NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

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# BANKRUPTCY

## Summary Judgment for Non-Dischargeability Denied [BKR MD AL]

In state court, the creditor sued the debtor for claims arising from a promissory note executed by the debtor. The creditor's causes of action included unjust enrichment, fraudulent misrepresentations and wantonness, breach of contract, conversion, and negligence. The court granted the creditor's motion to deem the averments in the complaint as admissions after the debtor failed to respond to the complaint. The state court's final order awarded the creditor $47,198.85- $47,197.85 for breach of contract and $1 for the remaining claims. After the state court proceedings, the debtor filed for Chapter 13 bankruptcy and listed the creditor as holding an unsecured claim for the total state court judgment award. The creditor brought an action seeking an order that the debt owed to it by the debtor would be non-dischargeable under 11 U.S.C. § 523(a)(2)(A). The debtor argued that under the doctrines of res judicata or collateral estoppel, the final order "conclusively establishe[d]" the nondischargeable debt was limited to the $1 awarded in state court. The debtor moved for summary judgment based on collateral estoppel. In response, the creditor argued that there was "a genuine issue of material fact" regarding whether the full judgment award or only $1 "'results from' and is 'traceable to' the [debtor's] fraudulent actions."

In **Payne v. Ball (In re Ball)**, No. 23-31153-CLH, Adv. Proc. No. 23-03023-CLH, 2024 WL 974422, 2024 Bankr. LEXIS 546 (Bankr. M.D. Ala. March 6, 2024) (opinion not yet released for publication); the bankruptcy court denied the debtor's motion for summary judgment based on collateral estoppel. Collateral estoppel bars issues that have been litigated and decided by a final court judgment from being relitigated. The bankruptcy court explained that the Alabama collateral estoppel law governs because the final order had been issued in Alabama state court. In order to prevail on a collateral estoppel claim in Alabama, "(1) the issue must be identical to the one involved in the previous suit; (2) the issue must have been actually litigated in the prior action; and (3) the resolution of the issue must have been necessary to the prior judgment." Ex Parte Flexible Prods. Co., 915 So. 2d 34, 45 (Ala. 2005). The court first determined that there was an identity of issues between the creditor's fraudulent misrepresentation and wantonness claims in the state court proceedings and the elements required to show a debt nondischargeable under § 523(a)(2)(A). In Alabama, a fraudulent misrepresentation claim requires a showing of (1) a misrepresentation; (2) the misrepresentation was related to a material fact; (3) there was a reliance on the misrepresentation; and (4) the reliance was to the party's detriment. Similarly, to prove a debt is nondischargeable under § 523(a)(2)(A), a creditor has to establish intent by a debtor to defraud or a reckless disregard for truth, justifiable reliance on the debtor's false pretenses, and a loss resulting from false pretenses. Next, the court found that the issue had not actually been litigated in the prior action. Instead, the state court had entered the final order by a default judgment after the debtor's "failure to appear and defend" in the state court proceedings. The court explained that Alabama courts have generally declined to find that issues have been actually litigated when a default judgment has been entered. Finally, the court found that the issue of fraud was not necessary to the state court's judgment because it had been a default judgment. The state court did not include any specific findings in the final order; thus, it was impossible to determine whether the prior outcome had been "hinged" upon determining the issue of fraud. The court determined that because the elements of collateral estoppel had not been met, the final order did not have a preclusive effect, and, therefore, genuine issues of material fact existed. Accordingly, the court denied the debtor's motion for summary judgment.

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# EFTA

## Credit Union Loses Motion to Dismiss on EFTA and Other Claims [SD CA]

The depositor was a customer of the credit union and opened a joint checking account with his minor son. The depositor's debit card was stolen, and numerous unauthorized transactions were made using the stolen card. The depositor filed a claim with the credit union to challenge the charges but the claim was denied. The credit union determined that "no error had occurred." The depositor appealed the finding and requested more information. The credit union once again denied the claim, stating that the depositor remained liable for the charges and needed to file a police report if the customer wished to receive more information on the reasoning for the denial. The depositor submitted a police report, a Consumer Financial Protection Bureau claim, and a complaint to the Better Business Bureau. Still, the credit union maintained that the depositor remained liable for the charges. In response, the depositor filed a class action lawsuit against the credit union, alleging violations of the Electronic Funds Transfers Act (EFTA), the California Unfair Competition Law (UCL), and breach of contract. The credit union filed a motion to dismiss, arguing that it had complied with the EFTA; the depositor did not have standing to bring the state unfair competition law claim because of a choice of law provision in the deposit agreement and had failed to state a claim for breach of contract.

