Debtors, Debtors annual rent expense increased by as much as \$80,000,000 to \$172,000,000.

With respect to the purchase of non-real estate assets, the Private Equity Sponsors created an acquisition vehicle to enter into the Equity Purchase Agreement with Target. The Purchase Price paid to Target for its equity in the Debtors was \$1,175,000,000, of which \$800,000,000 was funded through Senior and Junior Revolving Credit Facilities, each of which was secured by

all assets of the Debtors, the real estate assets and leasehold interests transferred to the RE Holding Companies and the Unitary Leases.

Only \$8,300,000 was paid or allocated to the Debtors, despite the fact the Debtors lost all of their real estate assets. Prior to closing, the Debtors had \$1,000,000,000 of real estate assets and after closing were left with none. In addition, the Debtors were forced to pay \$58,622,427 of transaction costs.

In sum, without receiving sufficient value from the transaction, the Debtors were allegedly disadvantaged in the following ways: (i) all of the valuable real estate assets were stripped from the Debtors, (ii) store occupancy costs were increased, even in stores that the Debtors previously owned, for no reason other than to support the \$800,000,000 loans advanced by the Secured Parties, (iii) any residual value in the real estate above the debt was also stripped from the Debtors because it was stripped from the Debtors' capital and no longer available to it or its creditors, and (iv) finally with respect to restricted leases, improper distributions in the form of notional rent were required to be made to the Private Equity Sponsors to service the debt.

Rather than simply maintaining the Debtors' retail operations, keeping integrated real estate assets intact and leveraging the real estate as would have been done under a traditional LBO transaction (whether or not vulnerable to a fraudulent transfer challenge), the Private Equity Sponsors physically separated the real estate assets at the moment of closing, converting the Debtors from a retailer operator with valuable below market leases and valuable owned real estate prior to the transactions into a shrunken operating company whose remaining capital consisted largely of inventory, cash, credit card receipts and intellectual property.

After the transaction, the Debtors were left with \$673,503,000 of assets (of which \$48,939,000 were intangibles), \$664,203,000 of liabilities and negative working capital.

The Debtors' Complaint sought to (i) Avoid the transfer of Real Property or Recapture Value under 11 U.S.C. 544(b) and 550 or the UFTA or UFCA, (ii) Avoid the Liens or Recapture Value under 11 U.S.C. 544(b) and 550 or the UFTA or UFCA, (iii) Avoid the Transaction and Other Fees Under 11 U.S.C. 544(b) and 550 or the UFTA or UFCA and (iv) Avoid the Notional Rent Payments, Occupancy Cost Increases and Other Payments, Transfers, Distributions or Dividends Under 11 U.S.C. 544(b) or the UFTA or UFCA and Debtors claimed (v) a Breach of Fiduciary Duty against the Private Equity Owners, Private Equity Sponsors and Target.

3. Effort to Limit Senior Indebtedness

In re Musicland Holding Corp., 368 B.R. 428

Musicland (the “Debtor”) entered into a \$200 Million Revolving Credit Agreement with Wachovia and various other lenders in August 2003 which was secured by a lien on all of Musicland’s assets. The Credit Agreement contemplated only revolving loans and defined “Loans” as loans now or hereafter made... on a revolving basis. In 2003, Musicland began experiencing financial difficulties and to induce its trade creditors to extend credit, granted them a lien on inventory and the proceeds thereof, such lien to be subordinate to the lien of Wachovia and the lenders under the Credit Agreement. Wachovia and the trade creditors entered into an Intercreditor Agreement to set forth the relative rights and priorities with respect to their collateral and liens.

The Intercreditor Agreement provided that the liens of the trade creditors were subordinated to the liens of the “Revolving Loan Creditors” to the full extent of the “Revolving Loan Debt.” The Revolving Loan Creditors were defined as any party to the Revolving Credit Agreement, the Revolving Loan Debt was defined as “any and all obligations... arising under the Revolving Credit Agreements, and the Revolving Credit Agreements, in turn, were defined as “the original revolving loan documents, as they now exist or may hereafter be amended, modified, supplemented, extended, renewed, restated, refinanced, replaced or restructured, in whole or in part and including any agreements with, to or in favor of any other lender or group of lenders that at any time refinances, replaces or succeeds to all or any portion of the Revolving Loan Debt or is otherwise a party to the Revolving Credit Agreements.” Finally, the Intercreditor Agreement provided that the trade creditors waived notice of and consented to any amendment, modification, renewal, extension, etc.. of any of the Revolving Loan Debt, including any increase or decrease in the amount of the Revolving Loan Debt.

In fall of 2005, Musicland requested that Wachovia increase the revolver, but Wachovia and the existing lenders denied such request. Musicland’s parent, Sun, also refused to inject any capital into the company, whether as equity or subordinated debt. Sun did convince Harris Bank, with whom it had a banking relationship, to provide Musicland with a \$25 Million Term Loan. The Harris Term Loan was made on substantially different terms than the Wachovia Revolving Facility, it was guaranteed by Sun, it was to be repaid on a short term basis, and its payment was not structured on a pari passu basis with the other revolving loans. Despite the different terms,

the Harris Term Loan was incorporated into the Wachovia Credit Facility as an amendment to take advantage of Wachovia's lien priority. In December, 2005, the Harris Term Loan was paid in full. Shortly thereafter, Musicland became a debtor in a bankruptcy case. The trade creditors were substantially undersecured and brought an adversary proceeding primarily alleging that the Intercreditor Agreement was breached by including the Harris Term Loan in the senior indebtedness.

The District Court affirmed the decision of the Bankruptcy Court that the Intercreditor Agreement unambiguously authorized Wachovia to amend the Revolving Credit Agreement to bring in another lender (whether revolving, term or otherwise). In reaching its decision, the Bankruptcy Court turned to the definitions contained in the Intercreditor Agreement and held that the net effect of such definitions was that the Lenders' priority extended to debts under the current Revolving Credit Agreement, and any amended agreement, including any new loans of any type made under the new agreement. Notably, Revolving Loan Creditors included "any lender... who is otherwise party to the Revolving Credit Agreement" and Revolving Credit Agreements included "all agreements subsequently executed by Debtors in connection with the Revolving Credit Facility or related thereto, as such agreement now existed or was thereafter amended, modified, restated, refinanced, replaced or restructured." The trade creditors were therefore held to have consented, in advance, to any amendments to the Revolving Credit Facility, including any type of increase of the Revolving Loan Debt.

The District Court specifically noted that the contract language was not ambiguous and that due weight must be given to what is in a contract, especially where in this case the contract is a fully integrated agreement, negotiated by sophisticated parties with the assistance of skilled counsel. The Court noted that the trade creditors had the opportunity to include language specifically restricting Wachovia's ability to incorporate by amendment term indebtedness into the definition of Revolving Credit Facility.

4. Improper Disclosure of Information

Tradition Homes, LLC v. Textron Financial Corp., 2008 WL 876975 (M.D. Fla. March 27, 2008) van's 2008 WL 2756473 (M.D. Fla. July 14, 2008)

Tradition Homes ("Tradition") filed a complaint against Textron alleging (i) tortious interference by Textron with the business relationship between Tradition and 21st Mortgage as a result of information disclosed at a cocktail reception and (ii) tortious interference with the business relationship between Tradition and its customers and potential customers as a result of Textron's mailing of Notice of Liens letters. In response, Textron filed a motion for summary judgment to dismiss all claims.

Tradition operated as a dealer of manufactured homes from 2002 through 2006. Manufactured home dealers require floor plan financing to purchase and maintain their inventory of manufactured housing offered to the public for sale. Tradition obtained floor plan financing from Textron and 21st Mortgage. In April 2006, Tradition experienced cash flow difficulties and, realizing it wouldn't be able to satisfy all of its obligations to Textron, presented Textron with a work out plan. On the same day the plan was presented to Textron, a VP of Sales for Textron attended a trade show cocktail reception where he told a 21st Mortgage representative that Tradition was having financial difficulties.

The next day 21st Mortgage performed a surprise inventory audit and soon thereafter terminated its financing arrangement with Tradition. Textron shortly thereafter sent notices of lien letters to Tradition's customers seeking to receive payment on account of Tradition's debt directly from Tradition's customers. Tradition alleged that these notices caused panic among its customers and damaged Tradition's business reputation. As a result of the foregoing events, Tradition ceased operations.

Under Florida law, the four elements to establish tortious interference with a business relationship are (i) the existence of a business relationship, (ii) the defendant's knowledge of the relationship, (iii) an intentional and unjustified interference with that relationship by the defendant, and (iv) damage to the plaintiff as a result of the breach of that relationship.

With respect to tortious interference with the 21st Mortgage relationship, Textron argued that the disclosure of the information may have been careless but there was no damage to the 21st Mortgage relationship because (regardless of any such disclosure) 21st Mortgage would have

withdrawn its business from Tradition anyway. The Court ruled that the vice president's intent in disclosing the information at the cocktail party was a question for a jury and thus summary judgment must be denied. Furthermore, it was also a jury question whether 21st Mortgage would have terminated the line or whether it would have considered a work-out arrangement.

With respect to tortious interference with customers and potential customers, Textron argued that it was justified in sending out the Notice of Lien letters to protect its own financial interests and that actions taken to safeguard or promote one's own financial interests are entirely non-actionable as long as improper means are not used. Tradition also argued that Textron's Notices were deceptive because they implied that Textron's lien on the units of Inventory continued after a sale, despite the fact that a buyer generally takes inventory free of a lender's security interest under the Uniform Commercial Code. The Court held that, aside from determining exactly what information was disclosed, whether the Notice of Lien letters were intended to tortiously interfere with Tradition's business or to protect Textron's financial interests was also a matter for a jury and therefore summary judgment should be denied.

