NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

A newsletter covering bank legal and compliance information.

Volume 25 • Issue 8

August 21, 2025

BANKRUPTCY

No Evidence, No Nondischargeability [BKR SD TX]

Three individuals, including the debtor, operated a business as principals. The creditor loaned money to the principals for their business. The loan was memorialized by a note, and all three principals were jointly and severally liable for the debt. Eventually, the principals stopped making full payments and defaulted on the loan. The creditor sued two of the principals, including the debtor, and received a default judgment for $10,429.02. Seven years after the default judgment, the debtor filed for Chapter 7 bankruptcy. The creditor brought this adversary proceeding, seeking a determination that the default judgment debt was nondischargeable under 11 U.S.C. - § 523(a)(2)(A). The creditor alleged that he loaned the debtor money "based upon oral and written representations made by [the debtor] and the [business] which were not true and materially false." The debtor's version of the facts differed, and he claimed that he made "no oral representations regarding the business other than [that] they needed cash to fund business operations."

In Vasquez v. Mascareno (In re Mascareno), No. 24-50036, Adv. No. 24-5001, 2025 WL 892553, 2025 Bankr. LEXIS 683 (Bankr. S.D. Tex. Mar. 21, 2025) (unpublished opinion), the bankruptcy court held that the creditor failed to meet the burden of proof for a debt to be deemed nondischargeable under § 523(a)(2)(A) of the Bankruptcy Code. The court first concluded that the creditor's claims regarding written representations were false and that the only valid claim concerned oral representations made by the principals. Other than that factual determination, the court explained that any factual differences between the parties were irrelevant because the creditor's nondischargeability claim failed on other grounds. "Section 523(a)(2)(A) excepts from discharge any debt owed by an individual debtor to the extent obtained by 'false pretenses, a false representation, or actual fraud, other than a statement representing the debtor's or an insider's financial condition.'" A creditor must prove nondischargeability by a preponderance of the evidence. The court noted that to succeed, the creditor must prove that (1) the debtor made the representations; (2) the debtor knew at the time they were false; (3) the debtor made the representations with the intention of deceiving the creditor; (4) the creditor relied on the representations; and (5) the reliance caused the creditor to sustain the alleged loss and damage. The court found that the creditor failed to prove elements (2) and (3). The court held the evidence insufficient to prove that the debtor knew any representations made were false or were made with an intent to deceive the creditor. The court noted the conflicting testimony and lack of corroborating testimony. An intent to deceive may be inferred by a debtor's use of false financial statements, but the record lacked any documentary evidence other than the promissory note itself. Therefore, the court found no evidence supporting the creditor's burden on elements (2) and (3) and thus discussion of the remaining elements was unnecessary. The court also denied the debtor's request for attorney's fees in defense of this adversary proceeding. Section 523(d) provides that if a creditor brings a nondischargeability claim for consumer debt under § 523(a)(2) and the court discharges the debt, then the debtor shall receive a judgment for the costs of the proceeding and reasonable attorney's fees if "the court finds that the position of the creditor was not substantially justified." Here, the court found that the debt was a business loan, not a consumer debt, so the debtor was not entitled to attorney's fees.

By Kristin Meurer krmeurer@ttu.edu
Edited By Taylor O'Brien taylobri@ttu.edu
Edited By Callighan Ard caard@ttu.edu
Edited By Hayden Mariott hayden.mariott@ttu.edu

No Objection to Foreclosure: Annulment Confirmed [5TH CIR]

A doctor (the "doctor debtor") and his medical practice (the "practice debtor"), of which the doctor was the sole member, filed for a total of three bankruptcies. The doctor debtor had a loan with the creditor that was secured by the property in which the medical practice operated its clinic (the "property"). The doctor debtor filed first for chapter 11 bankruptcy ("bankruptcy l"). The creditor filed a motion for abandonment and termination of the automatic stay under 11 U.S.C. § 362, which the bankruptcy court granted, ordering the property abandoned from the estate, terminating the automatic stay, and allowing the creditor to foreclose on the property. However, before the creditor could foreclose on the property, the practice debtor filed for chapter 11 bankruptcy ("the second bankruptcy"). The creditor again moved for termination of the automatic stay in the second bankruptcy, which motion the bankruptcy court also granted, and also ordered the practice debtor to pay adequate protection payments to the creditor. The practice debtor defaulted on the ordered payments, and the property was abandoned from the second bankruptcy estate as well. The doctor debtor then filed a second individual Chapter 11 bankruptcy, which was later converted to a Chapter 7 case (the "third bankruptcy"). The creditor did not move for relief in this case and instead filed a proof of claim based on the loan with the doctor debtor that had granted the creditor a lien on the property. The creditor and the doctor debtor's counsel also agreed that the automatic stay had been terminated in the third bankruptcy because thirty days had passed since the filing of the third bankruptcy. The provider debtor filed a notice of intent to abandon the property and moved out. The creditor foreclosed on the property. The doctor debtor received a discharge in the third bankruptcy, and over a year later, filed a motion claiming the creditor had violated the automatic stay under § 362(k), arguing the foreclosure had been a willful violation of the stay. The creditor then filed a motion for annulment of the stay and maintained that the foreclosure had been lawful. The bankruptcy court denied the doctor debtor's motion and stated the debtor had "not shown why annulment should be denied." The debtor appealed, but the district court affirmed the bankruptcy court's decision. The debtor appealed again, arguing that the district court erred when it (1) failed to determine if the creditor's automatic stay violation was willful; (2) "affirmed the [b]ankruptcy [c]ourt's retroactive annulment of the automatic stay"; (3) incorrectly interpreted and applied § 362; (4) failed to address the propriety of the foreclosure process used by the creditor, including the procedural and substantive fairness; and (5) "failed to adequately consider equitable principles in the decision to annul the stay and validate the foreclosure."