In **Stephenson v. Navy Fed. Credit Union**, No. 23-cv-1851-WQH-KSC, 2024 WL 4257639, 2024 U.S. Dist. LEXIS 170470 (S.D. Cal. Sept. 20, 2024) (opinion not yet released for publication), the court granted the motion to dismiss on the UCL claims and denied the motion to dismiss the breach of contract and EFTA claims. First, the court discussed the depositor's claims under the EFTA. The court found that the depositor had "adequately alledge[d]" a violation of the EFTA when the credit union required the depositor to file a police report to obtain more information on the denial. The EFTA requires the credit union to supply the depositor with "all documents which the financial institution relied on to conclude that such error did not occur." 15 U.S.C. §1693f(d). Further, the court found that the depositor had sufficiently alleged that harm had resulted from being "on the hook" for the unauthorized transactions. Second, the court addressed the California UCL claims and whether the choice of law provision in the agreement governed. The credit union argued that the agreement mandated that Virginia law be applied to dispute resolution. The court stated that, in California, an agreed-upon choice of law provision would govern unless it "would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which... would be the state of the applicable law in the absence of an effective choice of law." Nedlloyd lines B.C. Superior Court, 3 Cal. 4th 459,466 (1992). The court found that "Virginia's consumer protection laws generally do not allow for class actions... [t]hus, there is a substantial risk that a California fundamental public policy in favor of class actions would be harmed by applying Virginia law." Van Slyke v. Cap. One Bank, 503 F. Supp. 2d 1353, 1361 (N.D. Cal. 2007). Then, the court found that California had a "materially greater interest" in determining consumer protection claims and rendered the choice of law provision unenforceable. In the alternative, the credit union argued that the depositor lacked standing to bring a UCL claim because he had not suffered-monetary harm and that, regardless of harm, recovery was limited to restitution or an injunction. The court found that the depositor had sufficiently alleged injury by claiming that he lost money because the claim had been denied. However, the court held that (1) the depositor was not entitled to restitution because he had failed to show that the credit union had money to which he was entitled; and (2) the depositor did not state a claim for injunctive relief by because the customer had failed to allege an '"actual or imminent' threat of repeated injury." Thus, the court granted the credit union's motion to dismiss the California UCL claims. Third, the court addressed the depositor's breach of contract and covenant of good faith and fair dealing claims. The depositor argued that after proper notification of the unauthorized transaction and a finding of "no error," the agreement required the credit union to provide the depositor a "written explanation." However, the credit union had only sent the depositor a conclusory determination without an explanation. In addition, the court held that the depository had sufficiently alleged that the credit union had breached the implied ,covenant of good faith and fair dealing by "fail[ing] to exercise its discretionary· power" in determining whether to approve or deny a claim in good faith. Therefore, the court denied the motion to dismiss the breach of contract claim. In short, the court denied the credit union's motion to dismiss except for the UCL claims, for which the court allowed the depositor leave to amend.