5. Imposing Recourse Liability

Blue Hills Office Park LLC v. J.P. Morgan Chase Bank,

477 F. Supp. 2d 366 (D. Mass. 2007)

Blue Hills Office Park ("Blue Hills") entered into a non-recourse mortgage loan with Credit Suisse for \$33,149,000 in 1999. The mortgage loan was guaranteed by the principals of Blue Hills, Langelier and Fineburg ("Guarantors"). Ultimately, the property was foreclosed upon and sold for \$23 Million, leaving a deficiency of approximately \$10 Million. Blue Hills sued Credit Suisse and JP Morgan (the "Lenders") alleging that the Lenders breached the mortgage loan agreements by improperly declaring a default, wrongfully foreclosing, breaching a duty of good faith, and violating the Massachusetts Consumer Protections Act. Each of Blue Hills' claims was dismissed by the court.

The Lenders counterclaimed against Blue Hills and the Guarantors alleging breach of the Mortgage and breach of the Guaranty. As a result of such breaches, Lenders claimed that the Mortgage Loan became full recourse to Blue Hills and the Guarantors who thereby were liable for the full deficiency.

The Mortgage provided that if Blue Hills transferred or encumbered any portion of the “Mortgaged Property” without the consent of Lenders, the loan shall be full recourse. In 2003, Blue Hills, without the consent of Lenders, settled a zoning claim it had against an adjacent property owner over the construction of a parking garage. In connection with the settlement, Blue Hills received a \$2,000,000 payment which was transferred to Blue Hills’ counsel rather than distributed to the Lenders. The Lenders argued that the Mortgage provided that “Mortgaged Property” included causes of action derived from or used in connection with the Mortgaged Property, or the use, operation, or enjoyment thereof. The Court held that the zoning cause of action was Mortgaged Property and the settlement of such cause of action and the failure to turn over the \$2,000,000 in proceeds (which were proceeds of “Mortgaged Property”) was a breach of the Mortgage and as a result the Mortgage Loan became full recourse.

Lenders’ second claim was that the Guarantors breached the Guaranty. The Guaranty provided that the guarantors would be liable for the full amount of the debt in the event the Borrower failed to obtain Lenders’ prior written consent to any assignment, transfer or conveyance of the Mortgaged Property. The Guarantors pointed to other provisions contained in the Guaranty which limited liability upon the occurrence of certain events such as misconduct, fraud, intentional physical waste, etc... and argued that because these acts are more severe and egregious than the conduct of Blue Hills in this instance, recourse liability should not be imposed for the breach in question.

The Court held that although fraud, misconduct and waste may be more severe and egregious, that aspect of the Guaranty was negotiated in part by the Lenders to create restrictions severe enough to protect it from those risks, while at the same time the sanction of full personal liability was separately intended to protect the Lenders from the risk of Guarantors or Borrower assigning, transferring or conveying the Mortgaged Property and impairing their collateral. Because Blue Hills failed to obtain written consent of the Lenders prior to entering into the settlement, the Guaranty was breached and the Guarantors were liable for the full amount of the deficiency.

6. Another Effort to Impose Recourse

Mecorp. Capital Markets LLC v. Tex-Wave Industries LP,

265 Fed. Appx. 155 (5th Cir. 2008)

In June 2004, Mecorp Capital Markets (“Mecorp”) and Tex-Wave Industries, LP (“Tex-Wave”) entered into an agreement by which Mecorp agreed to loan \$4,620,000 to Tex-Wave to finance the construction of a hot-dip galvanizing facility. Mecorp also obtained a personal guaranty from Tex-Wave’s principals, Monty Guiles and David Croft (the “Guarantors”) and a pledge of the Guarantors’ partnership interests. Tex-Wave later defaulted on the loan leading Mecorp to file suit against Tex-Corp. in U.S. District Court, seeking a declaration that Tex-Wave defaulted on its loan, a judgment of \$4,620,000 plus interest and other fees, and enforcement of the Guaranty.

In May, 2006 during the pendency of the case, Mecorp foreclosed on the property and obtained \$3,000,000 at the foreclosure sale. On October 12, 2006, Tex-Wave obtained a temporary injunction from a Texas state court enjoining Mecorp from exercising its rights under the pledge and listing for sale or selling the business of Tex-Wave during the pendency of the U.S. District Court Case. On October 27, 2006, Mecorp. filed a motion for summary judgment against Tex-Wave in the District Court. The District Court granted summary judgment and held Tex-Wave and the Guarantors jointly and severally liable for \$7,013,869.92 (the balance due on the loan plus interest and late fees) and held that Mecorp had the right to vote the partnership interests pursuant to the pledge agreement. The Guarantors appealed.

Guarantor’s appeal did not dispute that Tex-Wave was in default, but rather that they should be released from their limited Guaranty. The Guaranty provided that “if the Guarantors cooperate with Lender in realizing the collateral, including without limitation, the foreclosure of the Mortgage, and they shall not in any way interfere with the Lender in connection therewith, and the foreclosure sale shall take place without interference by any of the Guarantors or principals, officers or directors of Borrower, then the Lender shall waive the provisions of the Guaranty and shall deliver the Guaranty back to Guarantor back to Guarantors marked satisfied.

The Circuit Court determined that whether the Guarantors failed to cooperate or interfered with Lender’s foreclosure process was a factual question and therefore the summary judgment granted by the district court was vacated and the proceedings were remanded. The

Guarantors had argued that the Lender had the burden to produce evidence that the Guarantors either failed to cooperate in or interfered with the collateral realization efforts. According to the court, summary judgment was not appropriate as the Lender failed to “establish” that no material issue of fact existed.

7. Directors’ Fiduciary Duties

North American Catholic Educational Programming Foundation, Inc. v. Gheewalla

930 A.2d 92 (Del. 2007)

North American Catholic Educational Programming Foundation (“NACEPF”), a creditor of Clearwire Holdings, Inc. (the “Company”) brought a direct claim for breach of fiduciary duty against three former directors of the Company (the “Directors”) in the Chancery Court of Delaware. The chancery court dismissed NACEPF’s claim for failure to state a claim. The Delaware Supreme Court affirmed the Chancery Court’s decision.

NACEPF held certain radio wave spectrum licenses regulated by the FCC. In March 2001, NACEPF and several other license holders entered into a Master Use and Royalty Agreement with the Company pursuant to which the Company could obtain rights to those licenses as then-existing licenses expired. NACEPF and other license holders would receive more than \$24.3 Million in compensation for such rights. NACEPF’s claim against the Directors alleged that the Directors, who were employees of and placed on the board by Goldman Sachs, had control of the Company because the Company’s only source of funding was Goldman Sachs and the Directors used their influence to favor Goldman Sachs’ agenda in derogation of their fiduciary duties to the Company. Specifically, NACEPF alleged that the Directors were aware that Goldman Sachs did not intend to fund the Company and therefore knew the Company’s business plan would fail, yet the Directors entered into the Master Use and Royalty Agreement and continued to act as if the Company would survive.

NACEPF’s alleged that because, at all times, the Company was either insolvent or in the zone of insolvency, the Directors owed a fiduciary duty to NACEPF as a substantial creditor of the Company and the Directors breached such duty by not preserving the assets of the Company for its benefit and that of its creditors once it became apparent the Company would not be able to continue as a going concern. Furthermore, NACEPF alleged that even though the Company did

not intend use NACEPF's license rights it held on to such rights solely to protect Goldman Sachs' investment.

Whether a creditor could assert a direct claim for breach of fiduciary duty against directors of a corporation was one of first impression in Delaware. NACEPF contended that such direct claims should be recognized in the context of insolvency and the zone of insolvency.

In addressing NACEPF's claim, the Court held that NACEPF had satisfactorily alleged that the Company operated in the zone of insolvency during at least a substantial portion of the relevant periods in question and NACEPF also accurately alleged that the company did become insolvent.

The Court noted that while shareholders rely on fiduciaries to protect their interests, creditors are afforded protection through contractual agreement, fraud and fraudulent conveyance law, implied covenants of good faith and fair dealing, bankruptcy law, general commercial law and other sources of creditors rights. Accordingly, the general rule in Delaware is that directors do not owe creditors direct duties beyond any relevant contractual terms. With respect to companies operating in the zone of insolvency, the court stated that such companies are most in need of effective and proactive leadership, as well as the ability to negotiate in good faith with its creditors, goals which would be significantly undermined by the prospect of individual liability arising from the pursuit of direct claims by creditors. Therefore, no direct claims for breach of fiduciary duty may be asserted by creditors of a solvent corporation that is operating in the zone of insolvency. The directors' fiduciary duty remains to the corporation and the shareholders in such instances.

On the other hand, in the case of insolvent corporation, the fiduciary duty shifts to creditors and creditors do have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties. However, the fact that the corporation has become insolvent does not turn a derivative claim into a direct claim; it merely provides creditors with standing to assert those claims. Recognizing that directors of an insolvent corporation owe direct fiduciary duties to creditors would create uncertainty for directors who have a fiduciary duty to exercise their business judgment in the best interest of the insolvent corporation. To recognize a new right for creditors to bring direct fiduciary claims against those directors would create a conflict between such directors' duty to maximize the value of the insolvent corporation for the benefit of all creditors and such a newly recognized direct fiduciary duty to individual

creditors. Accordingly, the court held that individual creditors of an insolvent corporation do not have a right to assert direct claims for breach of fiduciary duty against corporate directors.

RECENT CASES: LENDER LIABILITY THEORIES, TRENDS AND DEFENSES

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A supplement with additional cases is expected to be distributed at the Fall Meeting*

RECENT CASES: LENDER LIABILITY THEORIES, TRENDS AND DEFENSES

COMMITMENT LETTERS (AND ANALOGOUS AGREEMENTS)

Kena Properties, LLC v. Merchants Bank & Trust, 218 Fed. Appx. 402 (6th Cir. 2007) -- The Sixth Circuit Court of Appeals affirmed the district court's grant of summary judgment to a bank with regard to the appellants' claims of breach of contract and promissory estoppel. The commitment letter between the parties had a "material adverse conditions" clause. The Sixth Circuit agreed with the district court that the bank's discovery of a lawsuit filed against one of the appellants constituted a material adverse condition, and that the bank had no duty to investigate the potential impact of the lawsuit on the appellants' ability to borrow. Furthermore, as to the promissory estoppel claim, the district court correctly concluded that the appellants could not demonstrate that they reasonably relied on the alleged oral promise by the bank's representatives regarding the proposed financing.