In **Okorie v. Lentz (In re Okorie),** No. 24- 60377, 2025 WL 603890, 2025 U.S. App. LEXIS 4374 (5th Cir. Feb. 25, 2025) (opinion not yet released for publication), the Fifth Circuit affirmed the district court's ruling and found that "the bankruptcy court did not exceed its discretion by concluding that annulment of the automatic stay... was justified." The Fifth Circuit relied on two avenues in which the bankruptcy court could grant relief from the automatic stay by annulment: (1) for cause and (2) "if (A) the debtor does not have an equity in such property" and "(B) such property is not necessary to an effective reorganization." 11 U.S.C. § 362(d)(l)-(2). First, the Fifth Circuit found that "the bankruptcy court properly elected to annul the stay under § 362(d)(l) for cause." The court explained that "cause" for lifting stay exists when there is a "lack of adequate protection of an interest in property of such party in interest." 11 U.S.C. § 362(d)(l). It then noted that in the practice bankruptcy case, the bankruptcy court had recognized a lack of adequate protection, and the practice debtor had failed to make adequate protection payments as ordered by the bankruptcy court there. Additionally, the doctor debtor had failed to deny that adequate protection was lacking, instead arguing it was not required. The Fifth Circuit found the debtor's argument "unavailing." Second, the Fifth Circuit found that the bankruptcy court acted properly in finding that relief from stay was warranted under § 362(d)(2) because the debtor did not have equity in the property and the property was not necessary for an effective reorganization. The court explained that a debtor "lacks equity in [ ] property" when "the creditor is undersecured." United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 375 (1988). Further, "it is the burden of the debtor to establish that the collateral at issue is 'necessary to an effective reorganization"' after it is established that a creditor is undersecured. Id. The Fifth Circuit found that the bankruptcy court correctly concluded that the creditor was an "undersecured creditor" because the debtor had pledged the property as collateral, resulting in the property having "little or no equity for the benefit of the estate." This shifted the burden to the debtor to show why "the [ ] property was necessary for effective reorganization," which the debtor had failed to show. The debtor attempted to argue "that the bankruptcy court was required to engage in an analysis of equitable principles-separate from the court's inquiry under § 362(d)-when assessing whether annulment of the stay was merited." In short, the Fifth Circuit found none of the arguments made by the debtor for an equitable analysis convincing and affirmed the district court's ruling.

By Olivia Lewis oliviale@ttu.edu
Edited By Jace Brown jace.brown@ttu.edu
Edited By Kristin Meurer krmeurer@ttu.edu
Edited By Hayden Mariott hayden.mariott@ttu.edu

Agreements Not Followed but Pleading was Fine [BKR WD OK]

The creditor and debtor entered into a purchase agreement under which the creditor paid the debtor $4,350,000 for all the issued and outstanding membership units in the company. The debtor also "became a posttransfer employee of [the company] pursuant to a written employment agreement." A nonsolicitation clause and a non-competition clause were contained in this employment agreement were after the creditor purchased the company, the creditor discovered that the debtor owned two businesses that directly competed with the creditor and the company. The debtor had also been actively concealing this ownership from the creditor. Ownership of these two companies was in direct violation of the employment agreement. The creditor also alleged the debtor gained "insight as to the trade secrets and other protected information" of the creditor. The creditor filed an action in state court, and judgment was entered against the debtor in the amount of $58,980,460.20 plus interest. The debtor then filed for bankruptcy; the creditor filed its claim; and also filed an adversary proceeding claiming that the debtor was nondischargeable. The debtor moved to dismiss the claims. The creditor argued that the debt arising from the judgment should not be discharged because the debtor had fraudulently induced the creditor to enter into the purchase and employment agreement. The debtor moved to dismiss the claims, and the creditor opposed the motion.

In **Fusion Indus., LLC v. Friday (In re Friday)** Case No. 24-12364-JDL, 2025 WL 892618, 2025 Bankr. LEXIS 688 (Bankr.W.D. Okla. Mar. 21, 2025) (opinion not yet released for publication), the bankruptcy court granted the motion in part and denied the motion in part. The debtor argued that the creditor had failed to meet the requirements of alleging fraud under Fed. R. Civ. Pro. 9(b) and had failed to state a claim under Fed. R. Civ. Pro. 12(b)(6). The court explained that the purpose of Rule 9(b) is to provide "a defendant fair notice of the plaintiffs' claim and of the factual ground upon which it is based." It was not necessary for the creditor to "plead each fraudulent detail," rather, the creditor was just required to follow Rule 8(a)'s "short and plain statement pleading requirements." The court therefore found that the creditor's pleadings had given the debtor fair notice, and the debtor's motion to dismiss based on Rule 9(b) was denied. The creditor's complaint alleged the "debtor fraudulently induced" the creditor "to enter into the purchase agreement and employment agreement by false pretenses, a false representation, or actual fraud, with malice, citing [Bankruptcy Code] § 523(a)(2)." A false pretense claim asks "whether, by silence, insinuation, or inference the debtor knowingly acted in such a fashion as to create a false representation in the mind of the creditor about the transaction at issue." In re Woods, 616 B.R 803, 813 (Bankr. N.D. Okla. 2020). The elements of a nondischargeability proceeding based on false pretenses are: "(1) The debtor made a false representation; (2) The debtor made the representation [or omission] with the intent to deceive the creditor; (3) The creditor relied on the representation [or omission]; (4) The creditor's reliance was justifiable; and (5) The debtor's representation [or omission] caused the creditor to sustain a loss." A false representation claim also contained the same elements. The court also ruled that a claim for actual fraud was stated in the complaint by stating the debtor "materially concealing the fact" that he owned other competitor companies. Material omissions could also be considered false representations because the debtor had failed to explain that at the time of entering into the agreements that the debtor was already in violation of the non competition provision. Therefore, the court denied the debtor's motion to dismiss the creditor's complaint under Bankruptcy Code § 523(a)(2)(A). However, the court ruled that, under § 523(a)(4), the creditor had not stated a claim. The creditor had to prove one of three things to establish that a claim is nondischargeable under Bankruptcy Code § 523(a)(4): "(1) fraud or defalcation while acting in a fiduciary capacity; (2) embezzlement; or (3) larceny." Under the fiduciary capacity claim, according to the Tenth Circuit, "an express or technical trust is required for a fiduciary relationship." However, the creditor had not alleged any trust; therefore, the complaint had not alleged a fiduciary relationship. Accordingly, the creditor's complaint failed to state a claim for a breach of fiduciary duty under Bankruptcy Code § 523(a)(4). On the embezzlement claim, the creditor did not allege that the "debtor came into any property belonging to the creditor, that he appropriated for his own benefit, or that he had fraudulent intent." Therefore, the creditor failed to state a claim for embezzlement under Bankruptcy Code § 523(a)(4). Next, on the larceny claim, the creditor failed to "allege that the debtor took and carried away the property of the creditors." Therefore, the debtor's motion to dismiss the creditor's complaint was granted as to the creditor's claims asserted under Bankruptcy Code § 523(a)(4). Finally, the debtor's motion to dismiss under Bankruptcy Code § 523(a)(2)(B) was granted because the complaint had not alleged that the debtor gave the creditor a false written financial statement.

