

FACING THE ISSUES®

Legal Briefs from the Attorneys of
Mackall, Crouse & Moore, PLC

Creditors' Corner

Tuesday, May 3, 2011
Volume 11, Number 5

USE OF LEVERAGE IN NEGOTIATIONS IS NOT INEQUITABLE CONDUCT

The 2010 case of *In re Champion Enterprises, Inc.*, (2010 WL 3522132, Bankr. D. Del. 2010) found that Credit Suisse was not guilty of misconduct warranting the extreme remedy of equitable subordination and that its secured debt could not be subordinated due to aggressive exercise of leverage over the debtor. Credit Suisse had access to and monitored the debtor's financials, it exerted strong influence in obtaining amendments to the credit agreements, and it received concessions in negotiations. One of those concessions was the debtor's issuance of new unsecured notes to third parties, the proceeds of which were used to pay down the secured debt.

The court held that, "although the lending group may have forcefully negotiated, the fact that one party to a contract has more leverage does not indicate that the dealings are not at arm's length... and the use of that leverage does not provide a basis for the court to find inequitable conduct." The unsecured creditors' argument that Credit Suisse improperly affected or influenced the debtor's conduct failed to overcome that principle.

Practice Pointer: Lender liability claims such as the ones asserted in *Champion Enterprises* are on the uptick, particularly in large credit facilities in bankruptcy. Unlike the court in *Champion Enterprises*, courts have allowed a number of claims to get past the pleading stage and into discovery. While lender liability claims can arise in state court, the appointment of a trustee or establishment of an unsecured creditors' committee in bankruptcy creates additional entities any of whom can bring claims against the lender. Thus, with a borrower careening towards bankruptcy the lender should at least be mindful of possible litigation risks associated with collection actions. Adherence to the loan agreements is generally the best protection, and as the *Champion Enterprises* case notes, diligent, thorough, and forceful lenders should be able to dismiss any claims. The attorneys at Mackall, Crouse & Moore, PLC have defended lenders in this type of financial services litigation and aggressively negotiate with distressed debtors on behalf of secured lenders.

POWER OF ATTORNEY AUTHORIZING ASSIGNMENT OF MORTGAGE NEED NOT BE OF RECORD FOR FORECLOSURE BY ADVERTISEMENT

Certain documents need to be of record when a lender commences a foreclosure by advertisement including the mortgage, all applicable assignments, a notice of pendency, and a power of attorney granting authority to the attorney to foreclose. In a recent case before the Minnesota Court of Appeals, a debtor sought to annul a foreclosure sale by challenging the assignment of the mortgage because a power of attorney authorizing the subservicer to execute the assignment was not recorded.

In the case *Beecroft v. Deutsche Bank National Trust Company*, (Case No. 10-1144, Minn. App. 2011), the debtor granted Ameriquest Mortgage Company a mortgage in 2005 to secure repayment of a loan. In 2009, Ameriquest, by its attorney in fact, Citi Residential Lending, Inc., assigned its interest in the mortgage to Deutsche Bank. The assignments were executed by two officers of American Home Mortgage Servicing, Inc., as subservicer, on behalf of Citi Residential. The officers of AHMSI claimed their authority through a series of powers of attorney granting rights to service the mortgage, first by Ameriquest to Citi Residential and later from Ameriquest to AHMSI. Only one of the powers of attorney was of record at the time Deutsche Bank later commenced foreclosure, and the debtor claimed the failure to record the remainder rendered the foreclosure void. The debtor also argued that the powers themselves were not sufficient grants of authority to the officers of AHMSI, which broke the chain of title and severed Deutsche Bank's interest in the mortgage.

The court found that the foreclosure by advertisement statute expressly states which documents must be of record in order to proceed with a foreclosure and that a power of attorney authorizing a party to assign the mortgage was not required by the statute to be of record. Therefore, the unrecorded powers of attorneys did not void the foreclosure. The court however found that the district court's decision lacked sufficient findings to affirm that the limited power of attorney signed by Ameriquest to Citi Financial provided proper authority to Citi Financial to assign the mortgage. The district court failed to cite to a specific provision in the assignment. The court therefore remanded to the district court to clarify the ruling.

Practice Pointer: Mackall, Crouse & Moore, PLC routinely undertakes foreclosure by advertisement of mortgages and carefully reviews the record title of the property before commencing the sale

process. In an environment where more debtors, their consultants and counsel are challenging mortgage foreclosures, it is important for all assignments to be timely recorded and properly documented so that foreclosures are not later delayed, or become unnecessarily costly.

PROCEEDS FROM PERSONAL INJURY SUIT NOT EXEMPT FROM GARNISHMENT

The Minnesota statutes provide for a number of exemptions that would prevent a bank garnishment if the debtor can trace the funds in the account back to the exempt source. Wage exemption is the most common issue that arises. Section 550.37, subdivision 22 also exempts “rights of action for injuries to the person of the debtor.” The exemption primarily exists so that creditors cannot interfere with the debtor’s settlement of a tort claim, and also to preserve that protection in bankruptcy for those who elect non-bankruptcy exemptions.

A debtor in *Midland Credit Management v. Chatman* (Case No. 10-1241, Minn. App. 2011), argued that the exemption included moneys in the debtor’s bank account traceable to a personal injury settlement. The Court of Appeals disagreed, and held instead that a “right of action” is a distinct property interest from the settlement proceeds received from the action. The court therefore held that tracing funds in a garnished account to a personal injury settlement could not create an exemption or otherwise prevent the garnishment.

Practice Pointer: In addition to specific exemption rules, the garnishment statutes provide for specific procedures and timelines with respect to exemption disputes arising from garnishments, which in some cases could require a court appearance. The attorneys at Mackall, Crouse & Moore, PLC are familiar with the exemption rules in the Minnesota garnishment statute and have litigated disputes over exemptions in the local district courts.

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

Timothy D. Moratzka
(612) 305-1456
tdm@mcmlaw.com

Stacy A. Woods
(612) 305-1409
saw@mcmlaw.com

Andrew P. Moratzka
(612) 305-1418
apm@mcmlaw.com

Allen E. Christy, Jr.
(612) 305-1490
aec@mcmlaw.com

Patrick C. Summers
(612) 305-1473
pcs@mcmlaw.com

Matthew A. Anderson
(612) 305-1401
maa@mcmlaw.com

Mychal A. Bruggeman
(612) 305-1478
mab@mcmlaw.com

"MCM has prepared these materials for informational purposes only and not as legal advice or **recommendations for specific situations**. Receipt of this information does not create an attorney-client relationship. You should not act upon this information without seeking professional counsel **for specific legal guidance.**" If you do not wish to receive future newsletters from Mackall, Crouse & Moore, please email mcmlaw@mcmlaw.com with the subject of "Unsubscribe."

IMPORTANT NOTICE: Any tax information contained in this email or its attachments is not intended, and cannot be used by the taxpayer or any other person, to avoid any civil or criminal tax penalties which the Internal Revenue Service or another governmental agency may impose on the taxpayer or any other person for acting in reliance upon information contained in this email or its attachments.



1400 AT&T Tower · 901 Marquette Avenue · Minneapolis, MN 55402

Telephone: 612.305.1400 · Fax: 612.305.1414

E-mail: mcmlaw@mcmlaw.com · Web: www.mcmlaw.com