Crosspoint Seven v. Manufacturers Life Ins. Co., 148 Fed. Appx. 535 (7th Cir. 2005) -- The Seventh Circuit Court of Appeals affirmed the district court's grant of summary judgment to a mortgage lender on the issue of whether it had anticipatorily repudiated a contract with certain real estate developers. Under Indiana law, an anticipatory breach of contract occurs only when there is a positive, absolute and unconditional repudiation. No such repudiation occurred in this case, as the evidence demonstrated that the mortgage lender requested that the real estate developers mitigate newly acquired negative financial information and that the mortgage lender was willing to close the deal "as is." Furthermore, even if a repudiation had occurred, the mortgage lender retracted any such repudiation before the real estate developers suffered any detrimental reliance or considered the repudiation to be final.

Pressman v. Franklin National Bank, 384 F.3d 182 (6th Cir. 2004) -- The Sixth Circuit Court of Appeals affirmed the district court's judgment in favor of the lender and its officers in a case brought by the limited partner of a real estate development company alleging breach of contract, fraud and civil conspiracy. The commitment letter between the lender and the developer contained a provision that required the lender to find an acceptable participating lender before the lender had an obligation to make the loan, which condition was not satisfied. The appeals court found that there was insufficient evidence to conclude that the lender had waived this condition. The appeals court noted that the presence of a merger clause in the commitment letter that prevented the developer from relying upon alleged representations made prior to the execution of the commitment letter regarding a purported waiver of that condition. The appeals court affirmed the district court's rejection of the developer's claim that the lender did not act in good faith, as it was enough for the lender to solicit only two banks to participate, particularly given the lender's small size and the short time until the closing date.

Boise Tower Assocs., LLC v. Wash. Capital Joint Master Trust, No. CV 03-141-S-MHW, 2007 WL 1035158 (D. Idaho 2007) -- The district court granted the lender's motion for summary judgment in a case brought by a prospective borrower due to the lender's failure to fund pursuant to a commitment letter. The commitment letter contained multiple conditions precedent that would have to be satisfied by the borrower prior to the funding of the loan, including (1) a binding written

commitment evidencing that the borrower had sold a certain amount of condominium units, office space and parking spaces in the condominium building that it was to build with loan proceeds provided by the lender, (2) that certain amounts of the borrower's equity be invested in the condominium development project and (3) that a union labor would have to be used to construct the building. An officer of the lender misinterpreted the third condition and indicated that the lender would not close unless the condition, as so misinterpreted, was fulfilled. While the district court noted that anticipatory repudiation generally relieves the non-breaching party of any duty to tender performance or to demonstrate its ability to perform, the non-breaching party must nevertheless show that it would have been ready and willing to perform the contract if the repudiation had not occurred. The borrower in this case was not able to perform two of the conditions (relating to pre-sales and owner's equity). Even though the lender did commit some anticipatory repudiation of a portion of the contract, that anticipatory repudiation was "of no moment," according to the court.

Omega Healthcare Investors, Inc. v. Lantis Enterprises, Inc., 256 F.3d 774 (8th Cir. 2001) -- The Eighth Circuit Court of Appeals affirmed the judgment of the district court in favor of the lender in its cause of action to recover from defendants a nonrefundable commitment fee. Although the lender had drafted the commitment letter, the Eighth Circuit affirmed the district court's decision not to instruct the jury that the letter's terms should be construed against the lender, as the agreement had been reached through extensive negotiations and the parties were sophisticated and represented by counsel. The commitment letter clearly described the fee as nonrefundable.

Gaines v. Kelly, 235 S.W.3d 179 (Tex. 2007) -- The Supreme Court of Texas reversed the lower appellate court's decision, which in turn had reversed a grant of summary judgment to a mortgage broker and lender. The court concluded that there was insufficient evidence that the mortgage broker had apparent authority from the lender to communicate to a prospective borrower that a proposed loan was a "done deal." Furthermore, there was insufficient evidence to demonstrate that the lender had authorized the mortgage broker to commit the lender to fund the prospective borrower or to obligate the lender to any terms other than those agreed to between the lender and the prospective borrower.

Transit Management, LLC v. Watson Industries, Inc., 23 A.D.3d 1152, 803 N.Y.S.2d 860 (2005) -- The appellate court affirmed the lower court's grant of summary judgment to lenders in a case brought by prospective borrowers. The commitment letter between the first lender and the prospective borrowers contained a condition precedent that had to be fulfilled to render the commitment letter enforceable--the delivery by the prospective borrowers of written evidence that certain tax liabilities had been satisfied. The parties did not dispute that the prospective borrowers did not satisfy this condition precedent. With regard to the second lender, the appellate court concluded that the lower court correctly found that the evidence revealed that the prospective borrowers did not enter into a binding contract containing the terms required by the second lender.

Bank of America, N.A. v. Hensley Properties, L.P., 2007 WL 4591453 (E.D. Cal. 2007) -- The district court granted the lender's motion to dismiss the borrower's fraud counterclaim. The borrower's principal had meetings with the lender to discuss a mortgage loan to replace the borrower's existing mortgage, which the borrower believed to be in the process of being accelerated. The principal alleged that during these meetings, the lender's employees represented that the parties were entering into forward rate lock, and that she signed both a proposal and a confirmation letter

based on these representations. The signed documents did not constitute a forward rate lock agreement but an interest rate swap agreement. When the borrower's existing mortgagee declined to accelerate its mortgage, the borrower declined to make payments on the interest rate swap agreement with the lender. The lender brought suit for breach of contract, and the borrower counterclaimed for fraud and breach of duty. Under New York law, an express provision in a written contract that contradicts a prior alleged oral representation in a meaningful fashion will preclude a finding of reasonable reliance. Because the proposal and the confirmation letter signed by the borrower's principal expressly stated that the proposed transaction between the parties would be an interest rate swap, the borrower could not demonstrate reasonable reliance. Thus, the district court granted the lender's motion to dismiss the counterclaim. As for the borrower's second counterclaim, because New York law recognizes that banks may owe a duty of care to their customers, the district court denied the lender's motion to dismiss the borrower's breach of duty claim.

United Rentals, Inc. v. RAM Holdings, Inc., 937 A.2d 810 (Del. Ch. 2007) -- The Court of Chancery of Delaware ruled against the plaintiff in its lawsuit claiming breach of contract and seeking specific performance of an unconsummated merger agreement. At issue in this case was the interpretation of various provisions of a proposed merger agreement between the plaintiff and defendants. The first provision provided the plaintiff with the remedy of specific performance if the defendants breached the agreement. The first provision also provided that it was subject in all respects to a second provision, which stated that a \$100,000,000 termination fee was the sole and exclusive remedy against the defendants under the agreement in the event of the defendants' termination of the agreement. Both parties moved for summary judgment. The court noted that the plaintiff's interpretation of the two provisions was reasonable, as it was reasonable to interpret the second provision as requiring the termination fee only in the event of a termination by the defendant pursuant to a particular section of the merger agreement (which termination did not occur), and that the termination fee only limited remedies involving monetary compensation. Similarly, the court concluded that the defendants' interpretation of the provisions was reasonable, as it was reasonable to interpret the two provisions as denying plaintiff any equitable relief under all circumstances, with the termination fee being the only available relief available to the plaintiff. Due to parties' equally reasonable interpretation of these provisions, the court denied both parties' motions for summary judgment. Turning to the merits, the court first concluded that there was not a single shared understanding between the parties regarding the availability of specific performance under the merger agreement. Accordingly, the court employed the "forthright negotiator principle," in which a court may consider the subjective understanding of one party that has been objectively manifested and is known to the other party. Employing this principle, the court ruled against the plaintiff and in favor of the defendants. The evidence demonstrated that the issue of relief in addition to the termination fee was a point of serious contention between the parties. During key moments in the negotiations between the parties, including negotiations over the insertion of the provision concerning the termination fee, the plaintiff's lawyer failed to vocalize and clarify to the defendants' lawyers that it was his understanding that the plaintiff would maintain a right of specific performance under the agreement, regardless of the terms and conditions of the provision containing the termination fee. Conversely, the defendants and their lawyers effectively communicated to the plaintiff their understanding that the termination fee would be the only remedy available to the plaintiff in the event the merger agreement was not consummated. Furthermore, the evidence demonstrated that the plaintiff was well aware of this understanding, yet failed to communicate that it did not hold such interpretation of the agreement.

The Provident Bank v. Adriatic, Inc., 2005 WL 2840741 (Ohio App. 2005) -- The Court of Appeals of Ohio affirmed the trial court's grant of the bank's summary judgment motion for foreclosure. The bank received a note from the borrower establishing a line of credit that was secured by an open-end mortgage, a security agreement, and an assignment of rents, income and proceeds. The parties subsequently entered into a series of modifications and extensions that extended the note's maturity date. The last two modifications decreased the line of credit from \$750,000 to \$500,000. Eventually, the bank filed a complaint in state court asserting that (i) the borrower was in default and seeking foreclosure of the mortgage. The borrower counterclaimed, alleging that during the negotiations over the last two extensions and modifications, the bank's vice president told the borrower's principals that the line of credit would remain at \$750,000, and (ii) the decrease in the line of credit to \$500,000 caused irreparable financial harm to the borrower. The court affirmed the trial court's dismissal of the fraud and bad faith claims due to the fact that the vice president's alleged misrepresentations concerned the same subject matter covered by the modification and extensions. As a result, the parol evidence rule precluded enforcement of the vice president's oral statements in contradiction of the written agreements' express terms. The breach of fiduciary claim was also properly dismissed, as the court concluded that Ohio law does not recognize a fiduciary relationship between a debtor and creditor. Finally, with regard to the borrower's claims of negligence against the bank, the court found no authority to conclude that a lender negotiating a loan agreement owes a borrower any duty of care.

Genesco, Inc. v. The Finish Line, Inc., Case No. 07-2137-II(III) (Tenn. Chancery Court 2007) -- The Tennessee Chancery Court granted the plaintiff's request for specific performance in connection with the consummation of a merger agreement. The defendants claimed that the plaintiff's second quarter loss of earnings of 77% compared to the previous year constituted a material adverse effect under the merger agreement sufficient to justify the termination of the agreement. The chancery court agreed and ordered the defendants to specifically perform the terms of the merger agreement. In ordering specific performance by the defendants, the court focused on principles of equity under Tennessee law rather than a carve-out contained in the merger agreement's definition of material adverse effect for general economic and industry conditions.