By Olivia Lewis oliviale@ttu.edu
Edited By Hayden Mariott hayden.mariott@ttu.edu

Collateral Estoppel Prevents Re Litigation of Nondischargeable Debt [BKR SD MS]

The debtor, who acted as both member and manager of an LLC, misappropriated the LLC's funds and spent large sums on personal expenditures. In a state court proceeding, the debtor was found liable for a breach of fiduciary duties to the creditor (a partial owner of the LLC), and a judgment of $200,000 (the "state court judgment") was entered against the debtor. Subsequently, the debtor filed for bankruptcy. The creditor initiated this adversary proceeding to object to the discharge of the state court judgment debt. The creditor filed a motion for summary judgment and argued that the state court judgment was nondischargeable under 11 U.S.C. §§ 523(a)(2)(A), (a)(4), and (a)(6).

In **Wilkerson v. Williams (In re Williams)**, Case No. 24-50458-KMS, Chapter 7, Adv. Proc. No. 24-06022-KMS, 2025 WL 715461, 2025 Bankr. LEXIS 542 (Bankr. S.D. Miss. Mar. 5, 2025) (opinion not yet released for publication), the court granted the creditor's motion for summary judgment. First, the court explained that under§ 523(a)(4), a debt is nondischargeable "for fraud or defalcation while acting in a fiduciary capacity." The court stated that "[b]ecause the state court judgment sets forth the amount of the debt, the only question is whether issue preclusion, also known as collateral estoppel, applies to make the debt nondischargeable." The application of collateral estoppel prevents the debtor from attempting to relitigate a state court judgment. Gupta v. E. Idaho Tumor Inst., Inc. (In re Gupta), 394 F.3d 347, 349 (5th Cir. 2004). Applying. Mississippi law, which, on the issue of collateral estoppel, was the same as federal law, the court stated that the creditor had the burden to prove that the issue was actually litigated, determined, and essential to the judgment in the former action. Gibson v. Williams, Williams & Montgomery, P.A., 186 So. 3d 836, 845 (Miss. 2016). Further, the creditor had to show "an identity of parties from one suit to the next, and of their capacities as well." Campbell v. City of Indianola, 117 F. Supp. 3d 854, 865 (N.D. Miss. 2015). The court found that all of the requirements of collateral estoppel were established; however, collateral estoppel only applies in dischargeability actions if the first court made "specific, subordinate, factual findings on the identical dischargeability issue in question." Raspanti v. Keaty (In re Keaty), 397 F.3d 264, 271 (5th Cir. 2005). The court held that this standard had been met because the state court had explicitly found that the debtor misappropriated funds while acting in a fiduciary capacity; thus, the debt as well as the attorneys' fees were nondischargeable under § 523(a)(4). Therefore, the court granted the creditor's motion for summary judgment.

By Hayden Mariott Hayden.mariott@ttu.edu
Edited By Olivia Lewis oliviale@ttu.edu
Edited By Kristin Meurer krmeurer@ttu.edu

Nondischargeability Rules Apply to Corporate Debtors in Subchapter V [BKR DC]

The creditors, an LLC and its wholly owned subsidiary, are involved in the fire protection industry. The debtor was a "direct competitor" with the creditors. The creditors employed several individuals (each, an "employee" and, collectively, the "employees"), who signed non-disclosure, non-compete, and non-solicitation agreements. The creditors alleged that several of the employees, in coordination with the debtor, engaged in a scheme to steal its confidential information, trade secrets, and customers. The debtor and its related entity (collectively, the "debtors") each filed for subchapter V Chapter 11 bankruptcy, and the court jointly administered the cases. The debtors proposed joint reorganization plans, and the creditors, which asserted a general unsecured claim, opposed the plan. Additionally, the creditors initiated an adversary proceeding to object to the discharge of its general unsecured claim under 11 U.S.C. § 523(a)(6). The debtor filed a motion to dismiss under Fed. R. Civ. P. 12(b)(6), arguing that (1) 11 § 523(a) "only exempts from discharge debts against individual debtors and not corporate debtors in Subchapter V," (2) the creditors failed to demonstrate that it "acted with a culpable state of mind," and (3) the claims cannot be dealt with in an adversary proceeding.