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# LENDING

## The Debtor's Very Bad, No Good, Loan Default [SD NY]

The debtor borrowed $38 million from lenders (for simplicity, the "bank") to renovate its hotel. However, the debtor defaulted on the loan twice. The first event of default occurred when the hotel decided to close for at least four weeks in March 2020 because of COVID-19. This violated an operating covenant in the loan agreement requiring that the hotel "be operated, repaired and maintained as a 'first-class hotel.'" The second default event occurred when the debtor missed a loan payment. At the time of both defaults, the debtor requested the bank renegotiate the loan agreement. Eventually, the loan servicer sent a prenegotiation letter to the debtor. It contained a provision that no agreement made in the discussions would constitute a binding obligation "unless and until [the parties] have executed a definitive written agreement." The debtor signed the letter and later the parties signed a loan modification agreement that waived only the debtor's second event of default for the missed payments; however, the debtor thought the agreement had also waived the default that arose from its having closed the hotel. This default provided that the debtor would be liable for additional default interest payments. For the next year, the debtor's loan statements listed $0.00 due for past due default interest. The parties then signed a second loan modification agreement to address another issue. The second loan modification agreement contained an acknowledgment of an existing event of default. However, the loan statements continued to list $0.00 due for past due default interest. Meanwhile, the debtor was in discussions with potential third-party buyers about converting the hotel into a retail property with possible third-party investors. In connection with these negotiations, the loan servicer informed the debtor that the transition plan would require extensive modifications to the loan agreement or the debtor could pay off the loan early and face prepayment penalties. In response, the debtor approved the transfer of its loan to a special servicing division in the hope of getting the prepayment penalties reduced; however, the penalties were not reduced, and the debtor requested that the loan be transferred back out of the special servicing division. The debtor then requested a payoff quote from the loan servicer to use in its negotiations for the sale of the hotel. The quote, which the loan services sent on August 6, 2021, listed a charge of nearly $3 million in default interest. The debtor initially claimed August 9th was the first time it was made aware of the default interest, but later claimed it had actually been made aware of the default interest charges on July 22, before the sale negotiations had begun. The debtor challenged these interest charges and sued the bank and loan servicers for breach of the loan agreement, breach of the loan agreements implied covenant of good faith and fair dealing breach of the special-servicing agreement, intentional misrepresentation, and negligent misrepresentation. The debtor sought consequential damages for a total of nearly $58 million; 80% of this total came from consequential damages the debtor believed it was owed from the threat of the default interest, which it claimed had forced it to sell the hotel for $48 million below the property's market value.

In **360 N. Rodeo Drive, LP v . Wells Fargo Bank**, No. 22-cv-767(AS), 2024 WL 4039643, 2024 U.S. Dist. LEXIS 158837 (S.D. N.Y. Sept. 4, 2024) (opinion not yet released for publication), the court held the debtor only succeeded on its claim for breach of the special servicing agreement. The court denied the debtor's first claim that the bank breached the loan agreement because the debtor had believed the default interest had been waived under the first loan modification agreement. The court noted that the debtor had first breached its agreement by shutting down the hotel. Additionally, the court explained that the loan servicer acted within the bounds of the agreement when it listed zero default interest on one statement and then later added the charge. The debtor argued that its obligation under the operation covenant had been excused under the frustration-of-purpose doctrine because COVID-19 would have made operating the hotel valueless to the debtor. However, the court concluded that the debtor's obligations to operate the hotel had not been removed, and even if operating the hotel would have been less profitable to the debtor, it failed to prove that operating it would have been wholly valueless. For this reason, the servicer had not breached the loan contract. Additionally, the court explained that because of the equal sophistication of both parties and the worth of the total contract, the court could not find the accrual of interest to be unconscionable. Next, the court denied the debtor's second claim for breach of the loan agreement's implied covenant of good faith and fair dealing. The debtor asserted that it had received inaccurate loan statements, but as explained previously, the loan statements only showed that the loan servicer exercised its discretion as to when to charge for default interest, which the agreement permitted. Thus, the court chose not to limit the loan servicer's discretion, because doing so would have been "inconsistent with the express terms of the contract." Next, the court ruled in favor of the debtor's third claim for breach of the specialservicing agreement. It noted that the agreement to transfer the loan to the specialservices division stated that "[ the debtor] would pay $2,500 in special-servicing fees per month." However, in negotiating this agreement, the loan servicer sent the debtor an email regarding the special-servicing fees, and the debtor responded with certain conditions to which the bank had not responded. By not responding to an offer made by the debtor and completing the transfer to the special-servicing division, the loan servicer had partially performed, which could have been

considered a partial acceptance of the debtor's counteroffer. Examining the initial agreement, the court concluded that the loan servicer had overcharged the debtor for fees; therefore, the court awarded the debtor $548,645.42 in damages for that breach. By contrast the court denied the debtor's fourth claim for intentional misrepresentation because the statements made by the bank were never guarantees upon which the debtor could act or could have reasonably relied. Lastly, the court denied the debtor's fifth claim for negligent misrepresentation for the same reason and also because the bank could not have foreseen the debtor's intent to sell the hotel. Therefore, the debtor could not recover consequential damages because the bank did not breach the contract. Ultimately, the court found for the debtor only on its special servicing agreement claim and for the loan servicer on all other claims.