LENDER LIABILITY UNDER LABOR LAWS (WARN ACT)

Coppola v. Bear Stearns & Co., 499 F.3d 144 (2d Cir. 2007) -- In dismissing a lender liability class action, the Second Circuit Court of Appeals found that the lender was not an "employer" within the meaning of the WARN Act, and thus, could not be found liable. The Second Circuit determined that the appropriate test for imposition of liability under the WARN Act was whether the lender's conduct amounted to operation of the debtors' business. Its ruling followed the Eighth and Ninth Circuits. The Second Circuit declined to follow the Third Circuit's reliance on criteria developed by the Department of Labor in determining whether independent contractors and subsidiaries are to be treated as separate employers or as part of the parent or contracting company.

Zawlocki v. Rama Tech, LLC, 2005 WL 3358855 (E.D. Mich. 2005) -- The district court found that, while the plaintiffs' claim against survived the secured lender's motion to dismiss, it was not sufficient to withstand summary judgment. Noting that liability under the WARN Act attaches only to the party that orders a plant closing, the court focused on degree of control exercised by the

secured lender with respect to the closing. The secured lender presented unrefuted evidence that its control was limited to protecting its security. Due to the absence of evidence that the secured lender supervised or hired employees, the court held that summary judgment was appropriate.

Smith v. Ajax Mannathermic Corp., 144 Fed. Appx. 482 (6th Cir. 2005) -- The plaintiff appealed dismissal of his claim that defendant lenders were liable for violation of the WARN Act. The Sixth Circuit Court of Appeals noted that, although the Department of Labor's regulations do not explicitly authorize suits against lenders, three circuits - the Third, Eighth and Ninth - have recognized that lenders may be liable under the WARN Act. Thus, the Sixth Circuit found it "inappropriate" to dismiss the plaintiff's WARN Act claim for failure to state a claim, and it reversed the lower court's ruling.

EQUITABLE SUBORDINATION

Wooley v. Faulkner (In re SI Restructuring, Inc.), 532 F.3d 355 (5th Cir. 2008) -- The Fifth Circuit Court of Appeals overturned the decisions of the bankruptcy court and district court for invoking equitable subordination. The Fifth Circuit held that the critical factor in application of equitable subordination was that a claim should be subordinated only to the extent necessary to offset the harm which the debtor or its creditors have suffered as a result of the inequitable conduct. According to the Fifth Circuit, subordination of the insiders' secured claims was inappropriate because the bankruptcy trustee had failed to show that the defendant insiders' loans to the debtor harmed either the debtor or the general creditors. The court also rejected the plaintiff's "deepening insolvency" argument on the facts and as a matter of law.

Adelphia Recovery Trust v. Bank of America, N.A., 390 B.R. 80 (S.D.N.Y. 2008) -- The creditors' committee brought action against both those lenders who had acted as agents, known as the "agent lenders," under each credit facility for tort and bankruptcy claims, as well as lenders who had purchased the debt, known as the "non-agent lenders," at any time in any of the credit facilities, for only bankruptcy claims. The asserted claims stemmed from the lenders' alleged dealings with Adelphia's former management against whom Adelphia brought suit for looting the company. Notably, the plan provided that unsecured creditors of each of the debtors would be paid in full, in cash, with interest. Upon a motion to dismiss the district court determined that, given that the debtors' creditors received full payment with interest under the plan, the creditors would not benefit from the lawsuit and, therefore, plaintiffs did not have standing. In dismissing the equitable subordination and disallowance claims, the court noted that the bank defendants would be paid in full even if their claims were subordinated.

In re Enron Corp., 379 B.R. 425 (S.D.N.Y. 2007) -- The District Court for the Southern District of New York overturned two decisions rendered in Enron by Judge Gonzalez. In one decision, Judge Gonzalez held that the transfer of a claim subject to equitable subordination would not free the claim from subordination in the hands of the ultimate holder. Enron Corp. v. Springfield Assocs., L.L.C., 333 B.R. 205 (Bankr. S.D.N.Y. 2005). In the second decision, Judge Gonzalez held that where a claim is not allowable because the creditor had not returned a preference or other avoidable transfer, a transferee of the claim takes subject to disallowance on the same ground. Enron Corp. v. Avenue Special Situations Fund II, LP, 340 B.R. 180 (Bankr. S.D.N.Y. 2006). In reversing the two controversial bankruptcy court decisions, the district court held that a bankruptcy claim transferred

to a third party may be subject to equitable subordination under Section 510(c) or disallowance under Section 502(d) based on the conduct of the transferor only if the transfer is by way of assignment and not by way of sale. The district court noted that the unnecessary breadth of the bankruptcy court's decisions threatened to wreak havoc on the markets for distressed debt. The district court denied a motion for leave to appeal the interlocutory order to the Second Circuit. In re Enron Corp., 379 B.R. 425 (S.D.N.Y. 2007).

Adelphia Communications Corp. v. Bank of America, N.A. (In re Adelphia Communications Corp.), 365 B.R. 24 (Bankr. S.D.N.Y. 2007) -- The official committee of unsecured creditors brought an adversary proceeding on behalf of Adelphia, against Adelphia's lenders and investment banks. The committee's 256-count complaint charged the defendants with wrongdoing in their dealings with Adelphia's former management, the Rigas family, against whom Adelphia had brought suit for looting the company. The committee's numerous counts against the defendants included claims (i) for aiding and abetting the Rigases' breaches of fiduciary duty in connection with "co-borrowing" facilities under which Adelphia became liable to repay the banks for billions of dollars that benefited the Rigases, (ii) for breach of fiduciary duty (asserting that the bank lenders and investment banks themselves had fiduciary duties to the estate), (iii) for fraudulent transfers and preferences related to incurring and/or paying down the debt on borrowing facilities that benefited the Rigases, (iv) to equitably subordinate and/or disallow, and to recharacterize, bank lenders' claims and (v) for violations of the Bank Holding Company Act. In addition to seeking equitably to subordinate the defendants' claims, the committee sought equitable disallowance of such claims. The bankruptcy court ruled that equitable disallowance, whereby a court can completely disallow a creditor's claims based on its inequitable conduct, remains viable despite the enactment of Section 510(c), which authorizes equitable subordination.

Arena Dev. Group, LLC v. Naegele Commns., 2008 U.S. Dist. LEXIS 35628 (D. Minn. 2008) and Arena Development Group, LLC v. Naegele Communications, Inc., 2007 WL 2506431 (D. Minn. 2007) -- In two related cases, the Minnesota District Court held that there is no cause of action, outside of bankruptcy, for declaratory relief to recharacterize debt as equity or for equitable subordination.

DEEPENING INSOLVENCY

Bondi v. Bank of Am. Corp. (In re Parmalat Sec. Litig.), 383 F. Supp. 2d 587 (S.D.N.Y. 2005) -- The district court dismissed the plaintiff's deepening insolvency claim against the debtor's lender as duplicative. While stating that North Carolina courts have barely considered the issue of whether deepening insolvency is a claim under North Carolina law, the court noted that North Carolina recognizes a cause of action against a third party that aids a company's officers and directors in breaching their fiduciary duties by deepening their company's insolvency. Because the plaintiff's lawsuit against the lender included a cause of action for aiding and abetting the breach of a fiduciary duty, the court declined to rule on whether North Carolina recognizes an independent tort of deepening insolvency.

OHC Liquidation Trust v. Credit Suisse First Boston (In re Oakwood Homes Corporation), 340 B.R. 510 (Bankr. D. Del. 2006) -- The bankruptcy court denied the secured lenders' motion to dismiss the liquidating trustee's claims against them, including claims for deepening insolvency. The bankruptcy court concluded that the Third Circuit Court of Appeals would recognize a cause of

action for deepening insolvency under the laws of Delaware, New York and North Carolina. In this case, the court noted that the liquidating trustee's complaint sufficiently alleged that the secured lender's inducement of the debtor to continue to borrow resulted in the financial condition that prompted it to file for bankruptcy protection. The court also cited the growing acceptance of deepening insolvency among the courts, as well as its remedial theme.

Nisselson v. Ford Motor Co. (In re Monahan Ford Corp.), 340 B.R. 1 (Bankr. E.D.N.Y. 2006) -- The bankruptcy court denied the lender's motion to dismiss the co-trustee's claim of deepening insolvency. The co-trustee's complaint alleged not only that the lender made a bad loan to the debtor, but also that the loan was made for the purpose of defrauding the debtor. As a result, the lender had exposed itself to potential liability for a deepening insolvency claim. Furthermore, the court concluded that the co-trustee stated with sufficient particularity the fraud allegations underlying its deepening insolvency claim, in accordance with Federal Rule of Civil Procedure 9(b).

Official Comm. of Unsecured Creditors of VarTec Telecom, Inc. v. Rural Telephone Finance Cooperative (In re VarTec Telecom, Inc.), 335 B.R. 631 (Bankr. N.D. Tex. 2005) -- The bankruptcy court dismissed a deepening insolvency claim brought by the plaintiff creditors' committee against the debtor's pre-petition lender. The court concluded that because the injury caused by the deepening of a company's insolvency was substantially duplicated by torts already established in Texas, the Texas Supreme Court would not recognize an independent tort of deepening insolvency. Furthermore, assuming there was a cause of action for deepening insolvency, the liquidating trustee failed to demonstrate the requisite existence of an independent tort by the lender. Under Texas law, there is generally no fiduciary relationship between a borrower and lender, such as to impose any extra-contractual duties on a lender.

Kittay v. Atlantic Bank of New York (In re Global Serv. Group LLC), 316 B.R. 451 (Bankr. S.D.N.Y. 2004) -- The bankruptcy court granted the bank's motion to dismiss with regards to the trustee's claim that the bank and its insiders allowed the debtor to continue to do business and become further insolvent. The court stated that the prolonging of a company's life, without more, will not result in liability for deepening insolvency. Rather, a claimant must show that the defendant prolonged the company's life in breach of a separate duty, or committed an actionable tort that contributed to the continued operation of a company and its increased debt. With regard to the bank in this case, the court stated that the bank could not be liable for deepening insolvency solely by (1) its making of a loan it knew or should have known that the debtor could not repay or (2) its making of the loan on the strength of its relationship with the debtor's members and insiders.