In **Marmie Fire & Safety Co. v. ETG Fire, LLC (In re ETG Fire, LLC)**, Adv. Pro. No. 24-1225 TBM, 2025 WL 915381, 2025 Bankr. LEXIS 671 (Bankr. D. Colo. Mar. 20, 2025) (opinion not yet released for publication), the court denied the motion to dismiss. First, the court addressed whether the debt was nondischargeable under section 523(a)(6). The court noted that there is a split on whether section 523(a)(6) applies to subchapter V corporate debtors whose reorganization is nonconsensual. The issue "arises mainly from differing interpretations of the interplay between the text of Sect1on 1192(2) and the preamble of Section 523(a)." "Section 1192(2) makes no distinction between individual and corporate debtors." However, section 523(a) specifically states that section 1192 "does not discharge an individual debtor" from debts arising from "willful and malicious injury by the debtor to another entity." Code section 523(a)(6). The court was convinced that the only two Courts of Appeal cases to decide the issue had held that section 1192(2) applied to both individual and corporate debtors. Avion Funding v. GFS Indus., LLC (In re GFS Indus., LLC), 99 F.4th 223, 228 (5th Cir. 2024); Cantwell Cleary Co., Inc. v. Cleary Packaging, LLC (In re Cleary Packaging, LLC), 36 F.4th 509, 517 (4th Cir. 2022) ("In short... § 1192(2)'s cross-reference to § 523(a) does not refer to any kind of debtor addressed by § 523(a) but rather to a kind of debt listed in § 523(a). By referring to the kind of debt listed in § 523(a), Congress used a shorthand to avoid listing all 21 types of debts... [t]hus, we conclude that the debtors covered by the discharge language of § 1192(2) - i.e., both individual and corporate debtors - remain subject to the 21 kinds of debt listed in § 523(a)"). The debtor argued that the other circuits were mistaken and urged the court to consider a bankruptcy appellate court's holding that "Section 523(a) unambiguously applies only to individual debtors... [because nothing in § 1192 obviates the express limitation in the preamble of§ 523(a)... [and] [i]nterpreting § 1192 to extract from § 523(a) only the list of nondischargeable debts, without its limitation to individuals, would render the amendment surplusage." Lafferty v. Off-Spec Sols., LLC (In re Off-Spec Sols., LLC), 651 B.R. 862, 867 (9th Cir. BAP 2023). The court disagreed and found the arguments of Cleary Packaging more persuasive. Specifically, that "the more specific provision of the Bankruptcy Code which addresses both individual and corporate debtors, should govern over the more general

preamble of Section 523(a)." Further, the court adopted the Fourth and Fifth Circuit opinions completely, stating that the analysis "is so clear and compelling that, as a matter of judicial humility, the Court refrains from restating the same thing again." Second, the court addressed whether the creditors had sufficiently stated a claim for willful and malicious injury under section 523(a)(6). The debtor argued that the intent of a corporate debtor's employees should not be imputed to the corporation because section 523(a)(6) "requires conduct and intent 'by the debtor' to establish nondischargeability." However, the court disagreed and found that "a corporate entity's intent may be determined by imputing to the entity the acts and intentions of the corporate entity's management and senior employees, acting within the scope of such agents' employment, in the entity's interest." Here, there was evidence that two agents of the debtor had "participated in a scheme" to use confidential information and trade secrets to injure the creditors; thus, the court denied the motion to dismiss. Finally, the court dismissed the debtor's final argument, stating that although "the debt may be in dispute (and subject to a claims objection)," that alone does not warrant a dismissal of the adversary proceeding. Ultimately, the court denied the debtor's motion to dismiss in its entirety.

By Hayden Mariott hayden.mariott@ttu.edu
Edited By Callighan Ard caard@ttu.edu

Not the Best Start: Borrower Emerges from Bankruptcy but Must Pay Creditor's Attorney's Fees [WD WA]

In a previous proceeding, the court dismissed the borrower's case in response to the lender's motion to dismiss. The borrower, who had originally filed for Chapter 7 bankruptcy in 2010 and emerged a year later, filed the instant lawsuit. The borrower sought to quiet title for a deed of trust that she signed in 2006, but had not made any payments on the property since 2011. The deed itself contained a provision for the awarding of attorneys' fees. The borrower originally filed her cause of action in state court but moved to federal court after the Washington State Supreme Court ruled that the statute of limitations for installment payments begins to run after each installment due date. After removal to federal court, the lender moved for attorneys' fees for both its motion to dismiss and for its motion to sanction the borrower. The lender argued that the borrower knew of the meritless nature of her claims and that both the clause in the deed and Washington State law required the payment of attorney's fees. The court denied the lender's motion for sanctions because the lender failed to comply with several procedural requirements and failed to provide sufficient evidence to support its motion. The lender then submitted a motion for attorney's fees from the borrower for both the motion to sanction and the motion to dismiss.

In **Roe v. Deutsche Bank Nat'l Trust Co. N.A.**, No. 3:24-cv-05338, 2025 WL 388650, 2025 U.S. Dist. LEXIS 19794 (W.D. Wash., Feb. 4, 2025) (opinion not yet released for publication), the court granted the lender attorney's fees on its motion to dismiss but denied the motion for sanctions. The court found that both the deed's attorney's fees provision and Washington State law permitted the court to require the borrower to pay the lender. Here, the court found the award of attorney's fees proper because the borrower had initiated a lawsuit outside of the original bankruptcy case to get out of paying for a loan. The court reasoned that the award was proper because the lender had to go out of its way to defend itself from an almost frivolous lawsuit. Furthermore, the court rejected the borrower's argument that the bankruptcy case had discharged her from paying the loan and the attorney's fees provision in the deed. However, the borrower succeeded in obtaining relief from paying the fees for the lender's sanctions motion due to the lender's numerous procedural errors.