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## REGULATIONS

### Statute of Limitations Begins at Time of Injury, Not Publication of Regulation' [8TH CIR]

The retailer opened and operated a convenience store and truck stop that allowed customers to make debit card transactions. In 2011, the Board of Governors of the Federal Reserve System ("the agency") promulgated Regulation II pursuant to statutory authority. Regulation II allowed "a maximum interchange fee of 21 cents per debit-card transaction and an ad volorem allowance of 0.05 percent of the transaction." The retailer joined a lawsuit challenging the debit-card transaction fees of Regulation II on the grounds that the fees were "arbitrary and capricious" under the Administrative Procedures Act (APA) and violated the Durbin Amendment to the DoddFrank Act of 2010. The regulatory agency filed a motion to dismiss based on the statute of limitations provided in 28 U.S.C. § 240l(a), which states that claims against the United States must be "filed within six years after the right of action first accrues." The district court, affirmed by the Eight Circuit, held the limitations began to accrue upon the publication of the regulation in 2011 and dismissed the retailer's claims.

In **N.D. Retail Ass'n v. Bd. Of Governors**, 113 F.4th 1027 (8th Cir. 2024), the Eighth Circuit, at the direction of the Supreme Court, vacated its earlier opinion affirming the dismissal of the retailer's claims. The Supreme Court had reversed the Eighth Circuit's judgment to clarify that the six-year statute of limitations begins to accrue at the time of injury by the regulatory agency action, not the date of the issuance. Corner Post, Inc. v. Bd. of Governors of Fed. Reserve Sys., 144 S. Ct. 2440, 2460 (2024). Because the retailer filed suit within six years of the injury, the party was not barred from pursuing an action against the agency. The Eight Circuit remanded the case to the district court for further proceedings consistent with this decision.

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## SECURITY INTERESTS

### Conversion Claim Fails Because Bank Authorized Transfer of Collateral [5TH CIR]

The debtor obtained two loans for operating capital from the bank, and to secure to loan, the bank obtained a security interest on all inventory, including proceeds from the sale of the inventory. In the interest of encouraging the debtor's profitability, the terms of the loan allowed the debtor to sell inventory so long as it maintained a minimum amount of inventory. Furthermore, in accordance with U.S. Small Business Administration loan requirements, to which one loan was subject, the creditor did not require the debtor use sale proceeds to repay the bank. After two years, the debtor experienced financial difficulties, leading it to enter into a consignment agreement with an existing supplier, the payee. The payee later sued the debtor for violating the consignment agreement, and the bank intervened and filed a motion for a declaratory judgment that the inventory in question was its collateral. The bank also asserted a claim for conversion against the payee for the proceeds of the inventory that the debtor had transferred to it. The issue on appeal was whether the transfer of proceeds of the inventory made the payee liable to the bank for conversion.

In **Shinsho Am. Corp. v. TransPecos Banks, SSB**, No. 23-20520, 2024 WL 3738476, 2024 U.S. App. LEXIS 20102 (5th Cir. Aug. 9, 2024) (unpublished opinion), the Fifth Circuit Court of Appeals affirmed the district court's dismissal of the bank's conversion claim. To show proof of conversion in Texas, a party must control the property of another without authorization in violation of the owner's rights. The court found that the bank had authorized the transfer of sale proceeds to the payee and, in effect, released its security interest. Once the court decided that the transfer had been authorized, the bank's claim lacked a required element of conversion, and therefore failed.

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## Disposing of Collateral: What is Commercially Reasonable? [BKR SD TX]

The borrower and related guarantors (the "borrowing parties") brought claims against several secured parties, alleging the secured parties had failed to dispose of the collateral in a commercially reasonable manner, which would have paid off the debtor's outstanding debts. The secured parties on the loan consisted of the lender, an administrative agent, and an investment advisor to the loan. Each side also sought damages for breach of contract. The borrower had obtained two loans from the lender for a new business project. The maturity date on both loans had been extended to May 2020. The loans had been secured by the following collateral: (1) 25 million shares of the borrower's stock in his company (the "borrower's shares") (which the borrower did not want to be sold for the sake of the company's success); (2) a ranch located outside Aspen, Colorado owned by the borrower; and (3) various equity interests held by the borrowing parties. At the time of the second loan, the borrower and the lender executed an account control agreement, which provided that if a notice of control were issued, the investment advisor could take control of the account holding the borrower's shares.