Official Comm. of Unsecured Creditors v. Credit Suisse First Boston (In re Exide Technologies, Inc.), 299 B.R. 732 (Bankr. D. Del. 2003) -- The district court concluded that the Delaware Supreme Court would recognize a claim for deepening insolvency when there has been damage to corporate property. Because the plaintiff sufficiently pled a cause of action for deepening insolvency against the defendant administrative agent, the administrative agent's motion to dismiss such claim was denied by the district court.

LEVERAGED BUYOUTS

Liquidation Trust v. Fleet Retail Fin. Group (In re Hechinger Inv. Co. of Del.), 2008 U.S. App. LEXIS 10735 (3d Cir. 2008) (unpublished) -- Plaintiff liquidation trust brought an adversary proceeding against defendant lenders, former directors, and company alleging breach of fiduciary duty and fraudulent conveyance related to a September 1997 leveraged buyout which allegedly drained the company of at least \$ 127 million at a time when it was insolvent. The trust alleged that security interests in the debtor's assets were conveyed to a bank and other entities for less than reasonably equivalent value in violation of 11 U.S.C. § 548(a)(1)(B). In an unpublished opinion, the Third Circuit Court of Appeals affirmed the district court's summary judgment ruling in favor of the defendant lenders. The Court held that because the fair market value of the assets had been litigated and decided in parallel litigation, it was necessary to give preclusive effect to the district court's prior finding that the company's assets were worth \$ 260 million at the time of the buyout.

QSI Holdings, Inc. v. Alford, 382 B.R. 731 (W.D. Mich. 2007) -- The district court held that the payments to shareholders were protected from avoidance because they were included under the plain language of section 546(e). The facts of the case provided no exceptional circumstances to depart from the generally accepted broad view of the term "settlement payments."

FRAUD

Read & Lundy, Inc. v. The Washington Trust Co. of Westerly, 840 A.2d 1099 (R.I. 2003) -- The Rhode Island Supreme Court affirmed the trial court's dismissal of the plaintiff's claims against the bank, including claims for breach of contract, tortious interference with contractual relationships, conspiracy, and violation of the Rhode Island's statute regarding trade secrets. The plaintiff alleged that the bank loaned money to a competitor in part based on confidential information about the plaintiff obtained by the bank when a former employee of the plaintiff attempted to purchase the plaintiff. With respect to the plaintiff's breach of contract claim, the court agreed with the trial court that there was no agreement between the plaintiff and the bank as to what would happen to any information provided to the bank in connection with the former employee's proposed purchase, including whether it could be used in the competitor's loan application. The court concluded that the bank did not violate a duty when it considered another customer's information in determining whether to make a loan to another customer. As for the plaintiff's interference with contractual relationship claim, the court agreed with the trial court that there was no evidence that the bank intended to harm the plaintiff. Similarly, the conspiracy claim was dismissed due to the fact that the plaintiff had failed to demonstrate the required underlying intentional tort committed by the bank. Finally, the plaintiff's claim under Rhode Island's statute regarding trade secrets was time-barred.

ENVIRONMENTAL LIABILITIES

Canadyne-Georgia Corp. v. Bank of Am., 174 F. Supp. 2d 1360 (M.D. Ga. 2001) -- Based upon prior rulings in the case by the Eleventh Circuit Court of Appeals, a district court granted summary judgment in favor of Bank of America, N.A. ("BOA") based upon the fiduciary exemption from environmental liability under the federal Comprehensive Environmental Responses, Compensation and Liability Act of 1980 ("CERCLA"). In the case, the plaintiff sought reimbursement for the millions of dollars that it spent cleaning up contamination on a property for which BOA served as

trustee. The plaintiff alleged that BOA negligently allowed a third party to release hazardous materials on such property. While holding that fiduciaries may be personally liable under Superfund if their negligence “causes or contributes” to the contamination, the Eleventh Circuit had emphasized that the circumstances in which such liability attaches are limited. Specifically, the Eleventh Circuit recognized that under the express language of Superfund, a fiduciary’s liability is limited to the assets it holds in a fiduciary capacity, unless the fiduciary’s negligence causes or contributes to the contamination or the fiduciary is subject to liability based on factors other than its fiduciary status. Based on the Eleventh Circuit’s reasoning, the district court determined that BOA qualified for the fiduciary exemption from CERCLA liability. The district court stated that the “negligence exception” (to the CERCLA fiduciary exemption) did not apply because BOA had no duty to prevent the third-party release of hazardous materials. Also based on the Eleventh Circuit’s reasoning, the district court rejected the plaintiff’s assertion that BOA’s dual role as a lender caused it to lose its fiduciary exemption.

Bank of New York v. Bram Manufacturing, 2005 NY Slip Op. 51130U (Sup. Ct-Rockland Cty. 2005) -- The court granted the lender’s motion for summary judgment, holding that the bank had no obligation to perform an environmental assessment to maintain its defense to liability. The defendant borrower entered into a series of loans with a predecessor of Bank of New York (BONY), Nanuet National Bank. In 1998, when a potential purchaser conducted a Phase II on the site, the borrower learned that its property was contaminated with trichloroethylene (TCE) from a former operation. Because it could not sell the property, the borrower consolidated its loans and entered into a \$504,000 mortgage with BONY. As part of the restated mortgage, the borrower’s principals executed a guaranty. The borrower defaulted on its loan. Instead of foreclosing on the property, BONY opted to sue on the mortgage note and the guaranty. In response to BONY’s motion for summary judgment, the guarantors claimed that the bank was not entitled to recover under the note or the guarantee because it had concealed the extent of the contamination. The defendants argued that BONY had an obligation as a secured creditor to perform an environmental assessment and that this failure relieved the defendants of any liability under the guarantee. The court noted that the defendants had not performed their own due diligence when they first acquired the property and that BONY did not have any superior knowledge or unique information in its possession concerning the environmental conditions of the property that it would have been obligated to disclose to the defendants. Indeed, the court noted that the defendants were aware of the contamination and had equal access to investigate the environmental conditions of their property. Thus, the court granted BONY’s motion for summary judgment.

SECURITIES LAW VIOLATIONS - AIDING AND ABETTING

Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., 128 S.Ct. 761, 169 L.Ed.2d 627 (2008) -- Secondary actors were not liable in a private cause of action under Section 10(b) of the Securities and Exchange Act of 1934 because the petitioners could not demonstrate that they relied on the secondary actors’ statements or representations. The secondary actors did not prepare or disseminate fraudulent financial statements, had no duty to disclose their deceptive acts to the public, and the public had no knowledge of the secondary actors’ deceptive acts. Also, the implied private right of action under Section 10(b) does not extend to aiding and abetting liability.

Schaaf v. Residential Funding Corp., 2008 U.S. App. LEXIS 3745 (8th Cir. 2008) -- The district court did not err in dismissing the appellants' claims under the Minnesota Consumer Fraud Act ("MFCA"), as the plaintiff could not prove that the appellees' actions proximately caused the appellants' losses resulting from the purchase of certain debentures from the borrower. The appellees' nondisclosure of the borrower's defaults and violation of debt-to-worth covenants with each appellee did not harm the appellants, as the appellees did not act on their knowledge of these circumstances in a way that harmed the borrower or its debenture-holders, including the appellants.

Robyn Meredith, Inc. v. Levy, 440 F. Supp. 2d 378 (D.N.J. 2006) -- The district court granted the motion to dismiss filed by the officers of a purchasing corporation in a federal securities case brought by the shareholders of the purchased corporation. As partial consideration under the asset purchase agreement, the purchasing corporation gave the shareholders a \$1.2 million non-negotiable promissory note. The court examined several factors before concluding that the promissory note was not a "security" under the Securities and Exchange Act of 1934. These included the fact that the promissory note was not held out as an investment but rather as a loan for completing the commercial sale of the corporation, as well as the fact that the record did not demonstrate that the note carried a particularly high interest rate for investment purposes. In addition, the promissory note was non-negotiable, uncollateralized, uninsured, and not regulated by any statute. Having dismissed the federal securities claims, the district court also declined to exercise supplemental jurisdiction over the shareholders' state common law claims.

LENDER vs. LENDER

Northwest Bank & Trust Company v. First Illinois National Bank, 354 F.3d 721 (8th Cir. 2003) -- The Eighth Circuit Court of Appeals held that fraudulent inducement could be the basis for an action despite limiting provisions or disclaimers contained in a participation agreement. Northwest Bank & Trust entered into a loan participation agreement with First Illinois National Bank (FINB) to help finance the purchase of equipment for Whitehall Funding, Inc., a subsidiary of one of FINB's most important customers. Before entering the agreement, Northwest requested and received Whitehall's prior three years of audited financial statements along with a loan presentation package prepared by FINB. The agreement itself contained a strongly-worded, unambiguous disclaimer, acknowledging that Northwest had "made an independent investigation of the loan," had "satisfied itself with respect to [Whitehall's] credit standing," was "not relying upon [FINB's] judgment," and that FINB had "made no warranty of any kind, express or implied, in connection with the loan." After Whitehall defaulted on the loan, Northwest sued FINB in federal court under Iowa state law alleging a variety of claims. One of those claims was that FINB committed fraud by providing false and misleading information in an attempt to infuse one of its most important customers with more cash. The district court held that since Northwest, a sophisticated lending institution, had expressly disclaimed any reliance upon FINB's judgment, it was barred from asserting that it was fraudulently induced into the agreement. However, on appeal, the Eighth Circuit Court of Appeals reversed the district court's ruling, stating: "We find no language in [the case law] to support the district court's conclusion that the applicability of this rule [i.e., fraud in the inducement] turns upon the sophistication of the contracting parties. Instead, the rule is premised on the principle that the fraudulent inducement precedes the formation of the contract, and that to give preclusive effect to language contained therein would allow a party to bind the defrauded party to the contract through the use of a boilerplate disclaimer." Northwest Bank, 354 F.3d at 726.