By Conor Doris cdoris@ttu.edu
Edited By Taylor O'Brien taylobri@ttu.edu
Edited By Hayden Mariott hayden.mariott@ttu.edu

Promissory Fraud as Grounds for Ruling Debt Nondischargeable [BAP 9TH CIR]

The debtor borrowed money from the creditor to buy and resell goods and executed a "Secured Promissory Note & Security Agreement" (the "Agreement"). In the Agreement, the creditor agreed to fund the loan amount in exchange for the debtor's promise to repay the principal with an added transaction fee by maturity. The Agreement additionally granted the creditor a security interest in the goods, required the debtor to provide any instruments necessary to perfect the creditor's security interest in the collateral, and prohibited the debtor from leasing, lending, using, selling, or disposing of the goods without the creditor's written consent. The debtor also executed an "Unconditional Guaranty," ensuring "prompt and complete payment and performance ... when due." Without providing the bills of lading to the creditor or obtaining the creditor's consent, the debtor allowed the transfer of the goods from its warehouse to another entity in Mexico. Further, the debtor did not repay the loan at maturity. The creditor then sued the debtor and the owner under the Agreement in federal court and acquired a default judgment against the debtor and the owner for nonpayment. The judgment held the debtor and owner jointly and severally liable for the loan amount, the transaction fee, pre- and post-judgment interest, and attorneys' fees. In response to the creditor's efforts to collect on the judgment, the debtor made a partial payment and filed for Chapter 7 bankruptcy. The creditor filed an adversary complaint against the debtor on the grounds that the judgment was nondischargeable under 11 U.S.C. § 523(a)(2), (a)(4), and

(a)(6). After each party filed competing motions for summary judgment, the bankruptcy court dismissed the Bankruptcy Code section 523(a)(4) claim and denied the creditor's motion. At trial, the bankruptcy court excluded the creditor's rebuttal expert witness on the value of certain apparel because of the creditor's failure to timely disclose the rebuttal expert under Bankruptcy Rule 7026 or include the testimony in its case-in-chief. The bankruptcy court held that the judgment was nondischargeable under Bankruptcy Code § 523(a)(2)(A) and ordered the debtor to pay the principal, attorneys' fees, and prejudgment interest. Because the full amount of the judgment was deemed nondischargeable under section 523(a)(2)(A), the bankruptcy court did not address the creditor's alternative claim under section 523(a)(6). The debtor appealed the exclusion of the expert witness, the ruling finding the debt to be nondischargeable, and the award of prejudgment interest.

In **Islam v. Koral (In re Islam)**, BAP No. NC-24-1090-FBC, Bk. No. 22-40278-cn, Adv. No. 22-04036-cn, 2025 WL 1079081, 2025 Bankr. LEXIS 912 (B.A.P. 9th Cir. Apr. 10, 2025) (unpublished opinion), the court affirmed the bankruptcy court decision, which ruled the debt was nondischargeable under section 523(a)(2)(A), vacated the award of prejudgment interest, and remanded with instructions to award the amount calculated in the opinion. The court reviewed the finding of intent to defraud, a question of fact, for clear error and found none, with the evidence showing promissory fraud, or a promise made with no intent to perform. First, in reviewing the remainder of the nondischargeability ruling de novo, the court agreed with the bankruptcy court that the trial testimony and evidence supported the conclusions that the creditor had relied on the debtor's misrepresentations, and that the creditor incurred damages in the amount of the default judgment from that reliance. Second, the court held that the exclusion of expert testimony did not constitute an abuse of discretion. In addition to finding the testimony irrelevant, the court reasoned that the bankruptcy court correctly applied Bankruptcy Rule 7026(a)(2), which required disclosure of the expert testimony, and Bankruptcy Rule 7037(c)(l) to bar the evidence not timely disclosed. Further, the court-held that claim preclusion barred the debtor's defenses to the amount owed because the issue had already been adjudicated. Third, the court held that the bankruptcy court erred in the amount of prejudgment interest awarded and remanded the matter for the bankruptcy court to award the correctly calculated amount. Therefore, the court affirmed in part, and vacated in part and remanded in part.

By Taylor O'Brien taylobri@ttu.edu
Edited By Olivia Lewis oliviale@ttu.edu
Edited By Callighan Ard caard@ttu.edu
Edited By Hayden Mariott hayden.mariott@ttu.edu

Taking Advantage of Elderly Women Will Cost You [BKR D NM]

While the debtor served a prison sentence for bank fraud, he met the creditor's son. The debtor told him about his plans to start a business upon release, and the creditor's son informed him that the creditor, an elderly widow with limited knowledge of English, might be willing to invest. The creditor's son told the creditor that the debtor would help her start a business, had extensive experience, and was trustworthy. The debtor met with the creditor after he was released, and they agreed that the creditor would go into business with the debtor's father and would open a "high-end" restaurant. The debtor told the creditor that if she would invest 50% of the costs in the business venture, he would invest the other half, and the profits would be split 50/50. The creditor also wanted her son to have an ownership interest so he would have an occupation after being released. The creditor mortgaged her house and invested $194,644 because she "trusted [the debtor]." The debtor, however, did not invest 50% of the amount himself; instead, he borrowed money from his parents and only invested $80,000. The debtor then formed an LLC in Washington state, and the debtor received only a 25% ownership interest, rather than the 50% promised. Additionally, because of both of their criminal backgrounds, the debtor, despite being a co-owner, was not named on any of the legal documents, and the creditor's son was not listed as an owner. Instead, the debtor's father was named as an owner on the legal documents. Despite not being listed as an owner, the debtor was at all times in control of the management of the business venture and all its finances. The debtor later drew up a purchase agreement, which he represented to the creditor that she had to sign (and she did) for liquor license purposes; however, the document actually provided that the creditor was obligated to pay $480,000 to the debtor for a 75% ownership interest in the business. The debtor eventually found a restaurant location and received a $250,000 bid from the contractor. The space was remodeled, but the remodel violated the fire code. The restaurant did open but made very little profit, and the creditor's son, who had been released from prison, commonly came and "drank the profits," a fact of which the debtor was aware. At the end of the business relationship, the debtor sent the creditor a default letter stating that the creditor's interest in the LLC had been forfeited due to her failure to make the required payments. The restaurant closed shortly after. Throughout the entire relationship, the debtor also engaged in a series of wrongful behaviors, without the creditor's knowledge, including forging the creditor's signature on a credit card application and opening a credit card in her name. He also stopped making his mortgage payments he was supposed to make, bought a boat with the creditor's son using money from the LLC and, using a loan that the debtor obtained in the creditor's name, opened a credit card for "business expenses" in the creditor's son's name that was used for "clothing, expensive dinners, and trips." In addition, he purchased a limousine with the LLC's money. The creditor

