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Legal Briefs from the Attorneys of
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Creditors' Corner

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TWEETING BANKERS RUN RISKS

Given the dramatic increase in the use of social media for marketing and other communication, at least one party in a pending litigation matter may have discoverable information located online in a social networking profile. As with e-mail, what common sense a person may have as to what to say or not to say in a social or networking situation seems to evaporate once that person posts on Facebook or "tweets." With increasing frequency, courts are finding data on Facebook to be relevant. While the Stored Communications Act, 18 U.S.C. Sec. 2701, *et. seq*., provides protection from unauthorized disclosure, it is easily overcome with a subpoena. The New York Supreme Court in *Patterson v. Turner Constr. Co.*, 2011 N.Y. Slip Op. 07572, recently ordered a plaintiff to grant a defendant access to current and historical data on Facebook and MySpace. That data may certainly impeach a bank officer's direct testimony or affidavit in cross examination.

Deleting data from social networking sites may only complicate the matter if litigation has already been threatened. Most plaintiffs' attorneys will issue a "spoliation letter" at the beginning of a case to insure that electronic or other evidence is preserved. Deleting social networking data after that date, since it destroys the evidence, will subject the defendant to sanctions.

Practice Pointer: Any institution that allows use of social media should require daily or at least weekly deletion of information posted on social networking accounts. Facebook, MySpace and LinkedIn cannot provide data that has been previously deleted. Routinely managing the data pursuant to a company-wide policy mitigates the risk of any claim of spoliation. Nonetheless, once an institution receives a preservation letter, it generally must suspend ongoing deletion policies. The attorneys at MCM are well-versed in the Rules of Evidence and the role of electronic data in litigation and should be consulted about the appropriate policies for any institution.

COURT UPHOLDS 365/360 METHOD ON VARIABLE RATE NOTE

The Eighth Circuit Court of Appeals in *Kreisler & Kreisler, LLC v. National City Bank,* No. 11-1772 (Oct. 6, 2011), affirmed a lender's right to charge interest on a 365/360 basis notwithstanding language in the note stating that the interest rate would periodically adjust at 1.0 percent above the stated prime interest rate. Two provisions of the note discussed calculation of interest.

The first stated:

> **Payment** - The annual interest rate for the Note is computed on a 365/360 basis; that is, by applying the ratio of the annual interest rate over a year of 360 days, multiplied by the outstanding principal balance, multiplied by the actual number of days the principal balance is outstanding.

The second provision stated:

> **Variable Interest Rate** - The interest rate on this Note is subject to change from time to time based on changes in an index which is the Lender's Prime Rate. "Prime Rate" means the fluctuating rate per annum which is publicly announced from time to time by Lender as being its "prime rate"...The interest rate to be applied to the unpaid principal balance during this Note will be at a rate of 1.000 percentage point over the index.

The commercial borrower under this note asked the court to find that the lender had to charge interest based on actual days accrued, as opposed to the 365/360 method that increases the interest charged by 0.01389. The court found that the paragraphs were not contradictory. The second paragraph describes the applicable interest rate for calculating the interest accrual, but does not otherwise describe the method for charging or accruing interest. Thus, the court upheld the 365/360 method.

Practice Pointer: The decision is in accord with other decisions regarding the 365/360 accrual method. Nonetheless, care should be taken in drafting multiple provisions in a note that deal with interest so that provisions are not overtly contradictory. The language in the note in this case was confusing enough to lead to litigation. The attorneys at MCM routinely participate and advise in preparation of loan documents, even when the lender primarily relies on commercial forms and seeks advice on only limited provisions of a loan document.

AVOIDABLE PAYMENTS FROM INTERMEDIARIES, AGENTS, OR TRUST ACCOUNTS

The Eighth Circuit Court of Appeals recently held that a Chapter 7 trustee for a debtor who acted as a payment processor on behalf of utility customers could pursue recovery of payments remitted to the utility providers. In the case *Stoebner v. Consumers Energy Company (In re LGI Energy Solutions, Inc.)*, No. 11-6045 (8th Cir. BAP, December 8, 2011), a payment processer for utilities customers filed for Chapter 7. Shortly before the Chapter 7, the processor had remitted various payments received from customers to utility providers. The trustee found, however, that the debtor's principal had been fraudulently misappropriating funds from the dedicated trust account, which left a deficiency between the amounts deposited by customers and the amounts owed to providers. Thus, certain providers received payment and others did not. The court found that those providers who more aggressively sought collection from the debtor were those who were paid.

The court ruled that the trustee could assert preference and fraudulent transfer claims against the providers, even though the providers had no contractual debtor/creditor relationship with the payment

processor. The court found that once funds were siphoned out of the account, funds in the account were presumably no longer held in trust, but instead became property of the debtor's estate. To overcome this result, each provider must trace the funds they received to the initial deposit from the customer. To trace funds the court applied the "lowest immediate balance" test utilized by courts when a defendant asserts a constructive trust as a defense to a preference claim. Under that test "a court follows the trust fund to and decrees restitution from an account where the amount on deposit has at all times since the commingling of funds equaled or exceeded the amount of the trust fund." In this case, the principal routinely drew the trust account down, which likely bars any of the providers from asserting a constructive trust defense to the avoidance claims. The BAP therefore reversed the bankruptcy court's dismissal of the preference claims and remanded the case for further findings consistent with the tracing method described in the decision.

Practice Pointer: This decision continues the recent pattern of cases in a wide variety of areas that hold that when there is fraud, all bets are out the window. Attorneys at MCM routinely handle complex preference cases, as well as cases where courts explore equitable remedies due to the substantial fraud of a debtor or other agent the creditor deals with.

If you have any questions, please call one of the attorneys in our MCM Creditors' Remedies group:

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