Buena Vista Home Entertainment v. Wachovia Bank, N.A. (In re Musicland Holding Corp.), 374 B.R. 113 (Bankr. S.D.N.Y. 2007) -- The district court held that the terms of an intercreditor agreement, which granted senior lenders substantial latitude to amend their revolving secured loan documents, without the consent of junior subordinated lien creditors, unambiguously authorized those senior lenders to bring in a new lender and secure that lender's new term debt under their first priority lien in substantially all of the borrower's assets to the detriment of the subordinate lien creditors. The junior creditors, whose vendor claims were secured by liens on inventory, signed an agreement that did not cap the amount or terms of the debt that could be added to the senior position through amendment or modification of the senior credit agreement. The junior creditors, through the intercreditor agreement, consented to all future amendments of the revolving credit agreement. Several years later, the senior lenders amended the terms of the credit agreement to include a new \$25 million term loan. The term loan tranche was repaid as agreed, and the resulting liquidity crisis precipitated the borrower's bankruptcy filing. When the assets were liquidated, the senior lenders were paid in full, and the subordinate lien creditors received less than 25¢ on the dollar. In the ensuing lawsuit, the senior lenders moved to dismiss the complaint filed by the junior creditors. Granting the motion to dismiss, the court held that authority to amend documents under an intercreditor agreement, even to change the fundamental character of those documents from revolving loans to term loans to the detriment of junior creditors, will be upheld where the language granting that authority is broad and unambiguous.

Bremer Ban v. John Hancock Life Insurance Co., 2007 WL 1057056 (D. Minn. 2007) -- The court found that the majority loan participant in an aircraft financing deal may have violated the owner participant's rights by instructing the indenture trustee to conduct a commercially unreasonable sale or by failing to pursue remedies against the bankrupt lessee in violation of equity squeeze protection clause.

Hitachi Credit America Corp. v. Signet Bank, 166 F.3d 614 (4th Cir. 1999) -- The Fourth Circuit Court of Appeals held that a participant could rely on a lead bank's representations and omissions where a confidentiality agreement signed by the participant prevented a full investigation. Disclaimers of reliance were held to be insufficient to preclude a finding of reasonable and justifiable reliance by the participant. Signet assigned a portion of an existing loan to Hitachi. Because Hitachi's willingness to purchase the assignment depended on the existence of an underlying lease agreement involving the borrower, Hitachi requested, and Signet provided, a representation that "to the best knowledge of the Assignor... [the underlying lease] ... is in full force and effect." Ultimately, the underlying lease did not exist and Hitachi sued Signet, inter alia, for a breach of contract on the grounds that Signet breached its representation regarding the lease. In concluding that Signet had breached its representation to Hitachi, the court reasoned that a plain language reading of Signet's representation led to a determination that Signet had represented that it had actual knowledge that the underlying lease was in full force and effect. Moreover, the court refused to consider parol evidence in the form of merger and acquisition and banking treatises indicating that the "knowledge" qualification to Signet's representation meant that Signet lacked actual knowledge that the lease was not in full force and effect. The court noted that Signet could have drafted the representation to say "the Assignor is without knowledge" had it intended to qualify its representation in that manner.

Ottawa Sav. Bank v. JDI Loans, Inc., 374 Ill. App. 3d 394 (Ill. App. Ct. 2007) -- A participant bank, which was not paid when the lead bank transferred the loan, could not recover from the purchaser of loan. There was no privity of contract and no fiduciary duty between the participant and the purchaser. In addition, there was no evidence that the purchaser induced a breach of any duty lead bank owed participant. Accordingly, the Illinois state appellate court held that a purchaser of loans is not liable to the participants in the loans when the lender diverts the proceeds from the sale of the loans, where the purchaser did not collude with the lender to divert the proceeds.

LIEN AVOIDANCE

Tidwell v. LeGrand (In re Amron Techs., Inc.), 2007 Bankr. LEXIS 1028 (Bankr. M.D. Ga. 2007) -- Defendant lenders jointly agreed to fund a loan to a debtor. Only one lender (filing lender) filed a financing statement and perfected a security interest in the debtor's assets. The bankruptcy trustee brought an adversary proceeding to determine whether the lenders had a perfected security interest in the debtor's assets and, if so, the extent of such interest. It was undisputed that the filing lender had a perfected security interest in the debtor's assets, but the trustee contended that such interest only extended to the amount the filing lender contributed to the loan. The non-filing lenders argued that the omission of their names from the financing statement was not seriously misleading and thus did not affect the validity of their security interests, and that the filing lender filed the statement as a representative of the non-filing lenders. The bankruptcy court held that the filing lender alone had a perfected security interest in the debtor's assets and that such interest extended to the full amount of the loan. The financing statement was required to name the secured parties. Thus, the omission of the non-filing lenders could not be deemed a minor error. Further, absent any agency agreement, the filing lender had no authority to execute the financing statement on behalf of the non-filing lenders.

Geygan v. World Sav. Bank, FSB (In re Nolan), 2008 Bankr. LEXIS 541 (B.A.P. 6th Cir. 2008) -- A trustee brought an adversary proceeding against the creditor-mortgagee seeking to avoid the mortgage as defectively acknowledged because the certificate of acknowledgement did not identify the debtor-homeowner as the party executing the mortgage, as was required under the applicable state recording statutes. The bankruptcy court granted summary judgment in favor of the trustee and against the lender, voiding the lien. The appeals court affirmed the ruling of the bankruptcy court holding that the defective acknowledgement was insufficient to provide constructive notice of the mortgage to the trustee, and the mortgage was, therefore, avoidable by the trustee in the capacity of a bona fide purchaser under 11 U.S.C. § 544(a).

TAX LIABILITY (TRUST FUND, FEDERAL TAX LIENS AND WITHHOLDING TAXES)

Luria v. Standard Federal Savings and Loan Assoc., 116 Fed. Appx. 448 (4th Cir. 2004) -- The Fourth Circuit Court of Appeals affirmed the district court's dismissal of the appellant's claims that the lender had a contractual or OTHER legal duty to pay federal, state and local taxes. The appellant was the general partner of a limited partnership that secured a loan from the lender to construct a hotel. After the partnership missed several payments, the lender and the appellant entered into a letter agreement whereby the lender would receive all proceeds generated by the hotel in an account operated and maintained by the lender, and the hotel would submit requests to the lender for the payment of operating expenses. During the term of the letter agreement, a variety of federal, state and local taxes went unpaid. The limited partnership eventually filed for bankruptcy. The appellant

brought suit against the lender for the unpaid taxes. The Fourth Circuit agreed with the lower court that the language of the letter agreement clearly indicated that the lender did not assume any of the limited partnership's tax obligations. One isolated payment by the lender of the hotel's real estate taxes did not support the conclusion that the lender had assumed the hotel's tax obligations. As for a legal duty, the Fourth Circuit agreed that the lender (1) did not have sufficient control over the payment of wages to the hotel's employees, (2) was not a "responsible person" under the Internal Revenue Code such as to have the actual authority or ability to pay the taxes owed and (3) did not have actual knowledge that the limited partnership was not paying the proper amount of withholding taxes.

RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT (RICO)

Lum v. Bank of Am., 361 F.3d 217 (3d Cir. 2004) -- The Third Circuit Court of Appeals dismissed racketeering and antitrust claims made against a group of banks that allegedly had fraudulently inflated the prime rate, costing consumers more in interest payments. A group of plaintiffs argued that the defendant banks violated the Racketeer Influenced and Corrupt Organizations Act (RICO) and the Sherman Act by agreeing to misrepresent their prime rates as the lowest rates available to the most creditworthy borrowers. The plaintiffs contended that the banks conspired to fix the prime interest rate that serves as the basis for many adjustable rate loans. The plaintiffs alleged that the banks colluded to report higher prime rates to collect more interest from consumers, and the actual prime rate was lower than what was reported because the banks offered loans to the largest and most creditworthy customers at a rate lower than the reported prime rate. In dismissing the claims, the court found that the RICO claim, which was predicated on mail and wire fraud was not pled with specificity. The court concluded that the borrowers' claim was actually a disagreement about the meaning of the term "prime rate" and that such a disagreement did not rise to the level of fraud.

Royale Luau Resort, LLC v. Kennedy Funding, Inc., 2008 WL 482327 (D.N.J. 2008) -- The district court denied the defendants' motion to dismiss the plaintiff's fraud and RICO claims. The plaintiff and the defendants entered into a loan commitment, including a \$25,000 commitment fee paid by the plaintiff to the defendants. The loan proceeds were to be used to finance the development of certain real property. The loan commitment stated that the basis of the loan was on the market value of the real property "as completed". The commitment also stated that the defendants were obligated to loan no more than 60% of the appraised value of the real property, and in any event, no more than \$92,000,000. The plaintiff alleged that the defendant lender appraised the real property on an "as intended" rather than "as completed" basis, with the former focusing on pre-construction market value, and the former based on post-construction market value. As a result of the smaller appraisal, the loan to the plaintiff was insufficient to cover the development of the real property. The plaintiff sued the defendants alleging various state claims. The district court relied on a non-binding decision of the Third Circuit Court of Appeals in a similar decision involving the same defendants to conclude that the defendants' actions in securing a non-refundable commitment fee, requesting an appraisal at odds with the method agreed to by the parties, and their knowledge that a smaller appraisal would result in loan proceeds insufficient for their intended purpose was sufficient evidence to state a claim under the New Jersey Consumer Fraud Act. As for the plaintiff's New Jersey RICO claim against the defendants, the court construed the complaint as alleging that the corporate defendant was the entity through which the individual defendants committed racketeering acts. In such a scenario, the RICO claim against the corporate defendant had to be dismissed

because only individuals can be liable under the state RICO statute. The court found that the plaintiff's allegations regarding the defendants' statements in the loan commitment were pled with sufficient particularity to put them on notice of the claims filed against them.