sued the debtor in Oregon state court (the "prior state court judgment") for violations of the state's Abuse of a Vulnerable Person statute, conversion, wrongful LLC distributions, and sought to remove the debtor as a member of the LLC. The state court found the debtor liable and entered a judgment of $1,001,866. The debtor filed for Chapter 7 bankruptcy and was granted a discharge. The creditor then filed this adversary proceeding, which was remanded from the district court to the bankruptcy court for additional findings and conclusions of law.

In **Martin v. Zamani-Zadeh (In re Zamani Zadeh)**, No. 20-11939-t7, Adv. No. 20-1077- t, 2025 WL 1073135, 2025 Bankr. LEXIS 905 (Bankr. D.N.M. Apr. 9, 2025) (unpublished opinion), the bankruptcy court held that a portion of the debtor's prior state court judgment debt, in the amount of $194,644, was nondischargeable under § 523(a)(2)(A) of the Bankruptcy Code. "Section 523(a)(2)(A) prohibits the discharge of a debt 'for money ... to the extent obtained by… false pretenses, a false representation, or actual fraud.'" In re Young, 91 F.3d 1367, 1373 (10th Cir. 1996). In order to succeed on a§ 523(a)(2)(A) claim, a plaintiff must prove the necessary facts by a preponderance of the evidence. First, the court addressed the creditor's false pretenses and false representation claim. The court stated that a claim for false pretenses "presents the issue of 'whether, by silence, insinuation, or inference, [the d]ebtor knowingly acted in [a way] as to create a false impression in the mind of [the creditor] about the transaction at issue." In re Woods, 660 B.R. 905,918 (10th Cir. B.A.P. 2024). The court then explained that "' [f]alse representations are representations knowingly and fraudulently made that give rise to the debt." In re Osborne, 520 B.R. 861,868 (Bankr. D.N.M. 2014). The court stated that the elements for both are the same. To prove false pretenses and false representation under § 523(a)(2)(A), a plaintiff must show that the debtor: (1) made a false representation or omission; (2) made such false representation or omission to deceive the creditor; (3) the creditor relied on such representation or omission; (4) the reliance was justifiable; and (5) the creditor suffered a loss as a result of its reliance. The court emphasized that false pretenses under § 523(a)(2)(A) include material omissions when the omission or failure to disclose creates a false impression that the debtor is aware of. However, bankruptcy courts generally only find a failure to disclose under § 523(a)(2) when there was a duty to disclose. The Restatement (Second) of Torts § 551, as the bankruptcy courts have applied it, provides that there is a duty to disclose when the debtor knows: (1) matters that the creditor is entitled to know because of a fiduciary duty or similar relationship of trust and confidence between the debtor and creditor; (2) matters the debtor knows are necessary to prevent partial or ambiguous statements from being misleading; (3) information that the debtor subsequently acquired and would make a representation previously made untrue or misleading; (4) the falsity of a previous false representation made by the debtor when the debtor has knowledge that the creditor is about to rely on the false representation in the transaction with him; and (5) facts basic to the transaction when the debtor knows the creditor is about to enter into the transaction due to a mistake of the basic facts and the creditor would reasonably expect disclosure of facts because of the parties' relationship, the customs of trade, or other objective circumstances. The court found that the debtor had a duty to disclose based on reasons (1), (2), (3), and (5). First, there was a fiduciary duty and a similar relation of trust and confidence between the debtor and creditor. Washington law provides that a managing member of an LLC owes a fiduciary duty to the LLC and its other members. The court explained that the debtor was the manager of the company, and the creditor was a member; therefore, a fiduciary relationship existed. Additionally, the court found that, because the debtor was experienced and sophisticated, and because of the creditor's age, education, lack of sophistication, and limited knowledge of the English language, a relationship of trust and confidence existed. Next, the court found that the debtor was aware of matters necessary to prevent his partial or ambiguous statements of fact from being misleading. The court noted that the debtor had informed the creditor that the debtor's father would be involved in the business; however; the father was only listed on the legal documents and was not involved in the actual business. The debtor also represented that he was an equal investor, but in fact, he did not put in 50% of the total investment. Lastly, the debtor represented that the investment amount was sufficient for the venture, which it was not. Next, the court found that the debtor had subsequently acquired information that he knew made previous representations untrue or misleading. The court explained that the debtor represented that the investment funds would be sufficient for the venture, but then the debtor spent a significant amount of the funds on other items not disclosed to the creditor. Later, the debtor received a construction estimate that made him aware that the remaining investment funds were insufficient to continue the business. The debtor also learned that the creditor's son continued to fund his "drug dealer" lifestyle. Lastly, the court found that the debtor was aware of facts basic to the transaction that the creditor was mistaken about, and the creditor would have expected the debtor to correct the mistaken understanding due to the nature of the relationship. The creditor was under the impression that the debtor was competent to do the remodel, and the debtor should have told the creditor that he was not qualified or competent to do the remodel· because his remodel resulted in the venture not complying with the necessary fire code. The debtor also should have informed the creditor that the investment funds were not enough to lead to the venture becoming a high scale restaurant when the creditor had been led to believe they would be sufficient. The creditor was also led to believe the debtor was trustworthy, and the debtor should have informed her that he forged her signature on a credit card and boat loan application. The debtor also misled the creditor as to what documents she signed, for what purpose, and the amount of ownership interest she would actually be given. The court found that the creditor proved all elements for the § 523(a)(2)(A) nondischargeability claim for false pretenses