The borrowing parties defaulted on both loans and proceeded to enter into two bridge agreements (one for each loan) with the secured parties that provided the secured parties would forbear from exercising their rights in the collateral until either a termination event or until March 30, 2021. The bridge agreements provided, among other things, that the borrower would complete the sale of the ranch by December 2020, the proceeds of which would go to repay the loans. At the time of the bridge agreements, the investment advisor delivered a notice of control as required under the control agreement. The loans had still not been paid by March 2021, nor had the borrower fulfilled his obligation to sell the ranch; however, the secured parties agreed to continue working with the borrower and focused on selling the ranch rather than exercising their rights in other collateral. After a long period of negotiations, the ranch remained unsold, and the secured parties continued to refrain from selling the borrower's shares (as requested by the borrower). After this period, the secured parties informed the borrower that it planned to pursue repayment from other collateral and sell the shares because the secured parties believed the borrowing parties were attempting to avoid their obligations under the loans. Finally, at the beginning of 2023 (nearly two years after default), the secured parties sold the borrower's shares and a yacht owned by a guarantor of the loan. The ranch ultimately was sold in a Chapter 11 bankruptcy. Because of the value of the shares at the time of sale, the secured parties were not able to recover enough funds to fully forgive the debt. However, if the secured parties had sold the shares earlier in this process, the value of the collateral would have been more than enough to repay the borrowing parties' debts. Thus, the borrowing parties brought suit, alleging that the secured parties did not dispose of the collateral in a commercially reasonable way and also alleging that the lenders' proof of claim in the bankruptcy case should not be allowed.

In **AVR AH LLC v. Nineteen 77 Capital Solutions A LP (In re Strudel Holdings LLC)**, 659 B.R. 659 (Ban1cr. S.D. Tex. 2024), the court found that the secured parties did dispose of the collateral in a commercially reasonable way and held that the borrowing parties owed the secured parties at least $100 million on the loans before taking into account any reduction for the sale of the ranch through the related chapter 11 cases. First, the court found that under applicable New York law the secured lenders had disposed of the collateral in a commercially reasonable manner (i.e., did not act in bad faith). New York UCC Article 9-610(a),(b) provides that all aspects of the disposition of collateral by a secured party must be "commercially reasonable." Commercial reasonableness is a factual inquiry based on the whole circumstances of the case, including whether a creditor made good faith efforts when dealing with the disposition of collateral. Under 9-610(b), "a disposition is commercially reasonable if it is made '(1) in the usual manner on any recognized market; (2) at the price current in any recognized market at the time of the disposition; or (3) otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition."' The fact that the secured parties may have achieved a better price if they had sold the collateral at a different time or in a different method did not show, without other evidence, that the sale was commercially unreasonable.

As to the disposition of the shares, the borrowing parties argued that by being in control of the shares under the control agreement and by not selling them until February 2023, the secured parties unreasonably delayed the disposition of the collateral in order to gain more interest on the loans. However, the court found no evidence of undue delay but rather concluded that had been an active effort (through bridge agreements, respecting the borrower's own requests; focusing on the borrower's ranch sale plan instead as a method for repayment, etc.) by the secured parties to work with the borrower-in good faith to allow the borrower to repay the loan and avoid liquidating his personal assets. Therefore, based on the totality of the circumstances, the secured parties did not act commercially unreasonably for holding off on the sale of the borrower's collateral because the secured parties were in good faith discussions with the borrowing parties trying to recover the loan amount in the traditional way. The court also found that the method used for the disposition of the borrower's shares -the New York Stock Exchange- was commercially reasonable because it is a recognized market under the UCC. Further, the court held that the disposition

of the shares was still commercially reasonable regardless of any arguments that the secured parties could have conducted the actual sale differently. As to the disposition of the ranch, the court found no evidence that, as a result of the secured parties not following the borrowing parties' plans for the sale, the sale was commercially unreasonable. As to the disposition of the yacht, the court also found that the sale was conducted in a commercially reasonable manner. The borrower also argued that the secured parties' failure to communicate with him during the sale process made the sale commercially unreasonable. The court disagreed for several reasons - the secured parties had appointed a consultant to assist in the disposition of the vessel who had attempted to reach out to the borrower, but the borrower had failed to provide any meaningful response, and the actual sale and manner had been commercially reasonable based on the determined value of the yacht. The court then denied both the borrowing parties' and the secured parties' claim for breach of an implied duty of good faith and fair dealing. The court reasoned that the secured parties did not breach this implied contractual duty simply because they rejected the borrower's plans for repayments or sales; disagreements between the parties do not indicate a breach of the implied contractual duty because each party has a right to act in its own interest under the contract. Similarly, the court found that the borrowing parties did not violate the implied duty by filing the lawsuit; rather, they acted in their interest under the contract in the same way the secured parties had acted in their interest. Ultimately, the court found that because the secured parties did not breach any agreements with the borrowing parties, acted in good faith throughout negotiations with the borrowing parties, and used commercially reasonable efforts to dispose of collateral, there was no breach of contract or any claim in which the borrowing parties would not be found liable for the repayment of the loans.