Dahlgren v. First Nat'l Bank, 533 F.3d 681, 686 (8th Cir. July 11, 2008) -- When Damrow Cattle Company ("DCC") was placed in involuntary receivership and a Chapter 7 bankruptcy proceeding, fourteen cattle investors and corn producers who were fattening cattle and storing grain at the DCC feedlot lost over \$1.7 million plus nearly \$200,000 in bankruptcy litigation expenses. They sued the First National Bank of Holdrege, DCC's primary lender from 1983 until 2000, for treble damages and attorneys' fees under RICO and for fraud and negligent misrepresentation under state law, claiming that the Bank misled them into continuing to do business with DCC by concealing its increasing financial weakness to protect the Bank's substantial interest as DCC's creditor. A jury found the Bank liable on all claims, and the district court denied without opinion the Bank's post-verdict motion for judgment as a matter of law. The Bank appealed. The Eighth Circuit Court of Appeals ruled that because the plaintiffs failed to establish that the defendant bank directed the operations or management of the insolvent commercial cattle company during the time the plaintiffs were allegedly injured by the bank's pattern of racketeering activity, the district court erred in denying the bank's motion for judgment as a matter of law dismissing the RICO claims. Further, the Eighth Circuit found that the judgments for certain of the plaintiffs on their tort claims for fraudulent misrepresentation, fraudulent concealment and negligent misrepresentation were affirmed, while other portions of the judgment were reversed.

USURY

Raceway Properties, LLC v. LSOF Carlsbad Land L.P., 157 Fed. Appx. 959 (9th Cir. 2005) -- A borrower appealed dismissal of its usury claim against a lender following the district court's determination that a usury exemption for loans made to sophisticated borrowers applied. On appeal, the Ninth Circuit found no reversible error. First, the court dismissed the borrower's argument that the exemption did not apply because the requirement that the borrower could "reasonably be assumed to have the capacity to protect its own interests" should have been viewed from the borrower's perspective, and not the lender's. The Ninth Circuit found the distinction irrelevant, and that either the borrower or the lender could have reasonably expected that the borrower had the capacity to protect its interests in the transaction because of the borrower's experience and use of its professional advisors. Second, the court found that, while the district court omitted a licensed lender requirement that the borrower argued was necessary for the exemption to apply, such licensing was not required by the statute. Finally, the borrower took issue with the district court's omission of a \$2 million borrower asset requirement. The Ninth Circuit, however, found that the exemption applied if the borrower had at least \$2 million in assets or the loan was for at least \$300,000. Further, because the Ninth Circuit dismissed the borrower's usury claim on the merits, it did not address usury as an actionable unlawful business practice.

Scalici v. Bank One, N.A. 2005 WL 2291732 (Mich. App. 2005) (unpublished) -- Various investors charged a business more than 25% annual interest on a series of loans. The interest rate clearly violated Michigan's criminal usury statute. The investors could not avoid a claim of usury merely by asserting that they believed in good faith that the loans were legal. The rates shown on the notes clearly indicated that the annual return exceeded the Michigan usury ceiling.

LEASING (HELL OR HIGH WATER CLAUSE)

Locke's Graphic & Vinyl Signs, Inc. v. Citicorp Vendor Finance, Inc., 648 S.E.2d 156 (Ga. App. 2007) -- The plaintiff and defendant entered into an equipment lease pursuant to which the defendant was obligated to make 60 consecutive monthly payments to the plaintiff, plus applicable taxes. The lease provided that the defendant's obligations thereunder were absolute and unconditional without any abatement, set-off, defense or claim for any reason whatsoever. The lease disclaimed all warranties and stated that the equipment (a printer) was being rented to the defendant, and the defendant acknowledged that it had inspected and found the equipment to be satisfactory. The defendant later argued that the printer did not work at the time it was delivered and that the manufacturer had agreed to give the defendant a 90-day trial period once the printer was "up and operating." The plaintiff moved for summary judgment, which was granted by the trial court. The appellate court affirmed, noting that the equipment had been rented to the defendant on an "as is" basis and that the defendant had acknowledged that the equipment was satisfactory by executing an equipment and delivery acceptance receipt. Whether or not the manufacturer knew that the printer never worked correctly had no bearing on the defendant's liability to the equipment lessor under the lease.

FOOD LAWS (PACA AND PASA)

J.A. Besteman Co. v. Carter's, Inc., 439 F. Supp. 2d 774 (W.D. Mich. 2006) -- The defendant had purchased perishable agricultural commodities from the plaintiff regularly, and at all times had an unpaid balance on its account with the plaintiff. When the defendant's unpaid account balance exceeded \$940,000, the plaintiff brought an action against the defendant to recover the unpaid purchase price of the perishable goods and to enforce the "floating trust" authorized by the Perishable Agricultural Commodities Act ("PACA") for the benefit of unpaid sellers of perishable agricultural commodities. The district court entered a temporary restraining order to prevent the defendant from disposing of its assets other than in the ordinary course of business and held a hearing to determine the time at which the PACA trust first arose and the assets of the defendant that were the subject of the trust. The court concluded that the trust came into being when the first PACA indebtedness was incurred and the scope of the trust included all perishable agricultural commodities, all proceeds of those commodities and all assets acquired using the proceeds of those commodities. The court put the burden upon the defendant to demonstrate that a particular item of property was not acquired by it with proceeds of perishable agricultural commodities. Because the defendant was unable to do so, the court found that all of the assets of the defendant should be impressed with the PACA trust. Even though the effect of the court's ruling might be harsh on secured creditors, the district court stated that PACA reflects a congressional policy attempting to protect sellers of perishable agricultural commodities and affording them priority over other creditors.

Weis-Buy Services, Inc. v. Paglia, 411 F.3d 415 (3d Cir. 2005) -- Joining other appeals courts, the Third Circuit Court of Appeals ruled that, under certain circumstances, individual officers and shareholders may be personally liable for breaching their fiduciary duties under PACA. The statute of limitations, however, on such a cause of action begins when a buyer fails to pay on a timely basis

the amount owed to the seller. In this case, that time period was not equitably tolled while the buyers pursued their PACA remedies against the buyer in his Chapter 11 bankruptcy case.

Movsovit & Sons of Florida, Inc. v. Scotiabank, 447 F. Supp.2d 156 (D.P.R. 2006) -- In denying defendant bank's motion for summary judgment, the court held that it had failed to provide evidence to support its bona fide purchase defense. Under PACA, a secured lender will be forced to return property subject to a PACA trust unless it can establish that (1) no such trust existed when the property was transferred, (2) if a PACA trust did exist, that the transfer did not include trust assets or (3) if a PACA trust did exist and the transfer included trust assets, that all sellers were paid in full prior to the transaction. Alternatively, as in this case, a secured lender can establish that although it received property in breach of a PACA trust, it was a bona fide purchaser of the property. In the instant case, the court found that the bank had constructive knowledge of the trust based on its admitted knowledge of the borrower's business and such borrower's financial insolvency, and thus, denied the motion for summary judgment.

CONSUMER LAW THEORIES

A. FAIR CREDIT REPORTING ACT (FCRA)

Holmes v. Telecheck Int'l, Inc., 556 F. Supp. 2d 819 (M.D. Tenn. 2008) -- In ruling on the parties' summary judgment motions, the a district court in Tennessee found, among other things, that (i) simple numeric codes recommending whether to accept a check are "consumer reports" for Fair Credit Reporting Act (FCRA) purposes when issued by a consumer reporting agency, and (ii) the U.S. Supreme Court's recent holding in Safeco Ins. Co. of Am. v. Burr, 127 S.Ct. 2201 (2007) does not eliminate the relevance of pattern and practice proof to showing whether a violation was willful. The consumer plaintiff presented six checks as payments to four merchants. On the recommendation of TeleCheck, a provider of check verification services largely based on a database it maintains of consumer check writing histories, five of the six checks were declined at the point of sale. The merchant ultimately accepted the other check, but TeleCheck initially issued a code requiring the merchant to whom the plaintiff had presented the check to contact TeleCheck to provide additional information regarding the transaction. The plaintiff alleged that TeleCheck violated the FCRA in a number of ways. The court found that TeleCheck was a consumer reporting agency under the FCRA, and that the numeric codes issued to merchants by TeleCheck constitute consumer reports under FCRA. On the issue of damages, the court noted that the Supreme Court held in Safeco that punitive and statutory damages may be recovered under the FCRA only if a plaintiff demonstrates (i) the defendant knowingly violated her FCRA rights or (ii) the defendant acted with reckless disregard for those rights. The court determined, however, that the Safeco ruling did not eliminate the relevance of pattern and practice proof to establishing willfulness.

B. TRUTH IN LENDING ACT (TILA)

American Mortgage Network, Inc. v. Shelton, 486 F.3d 815 (4th Cir. 2007) -- The Fourth Circuit Court of Appeals joined a majority of other federal circuits in concluding that a borrower's notice to rescind a loan transaction under Truth in Lending Act ("TILA") does not automatically void the loan agreement. Rather, the "natural reading" of the statute is that a security interest becomes void when the borrower exercises a right to rescind that is available in a particular case, either because the

creditor acknowledges that the right is available or because an appropriate decision maker (i.e., court) makes that decision. Until then, borrowers “have only advanced a claim seeking rescission.”

Kellie Lippner v. Deutsche Bank National Trust Company, et al., 544 F. Supp. 2d 695 (N.D. Ill. 2008) -- A district court in Illinois ruled that a borrower’s rescission rights do not require a court determination before a lender must honor them and that a lender is required to perform its obligations before the borrower has any obligation to show his or her ability to pay the loan proceeds. The court further held that the assignee of a mortgage should be held liable for statutory damages and attorney’s fees for failing to honor a demand for rescission where the assignee has fair notice of the underlying TILA violation.

McKenna v. First Horizon Home Loan Corp., 475 F.3d 418 (1st Cir. 2007) -- The First Circuit Court of Appeals held that rescission claims under TILA cannot be aggregated for class action purposes. Adopting the views promoted by First Horizon and the industry *amici*, the court concluded that TILA’s \$500,000 class action damages cap implicitly bars class action treatment of rescission claims, which would impose on lenders overwhelming liability for relatively minor violations. Further, the court noted that TILA expressly provided for class relief for actions seeking damages but did not do the same with respect to rescission claims.