and false representations. The court found that the debtor made numerous misrepresentations, such as the ownership interest amount the creditor would receive, the investment amount the debtor was putting in and where that money actually came from; failed to tell the creditor that he forged her signature and obtained a creditor card in her name; failed to tell the creditor he had been to prison for bank fraud; failed to give information about the creditor's son (i.e. that he was a drug dealer and was drinking away profits) that jeopardized the venture; failed to inform the creditor of where large portions of the investment funds were going; failed to inform the creditor of certain terms of the purchase agreement that would result in her forfeiting her interest in the company; and failed to inform the creditor of the payments due but had not been paid. Several of these representations were made before the creditor invested any money. The court then found that the debtor made the false representations with the intent to deceive the creditor, and that the debtor hid the truth because he knew if the creditor had known of the misrepresentations, the creditor would have changed her mind about investing.

The court next found that the creditor actually relied on the debtor's misrepresentations and omissions. The court explained that actual reliance is equivalent of causation-in-fact. The creditor believed she was acquiring a 50% ownership interest and thought the debtor had been incarcerated for tax reasons, not bank fraud. The court then found that the creditor's reliance on the misrepresentations was justifiable. Courts, in deciding whether reliance was justifiable, "appl[y] a subjective standard that takes into account the qualities and characteristics of the particular creditor." Woods, 660 B.R. at 921-22. "To justifiably rely, a party is 'required to use its sense and cannot recover if it blindly reli[ed] upon a misrepresentation, the falsity of which would be patent to it if it had utilized its opportunity to make a cursory examination or investigation." Id. The court explained that the creditor was an elderly widow, who knew limited English, and was not knowledgeable or sophisticated in business or legal matters; therefore, because of her naivety, there were no red flags. Further, the creditor had no knowledge of the creditor's conviction, fraud, or forgery. The court emphasized that if she did have such knowledge, then red flags should have been raised for her, but she did not, and she had confidence in the debtor. Addressing the last element, the court found that the creditor suffered a loss as a result of her justifiable reliance. The court found that the misrepresentations induced the creditor to invest her life savings, all $194,644 of which was lost. Therefore, the court found that the creditor successfully proved that the debtor's false pretenses and false representations caused her to sustain an actual loss of $194,644. Finally, the court addressed claims for actual fraud for nondischargeability actions. Actual fraud for § 523(a)(2) purposes, includes any fraud involving "moral turpitude or intentional wrong" such as fraudulent schemes. The elements of actual fraud are: (1) fraud; (2) wrongful intent; (3) the debtor obtained "money, property, services, or ... credit"; and (4) the debt arose as a result of the actual fraud. Proof of reliance is not required for fraud claims. The court found the creditor met her burden to prove actual fraud under § 523(a)(2)(A) because the entire scheme constituted an actual fraud. The court explained that the debtor first fraudulently induced the creditor to invest her savings for a 25% ownership interest, and then continued to defraud her by using a very significant amount of the investment funds for a boat and limousine, forging her signature, using company money for purposes the creditor was not aware of, and induced the creditor to sign the purchase agreement, which provided a way for her to lose her interest in the company. The court then found that the debtor wrongfully intended to defraud the creditor out of her life savings. The repeated acts of fraud were all actual, and the debtor used the creditor's blind love for her child to con her into investing. The court then found that the debtor obtained money by actual fraud in the amount of at least $194,644. Lastly, the court found that a portion of the debt arose from the actual fraud. The court explained that all debts arising from fraudulently obtained money must be declared nondischargeable by the court. The court found the creditor was entitled to a nondischargeability judgment for the entire amount invested ($194,644) because that entire amount had been lost as a result of the debtor's fraud. The court also explained that as a part of the prior state court judgment, the creditor was entitled to non-economic damages, treble damages, and post-judgment interest as a result of the fraud. Ultimately, the court held that together with the $194,644, the creditor's damages for fraud equaled $883,992 plus interest accrued, the entirety of which was nondischargeable under§ 523(a)(2)(A).

By Kristin Meurer knneurer@ttu.edu
Edited By Hayden Mariott hayden.mariott@ttu.edu

CONTRACT/ESTOPPEL LAW

Shady Business and the Alliance of American Football League [BKR WD TX]

This dispute arose out of the dissolution of the Alliance of American Football League (the "AAF"). An individual investor financed AAF; however, due to the investor's criminal activity, AAF faced liquidity problems entering its inaugural season in 2019. After realizing the liquidity issue, one of the AAF founders engaged with a millionaire investor and financial company (the "lender") to secure immediate and long-term funding. Eventually, the lender "allegedly agreed to cover the [AAF]'s entire financial need until the [AAF] became financially profitable." A term sheet was prepared by a partner of the lender and signed by the lender and the founder, as a representative of his LLC (the debtor). The new investor allegedly promised $250 million and represented the same to the media, but the term sheet only provided for funding requests up to $70 million. The new investor allegedly assured the debtor that the term sheet merely reflected a first installment and that he was agreeing

to pay up to $250 million. After receiving an initial payment, the AAF, through the debtor, did not receive that which the lender had promised. Ultimately, the AAF and the debtor filed for Chapter 11 bankruptcy, and the Chapter 11 Trustee brought claims against the lender regarding the funding of AAF, including the following: "(1) breach of oral contract against the new investor; (2) breach of contract against the financial company; (3) breach of covenant of good faith and fair dealing against the new investor and financial company; (4) promissory estoppel against the new investor; (5) breach of fiduciary duty against new investor; (6) fraudulent misrepresentation, fraud by nondisclosure, and constructive fraud; (7) fraud in the inducement; (8) negligent misrepresentation; (9) unjust enrichment; (10) disallowance under 11 U.S.C. § 502(d) against the new investor and financial company; and, (11) equitable subordination." The lender subsequently filed a summary judgment motion in response to all the debtor's claims.