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## Prior Perfected Security Interest Protects the Bank from Equitable Subrogation [MN APP]

The surety appealed a district court decision that granted summary judgment to the bank regarding disputed funds held by a receiver in a receivership action. The surety argued it was entitled to account receivable funds held in receivership under an equitable subrogation theory. In March 2020, the bond principal and surety had entered into a surety relationship by executing a General Agreement of Indemnity (the "indemnity agreement") for public works projects (the "bonded projects"). Earlier, in April 2020, the bank had made three loans to the bond principal. For all three loans, the bank and bond principal executed security agreements that granted the bank a security interest in the debtor's property, including the debtor's accounts receivable. That same month, the bank perfected its security interest by filing UCC financing statements with the Minnesota Secretary of State. The bond principal defaulted on the bonded projects, and several subcontractors and suppliers filed claims with the surety for their losses. Later, in April 2021, the surety issued several bonds, noting the bond principal as contractor and itself as surety, and paid a large sum on the bonded projects. In May 2021, the bank provided written notice to the bond principal that it had defaulted on its loans, but the bond principal failed to cure the default. In November 2021, the surety filed a UCC financing statement with the secretary of state, listing the indemnity agreement as collateral. In December 2021, the bank sued the bond principal. The district court entered judgment in the bank's favor and appointed a limited receiver over the bond principal's property. The receiver identified over $500,000 in accounts receivable funds in February 2023, the bank and the surety filed motions for summary judgment seeking the accounts receivable funds. The district court denied the surety's motion and granted the bank's motion.

In **Receivership of United Prairie Bank v. Molnau Trucking**, LLC, No. A23-1478, 2024 WL 1987878, 2024 Minn. App. Unpub. LEXIS 362 (Minn. Ct. App. May 6; 2024) (unpublished opinion), the court affirmed the district court holding that summary judgment for the bank was proper because (1) the doctrine of equitable subrogation was not available to the surety; (2) even assuming the doctrine was available, the bank had perfected its interest in the bond principal's collateral before the surety's equitable subrogation claim could have attached; and (3) even if the indemnity agreement gave the surety the obligation to pay, the surety had not executed the agreement to bind itself to it. The doctrine of equitable subrogation provides that "a party 'who has discharged the debt of another may succeed in substitution to the rights and position of the satisfied creditor.'" Ripley v. Piehl, 700 N.W.2d 540, 545 (Minn. App. 2005). Equitable subrogation is only applicable where "(a) the party seeking subrogation has acted under a justifiable or excusable mistake of fact; and (b) injury to innocent parties will otherwise result." Peterson v. Zero Ests., 261 N.W.2d 346, 348 (Minn. 1977). The court found that the surety failed to establish any mistake of fact to meet the first requirement for imposing equitable subrogation. The court reasoned that because the bank had filed its UCC statement, the surety was on notice that the bank had perfected its interest in the bond principal's property. And despite the notice, the surety had paid on the bonds. Therefore, the court could find

no mistake of fact. Regardless, even if the surety agreement could meet the required prongs, the court agreed with the district court that the bank's security interest was first in time. Under Minnesota law, a surety's equitable subrogation claim attaches when the surety issues a payment bond. Here, the surety company did not issue the bond until the year after the bank had already perfected its security interest. The court noted that the surety company was not required to pay the bonds under the indemnity agreement, and as such, there was no argument that the bank should not retain priority over any interest of the surety company.

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## Unsurprisingly, A Subordinate Creditor's Interest is Subject to the Superior Creditor's Interest [RI SUPER]

In 2005, a debtor issued bonds to expand its business, and a bond trustee was appointed (primary creditor). The debtor ultimately defaulted on this loan. Later, in 2008, the debtor entered into an agreement with a company (secondary creditor) that provided operational and management services. In 2009, that agreement was terminated, but the debtor still owed money to the secondary creditor. In 2019, the secondary creditor obtained a stipulated judgment for the funds during a mediation with the debtor and with the authorization of the primacy creditor. However, the secondary creditor did not receive payment. The secondary creditor commenced an action demanding payment in full and priority above the primary creditor's interest. The debtor and the primary creditor opposed this and, in turn, filed a motion to dismiss, arguing that the secondary creditor's rights were secondary to the rights of the primary creditor.