Andrews v. Chevy Chase Bank, FSB, 240 F.R.D. 612 (E.D. Wis. 2007) *rev’d*, 2008 U.S. App. LEXIS 20153 (7th Cir., Sept. 24, 2008) -- The plaintiffs alleged that the material disclosures the lender delivered to the consumer contained numerous violations, including violations of TILA’s disclosure requirements relating to payment period, the annual percentage rate, and the variable rate feature. The district court concluded that there is nothing in the language of TILA which precludes the use of the class action mechanisms to address rescission claims. On Appeal, the Seventh Circuit Court of Appeals recently reversed the district court holding that claims for rescission (as distinct from damages) under TILA may not be pursued on a classwide basis because “the rescission remedy prescribed by TILA is procedurally and substantively incompatible with the class action device.” *Id.* at *11.

Newman v. Apex Financial Group, Inc., 2008 U.S. Dist. LEXIS 2249 (N.D. Ill. 2008) -- The district court denied a motion to dismiss a TILA claim against the Mortgage Electronic Registration System (MERS), rejecting MERS’s argument that it was neither the creditor or assignee of the loan in question. The borrower brought suit against the broker, the alleged mortgage broker firm, several successor lenders and banks, and MERS alleging he was defrauded by a mortgage broker who allocated more of a fifth of the proceeds of the loan to himself. Among the many statutes under which claims were brought, the borrower alleged MERS was liable for violations of TILA. MERS moved to dismiss arguing that a TILA claim could only be brought against a creditor of the plaintiff or an assignee of the creditor. The court denied the motion noting that (i) as holder of the title, MERS has certain powers such as the ability to foreclose which, if exercised, would interfere with the proceedings of the case and (ii) the borrower could acquire complete relief only with the inclusion of MERS.

C. REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

Edward Friedman, et al. v. Market Street Mortgage Corporation, 520 F.3d 1289 (11th Cir. 2008) -- The Eleventh Circuit Court of Appeals vacated a class certification and remanded a case with instructions to dismiss the complaint because the plaintiff alleged that settlement fees were excessive in relation to the services actually performed, which the court held was not a valid claim under the Real Estate Settlement Procedures Act (RESPA) because the act requires a plaintiff to allege that no services were rendered in exchange for a settlement fee. Finally, the court held that Section 8(b) of RESPA did not govern excessive fees because it was not a price control provision. The plain language of Section 8(b) showed that it was a means of targeting abusive practices and was not as a means of setting broad ranging price controls.

Busby v. JRHBW Realty, Inc., 513 F.3d 1314 (11th Cir. 2008) -- The Eleventh Circuit reversed a district court's denial of class certification in a case alleging violations of Section 8(b) of the RESPA. The plaintiff Busby purchased a home and, in addition to paying a real estate brokerage commission, was charged an Administrative Brokerage Commission Fee ("ABC Fee") of \$149 at closing. Busby filed suit on behalf of herself and all others who were charged an ABC Fee, alleging that the fee violated RESPA as a fee charged for unperformed services. The district court denied her motion for class certification, finding that individual factual issues predominated the class. Relying upon Heimmermann v. First Union Mort. Corp., 305 F.3d 1257, 1264 (11th Cir. 2002) (addressing claims that yield spread premiums were unreasonably excessive) to deny class certification under RESPA Section 8(a), the district court determined that the excessiveness of a fee must be gleaned on a case-by-case basis. The Eleventh Circuit reversed, finding that the district court applied the wrong legal standard. The Eleventh Circuit emphasized that Busby and the purported class claimed that no work had been done in exchange for the ABC Fee, not that the fee was excessive. Thus, the court noted, class treatment is appropriate because "a simple binary determination of 'any services' or 'no services' is all that need be done."

Clearing House Ass'n, L.L.C. v. Cuomo, 510 F.3d 105 (2d Cir. 2007) -- The Second Circuit Court of Appeals affirmed the injunctive and declaratory relief granted by the District Court barring the New York State Attorney General from investigating national banks and their operating subsidiaries for possible violations of federal and state fair lending laws. The lawsuit originated in 2005 when the New York State Attorney General launched an investigation into the purported racially discriminatory real estate lending practices of several national banks. After analyzing loan data for 2004 under the federal Home Mortgage Disclosure act ("HMDA"), the Attorney General noted differences in loan prices that may have been based on the race of borrowers. The discovery of these disparities prompted the Attorney General to send inquiry letters to mortgage lenders implicated by the data. The letters suggested that racial disparities in the loan rates might be a violation of state and federal laws. Both the Office of the Comptroller of the Currency ("OCC") and The Clearing House Association, a consortium of national banks, filed separate complaints in the U.S. District court for the Southern District of New York, seeking to enjoin the attorney general's efforts. After a trial on the merits, the district court agreed that the attorney general's investigation was prohibited. The Second Circuit affirmed that part of the Clearing House judgment granting Clearing House the injunctive relief.

ANTITRUST (BANK HOLDING COMPANY)

Parsons v. James Parsons Construction Company, Inc., 2007 U.S. App. LEXIS 16519 (6th Cir. 2007) -- To state a claim under the Bank Holding Company Act (“BHCA”), a plaintiff must allege: (1) an anticompetitive tying arrangement, (2) that the banking practice at issue was unusual in the banking industry and (3) that such banking practice benefits the bank. The court dismissed the plaintiffs’ actions, which the court believed could be “distilled” into a single underlying action: “that actions taken by the defendant bank were not traditional bank practices directed toward securing loans” made by the bank to plaintiffs. According to the plaintiffs, the bank had asked for a “death-bed” assignment of life insurance policy to the bank. The court held that requests for further collateralization was standard in the banking industry, and thus, did not violate the BHCA. Further, it distinguished a case cited by the plaintiffs that related to a credit extension and improper conferral of a financial benefit on the bank itself.

Rosemont Gardens Funeral Chapel-Cemetery, Inc. v. Trustmark Nat’l Bank, 330 F.Supp.2d 801 (S.D. Miss. 2004) -- The court held that, under the BHCA, banks are not liable for imposing requirements on borrowers for the benefit of independent companies that purchase participations in a loan because those companies are not considered to be holding companies or subsidiaries of the principal bank. Moreover, in dismissing the borrower’s second claim under the BHCA, the court held that it was not unreasonable or unfair to propose that borrowers liquidate assets as a condition to lowering borrower’s loan payments.

Ticket Center, Inc. v. Banco Popular De Puerto Rico, 2006 WL 1047028 (D.P.R. 2006) -- The court refused to grant the bank’s motion to dismiss under the BHCA because the plaintiffs were only required to provide the bank with sufficient notice of their action through their complaint. Importantly, the court noted that antitrust actions should “rarely” be dismissed at the motion to dismiss stage, nor prior to giving a plaintiff “ample opportunity” for discovery.

Gold Bank v. Post Hill Greens, L.L.C., 2006 WL 2883262 (W.D. Mo. 2006) -- The defendant counterclaimed that the bank had violated the BHCA by requiring him to transfer monies from accounts of certain entities that had previously obtained loans from the bank, and to which the defendant had personally guaranteed, to a related entity’s account to pay interest on such related entity’s loans from the bank. The court found that this did not constitute a tying arrangement in violation of the BHCA. The court emphasized that this case was “not about a bank requiring one customer to guarantee the debt of another unrelated or incidentally related customer,” but was rather an effort by the bank to protect its investment. Thus, the bank’s motion for summary judgment was granted.

OTHER NOTEWORTHY CASES

National Energy & Gas Transmission, Inc. v. Liberty Electric Power, LLC, 492 F.3d 297 (4th Cir. 2007), petition for cert. denied, 2008 U.S. LEXIS 2113 (U.S. 2008) -- The Fourth Circuit Court of Appeals overturned both the bankruptcy and district courts and disallowed a claim for unpaid principal on a debt guaranteed by a nondebtor third party where a portion of the guarantor’s payment had been applied to post-petition interest. Liberty Electric Power, the creditor in this matter, was entitled to \$140 million plus \$17 million of interest. Liberty recovered the full amount of its

principal claim from a nondebtor surety, whose liability was capped at \$140 million. Liberty allocated that payment first to accrued interest and then to principal, thereby preserving \$17 million in unpaid principal for collection through the bankruptcy. Even though Liberty's claim was valid under state law and even though there were no allegations of wrongdoing or inequitable conduct, the Fourth Circuit rejected Liberty's claim. Citing purported equitable principles, the majority found that Liberty's claim effectively sought the recovery of post-petition interest, which is barred by Section 502(b)(2) of the Bankruptcy Code. In other words, as the dissent pointed out, the court "jettison[ed]... basic contract law principles in favor of an expansive reading of Section 502(b)(2)" and effectively limited the nondebtor guarantor's liability for interest that accrued after the debtor's bankruptcy petition.

Motorola, Inc. v. Official Committee of Unsecured Creditors and JPMorgan Chase Bank, N.A. (In re Iridium Operating LLC), 478 F.3d 452 (2d Cir. 2007) -- Narrowing the ways in which secured lenders can settle objections to their claims in Chapter 11 cases, the Second Circuit held that a pre-plan Chapter 11 settlement of lender liability and other claims against a senior lender might not be approved if the settlement would violate the "absolute priority rule" of the Bankruptcy Code.

Gettis v. Green Mountain Economic Development Corp., 892 A.2d 162 (Vt. 2005) -- The Vermont supreme court affirmed summary judgment in favor of lenders and economic development corporation. Borrowers claimed that they were forced to take on \$20,000 worth of credit card debt to complete the purchase of business equipment after initial loans they obtained from defendants proved to be insufficient and that lenders had promised to provide a consolidation loan at a lower interest rate to replace the credit card debt. Borrowers argued that the incurrence of such debt and their failure to obtain a consolidation loan led to the failure of the business. On appeal, the court found that the plaintiffs could not establish a causal link between the success of their business and the incurrence of the credit card debt. Plaintiffs failed to identify any lender that would have provided a consolidation loan had they not taken on the additional credit card debt, nor did they identify how their future creditworthiness affected the failure of the business. The court also found that the plaintiffs' other claims against defendants were merely speculative, including their assertion that they were forced to open their business during a slow period.