In **Osherows v. Dundon (In re Legendary Field Exhibitions, LLC)**, No. 19-50900-CAG, 2025 WL 977175, 2025 Bankr. LEXIS 841 (Bankr. W.D. Tex. Apr. 1, 2025) (opinion not yet released for publication), the court denied summary judgment on all counts, except for the breach of contract claim, which it determined had been rendered moot. The court began its analysis by determining that the investor could not escape liability because his wrongdoing. stemmed from more than a single transaction. Further, the court found that genuine disputes of material fact existed as to whether the investor acted as a controlling shadow director. Next, the court analyzed the evidence surrounding the alleged oral agreement. The court determined that the record contained sufficient evidence to identify the investor, the timing of payment, the mechanisms for drawing the commitment, and the terms and conditions of the investment. The court further found a genuine dispute of material fact over whether a meeting of the minds occurred. Additionally, for the lender's attempted affirmative defense of merger, the court declined consideration because the lender raised the issue for the first time in the summary judgment motion; however, the court allowed the lender to pursue that defense at trial. Next, the court. concluded that the lender could not rely on parol evidence because the court had already ruled that the term sheet was not a valid contract under Delaware law. The court concluded that a genuine question of material fact also existed as to whether the debtor's "oral contract claim is property of the estate," and thus found summary judgment to be inappropriate. Based on the prior ruling regarding whether a contract had been formed under Delaware law, the court rendered the trustee's claim for breach of contract regarding the term sheet moot. The court further held that the trustee "properly established its claim for breach of covenant of good faith and fair dealing" because sufficient evidence showed a special relationship between the investor and the debtor. Also, because the court rendered the term sheet moot, it ruled that the issue of preclusion on this type of claim was irrelevant. The court next permitted the promissory estoppel claim to survive summary judgment because the lender failed to show that the trustee sought improper damages. The lender argued that the fraud claims failed because "justifiable reliance is negated as a matter of law." However, the court disagreed, concluding that "justifiable reliance is not 'negated' as a matter of law because the term sheet was not a contract, and the promise was not "too vague and indefinite." The court additionally found that the lender made statements to the media contrary to the stated amount of money lent, and as such, raised a question of fact, precluding summary judgment on this claim. The court next held the negligent misrepresentation claim to survive summary judgment because, contrary to the lender's argument of inapplicability, the court determined that the trustee presented sufficient evidence based on the lender's statements. Next, the court determined that the trustee's fiduciary duty claims raised a genuine issue of material fact by providing evidence that the lender purposefully failed to preserve player contracts and various other actions evidencing a breach. The court then found that the "fiduciary duty claim [was] not barred by the breach of contract claim," except for one portion that duplicated the breach of contract claim. On the unjust enrichment claim, the court held that a "genuine issue of material fact remain[ed]" because evidence showed the lender had gained a tax benefit through free advertisement and had pushed funds away from the league before it entered bankruptcy. Finally, the court ruled that an issue of material fact existed "as to whether the economic loss rule applie[d]" because the lender did not allege how the damages "could not relate to anything outside of the oral agreement." Therefore, the court denied the lender's motion for summary judgment, with the exception of Count II regarding the term sheet.

By Jace Brown jace.brown@ttu.edu
Edited By Taylor O'Brien taylobri@ttu.edu
Edited By Kristin Meurer krmeurer@ttu.edu
Edited By Hayden Mariott hayden.mariott@ttu.edu

SECURITY INTERESTS

First in Time; First in Right [MD PA

The debtor borrowed money from the creditor (the USDA Farm Service Agency) and granted a security interest in his crops to the creditor. The creditor perfected its security interest and remained perfected in the crops over the years, by filing continuation statements over a period of roughly ten years. The debtor rented land on which he farmed. Later, the debtor defaulted on the loan to the creditor and vacated the farmland. The debtor's landlord sold the crops although the creditor had approached the landlord and suggested they settle with a 50/50 split in the proceeds from the sale of the crops. In this matter, the creditor seeks to recover the proceeds from the sale of the crops from the landlord.

In **United States v. Forrest,** No. l:19-CV- 564, 2025 WL 1919490, 2025 U.S. Dist. LEXIS 131664 (M.D. Pa. July 11, 2025), the court ruled for the creditor. The landlord claimed he was entitled to a super priority under Pennsylvania's Landlord and Tenant Act of 1951, 68 Pa. Stat. Ann. 250.302 et. seq. (Purdon 1987), but the landlord had failed to comply with the technicalities of the statute and was therefore not entitled to a priority. Rather, he was guilty of conversion of the crops.

By: The Editors

Tracy Kennedy
NDBA General Counsel

Role of NDBA General Counsel

NDBA's general counsel serves as the attorney for the association. Although Tracy is pleased to be able to serve as a resource for NDBA members in responding to their questions, she is providing general information, not legal advice. Banks must obtain legal advice from counsel who has been retained by the bank to represent the bank's interests in a specific matter.

To contact Tracy Kennedy, NDBA General Counsel, call 701.772.8111 or email at tracy@ndba.com.