

## FACING THE ISSUES®

### Creditors' Corner

#### **Court Permits Lenders to Resuscitate Note Inadvertently Satisfied by an Improper Disbursement from a TILA-Rescinded Refinancing Transaction**

In *In re Thayer*, \_\_\_ B.R. \_\_\_, 2008 WL 833970, (8th Cir. BAP, March 31, 2008), Debtors attempted to refinance a mortgage held by TCF with American Residential Mortgage. American transferred the refinancing proceeds to the closing agent the same day Debtors executed the refinancing note. Three days later, Debtors timely exercised their Truth in Lending Act rescission rights. American received notice the next day, but the closing agent did not, and the agent disbursed funds to satisfy the TCF mortgage. The closing agent disbursed residual funds to Debtors, who properly returned that check to American. The Debtors tried to continue payment on the TCF note, but TCF refused payment because American had satisfied the note. TCF also delivered a satisfaction of the mortgage to the closing agent, but the agent failed to record the satisfaction.

Once TCF and American realized the mistake, TCF decided to treat American's previous disbursement as a purchase of the TCF note and assigned the note.

In Debtors' subsequent bankruptcy, American asserted a secured claim as holder of the assigned TCF note and mortgage. Debtors objected and argued there was no note or mortgage applicable to their property. The Court found that the Debtors effectively rescinded the American note. Debtors further argued that under the law of payment, full payment discharged the TCF note and mortgage.

The Bankruptcy Appellate Panel found the Bankruptcy Court possessed sufficient equitable power to unwind this transaction and endorse the purchase and assignment solution by the lenders. The BAP noted that rescission returns Debtors to the legal and financial position they held prior to signing the note, and that rescission could not impact TCF, a stranger to the note between Debtors and American. The solution in which American "purchased" the note from TCF placed Debtors in the proper position and prevented their windfall. From their perspective, the terms of the TCF note were the same, only American became the holder.

#### **Compelling Arbitration in Bankruptcy Cases**

The Federal Arbitration Act ("FAA") provides that arbitration agreements "shall be valid, irrevocable and enforceable". The purpose of the Bankruptcy Code is to centralize the administration of the debtor's assets. When a federal statutory scheme conflicts with the FAA, courts usually apply the test in *Shearson/American Express v. McMahon*, 482 U.S. 220 (1987), which states that the court needs to find an inherent conflict between the statute and the FAA in order to find that Congress intended to override the FAA. The federal circuits are split three ways on how this is dealt with in bankruptcy matters. The Fourth Circuit says that core bankruptcy issues are not subject to FAA. The Third Circuit requires a specific showing of Congressional intent. The Second Circuit requires a fact-based inquiry. A creditor's decision to enforce a mandatory arbitration clause in bankruptcy litigation should be initially made on which forum is the most convenient for the creditor. Secondly, the "tilt" toward the creditor or the debtor should be considered. Enforcing the arbitration clause in the wrong instance could lead to bad precedent.

#### **Escrow Accounts, Waivers and the Automatic Stay**

The court in *In re Dominique*, 368 B.R. 913 (Bankr.S.D. Fla. 2007) held that it is not a violation of the automatic stay for the lender to send out a post-bankruptcy notice of an escrow deficiency to the debtor. On the other hand, the court found that a lender's failure to perform an annual escrow review and provide annual notices resulted in a waiver of the lender's right to recover the deficiency. Bank policy should require the annual reviews and notices, and Director's audits should review compliance with that policy.

#### **Mackall, Crouse & Moore, PLC Associate Sits on Local Bankruptcy Rules Committee**

Have any issues or complaints with local bankruptcy procedures? Mackall, Crouse & Moore, PLC senior associate Andrew P. Moratzka recently began his tenure on the Bankruptcy Local Rules Committee, and is interested in any complaints or suggestions by Minnesota creditors regarding current bankruptcy procedures. If you have any, please contact him at (612) 305-1418.

#### **Secured Creditors Note: SARE Analysis Remains the Same Under BAPCPA**

For a link to an article published by Drew Moratzka in the May edition of the *American Bankruptcy Institute Journal*, [please click here](#).



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Wednesday, April 30, 2008 • Volume 8, Number 5

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