In **Avcorr Management LLC v. Central Falls Detention Facility Corp.**, No. PC-2023-02605 2024 R.I. Super. LEXI 76 (R.I. Super. Ct. Aug. 27, 2024) (opinion not yet released for publication), the Superior Court of Rhode Island, Providence, partially granted the motion to dismiss, finding that the secondary creditor could not enforce its judgment against the debtor without the permission of the primary creditor. Adhering to traditional commercial laws, the court determined that the primary creditor's rights were superior to the secondary creditor's rights because the primary creditor perfected its security interest first in 2005. The court reasoned that the primary creditor had the right to "determine the proper course of action" upon default of the debtor. The primary creditor chose to work with the debtor instead of collecting on the outstanding debts, arguing its best chance of a full recovery was to let the debtor corporation continue operating. Thus, the court said that the secondary creditor could not, force the sale of the assets to recover its funds because the primary creditor held and exercised the right of disposition upon default. However, the court did mention that the secondary creditor may be able to hold the primary creditor liable for the debtor's obligations under the doctrine of equitable subordination, because the primary creditor has likely exercised excessive control over the debtor's business. However, this issue was not decided by the court.

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# WIRE FRAUD

## Not Your Client? You May Nevertheless Owe a Common Law Duty to Protect Against Fraud [D ME]

The payee brought an action against the bank seeking to recover fund lost to a non-party fraudster. The payee is a single attorney law firm; the lawyer had directed his client via email to wire funds to the firm's bank account. Later, the fraudster gained access to the payee's email account and, mirroring the payee's original email sent a message to the client directing it to wire the funds to a different account held by the fraudster at one of the bank's Texas locations. Once the payee was aware of the apparent fraud, he contacted the bank to inform it of the issue; the bank nevertheless allowed withdrawals out of the fraudster's account after receiving notice of the fraud from the payee. The payee alleged various UCC and common law claims and argued that the bank owed the payee and its client a duty of care, had a fiduciary responsibility to protect the stolen funds once the bank was made aware of the fraudulent activity, and that the bank breached that duty of care. The bank filed a motion to dismiss the claims, arguing that (1) a Maine statute bars the claims, (2) the UCC preempts the common law claims, (3) there was no fiduciary relationship between it and the client, (4) the payee had failed to provide a specific UCC provision that the bank had violated.

In **Hirshon L. Grp. PC v. Wells Fargo Bank N.A.**, No. 2:23-cv-00445-LEW, 2024 WL 4308285, 2024 U.S. Dist. LEXIS 174079 (D. Me. Sept. 26, 2024) (opinion not yet released for publication), the court dismissed the payee's claims for breach of fiduciary duty and the UCC claims but allowed the payee to proceed on claims for the breach of common law duties. First, the court discussed the choiceof-law provision to

determine whether Maine or Texas law governed. The court applied Texas law after finding that "Texas bears the most direct relationship to the controversy." Thus, the court denied the bank's motion to dismiss based on a Maine statute. Second, the court dismissed the bank's argument that the UCC preempted or displaced the payee's claims. The bank argued that the only relief available to the payee was through a judicial order under UCC Article 4A-503. The court held that Article 4A-503 was not the "be all, end all of this dispute" because this case "concerns post-acceptance oversight of funds on deposit, rather than any claim of improper acceptance or deposit." Further, the court stated that it was "not persuaded" that Article 4A-503 was applicable to the controversy; However, it left the issue open for an evaluation of Texas law in a later proceeding. Third, the court found that the bank's argument that it had no fiduciary duty to the payee or its client was "intuitively reasonable," because the payee had provided no binding authority that could hold the bank liable as a fiduciary to a non-client depositor. Therefore, the court granted the bank's motion to dismiss the claim for breach of fiduciary duty. Finally, the court held that the payee had failed to specifically identify a provision in the UCC showing the bank owed the payee or his client a post-acceptance duty regarding the deposit. Thus, the payee's UCC claim was dismissed. Ultimately, although the court dismissed the payee's fiduciary duty and UCC claims, it allowed the payee on its remaining claims for breach of common law duties.

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