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FACING THE ISSUES[®]

LEGAL BRIEFS FROM THE ATTORNEYS OF MACKALL, CROUNSE & MOORE, PLC

Creditors' Corner

Bank Denied Guarantee Because of Negligent Loan Servicing

At issue in *Farmers Bank of Hamburg v. U.S.D.A.*, -- F.3d --, 2007 WL 2050842 (8th Cir., July 19, 2007), were three loans to the Hermitage Tomato Co-operative Association ("Co-op") guaranteed by the Rural Business-Cooperative Service (the "Agency"). The Phase I loan closed in March of 1998, and Phase II closed in March of 1999. The Agency guaranteed 90% of the value of the Phase I and Phase II loans. By December 1999, the Co-op was in default on the Phase I and II loans. Nonetheless, and in order to close the Phase III loan, the bank (via the bank's president) permitted the Co-op to obtain bridge loans to cure the delinquencies and represented to the Agency that there had been no material adverse change in the Co-op's financial condition, even though the bank had not reviewed the Co-op's 1999 audited financial statements. After the Co-op's ultimate default on all three loans, the bank submitted a loss to the Agency. The bank also sued its president and the Co-op for fraud. This appeal was from the Agency's denial of the bank's claim.

The Eighth Circuit affirmed in part and reversed in part the District Court's decision to uphold the Agency's ruling. Its decision was based on federal regulations, which provide that a guarantee of the Agency is unenforceable if the loss is occasioned by negligent servicing. The bank attempted to avoid responsibility for the negligent servicing on the basis that its board of directors was unaware of the president's actions. The Eighth Circuit noted that was irrelevant because the bank is ultimately responsible for the negligent acts of its agents made within the scope of their employment. The Eighth Circuit affirmed the denial of the bank's claim with respect to the Phase III loans, but reversed the denial of the Phase I and II loans.

Seventh Circuit Holds Creditor Entitled to Deficiency Under "910-Day" Rule

At issue in *In re Wright*, No. 07-1483, (7th Cir., July 3, 2007), was application of the "910-Rule" to deficiency claims. A federal court of appeals, the highest-ranking court to address the subject, found in favor of the secured creditor. The debtor in *Wright* surrendered his vehicle and argued that the 910-rule eliminated any recourse to him for the deficiency. The court stated that federal law only overcomes the rights and obligations established in contracts governed by state law when there is an express override. Here, the bifurcation provision of the Bankruptcy Code provides an express override of the parties' contractual rights, but Congress eliminated bifurcation in regards to 910-day vehicles without providing a replacement. The court therefore determined the rule of contract returns, allowing the secured creditor to preserve its deficiency rights under state contract law and the Uniform Commercial Code, which in most states permit a deficiency when the surrendered collateral does not fully satisfy the debt.

Unfortunately, the day after the 7th Circuit issued *In re Wright*, the 10th Circuit Bankruptcy Appellate Panel reached an opposite conclusion on the identical issue. Therefore, this issue remains unresolved in most circuits and it is likely that additional Courts of Appeal and possibly even the U.S. Supreme Court may eventually address the topic.



Multi-Party Accounts Act Prohibits Creditor from Garnishing Funds

At issue in *Enright v. Lehmann*, -- N.W. --, 2007 WL 2051019 (Minn., July 19, 2007), was the creditor's ability to garnish funds in a joint bank account. Judgment creditor Enright garnished two joint bank accounts held jointly in the name of debtor Lehmann and his non-debtor spouse. The non-debtor spouse had deposited all money in the accounts. Lehmann claimed the funds were his wife's property and thus not subject to garnishment. Citing the Minnesota Multi-Party Accounts Act ("MPAA"), the Minnesota Supreme Court held that where one party has contributed all money in a joint account, a creditor cannot garnish the account to satisfy a debt of the other party unless the creditor can show with clear and convincing evidence an intent by the depositor to confer ownership in the funds to the debtor. The Court noted that under the MPAA, a joint account holder's unlimited ability of withdrawal from a joint account did not make the funds subject to garnishment because that ability is conditioned on the consent of the contributing party, who is entitled to bring an action to recover any wrongfully withdrawn funds.

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