

## FACING THE ISSUES®

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

### Creditors' Corner

Wednesday, October 01, 2008  
Volume 8, Number 10

#### **Bank Customers Cannot Recover Damages for Usury Interest when Bank President Commits Fraud**

In *Mamot Feed Lot & Trucking v. Hobson*, No. 07-3129, (8th Cir. August 26, 2008), the president of Exchange Bank of Gibbon in Nebraska defrauded the bank for over a million dollars. Customers of the bank sued the bank, its holding company, and various shareholders, officers and employees of the bank under federal usury laws. Each customer claimed that the amounts misappropriated, stolen, misstated or diverted by the president would be deemed excessive interest paid by the borrowers of the bank. In addition, plaintiffs alleged that the president diverted loan payments and converted collateral of certain loan which triggered defaults, acceleration clauses, and attorneys' fees clauses, which also qualified as "excessive interest."

The District Court found and the Eighth Circuit Court of Appeals affirmed that Federal law did not provide the customers with a remedy for excessive interest under these circumstances. The Court examined 12 U.S.C. § 1831d, which allows federally-insured state-chartered banks to charge up to a specified interest rate and provides a civil remedy for interest charges above that rate. The damages are twice the amount of excessive interest paid. Federal law defines interest as "any payment compensating a creditor or prospective creditor for the extension of credit" which includes: "late fees, insufficient fund fees, overlimit fees, annual fees, cash advance fees, and membership fees." The test for "interest" is whether the charge directly benefits the lending institution extending the credit. Some examples of payments that are not interest include: "appraisal fees, credit insurance premiums, finders fees, document or notary fees, or fees charged for obtaining a credit report." The court found that amounts converted by the bank president were not fees or charges that benefited the bank, and therefore were not "interest" charges for the purpose of assessing damages under Federal usury laws.

#### **Bank not Liable for Fraudulently Indorsed Checks**

In *Distributor Label Products v. Fleet National Bank, et al*, No. A-3260-06T5, (N.J. Super. Ct. App. July 8, 2008), the customer of PNC bank was the victim of embezzlement by a former bookkeeper who managed to get the customer's president to sign checks for which there were no outstanding invoices. The bookkeeper then forged endorsements and deposited the funds to his own accounts and they were in due course honored by Fleet and PNC. The customer sued Fleet and PNC alleging breach of contract and negligence. The court found that UCC Sec. 3-406 precludes recovery because the bank and/or its customer are held to a standard of ordinary care. The court found Fleet and PNC used ordinary care but the customer failed to do so in issuing the checks in the first place without supporting invoices.

#### **Federal Bank Examination Privilege Upheld**

In *Shirk v. Fifth Third Bancorp*, No. 1:05-cv-049, (S.D. Ohio, July 2, 2008), the U.S. District Court for the Southern District of Ohio denied the plaintiff's motion to compel production and discovery of bank examination reports. Plaintiff sought to prove accounting irregularities at the bank in the administration of an ERISA plan. The court found that under 12 C.F.R. § 261.2(c) the examinations and reports were "confidential supervisory information" and were privileged. The court went on to say that this privilege was long recognized to preserve candor in bank examinations concluding that the only "good cause" exception to the privilege is if purely factual material is separate from any "deliberative material" in the documents. In this case, factual and deliberative material was interspersed throughout the documents.

#### **Credit Reporting Agencies Ordered to Clean-Up Discharged Debt from Credit Files**

As reported recently by the Wall Street Journal on September 30, 2008, a Judge from the Central District of California has ordered the three major credit agencies, Experian Group Ltd., Equifax Inc. and TransUnion LLC to correct credit files for individuals who filed Chapter 7 bankruptcy by October 1, 2008. A class action suit was brought against these agencies because they are still reporting debts that the bankruptcies have discharged. The Court will next consider what damages may be appropriate for consumers impacted by the erroneous credit reporting. Banks and other lenders should also be vigilant in updating consumer debt files after receiving notice of bankruptcy, as banks and other lenders are the source of information for the credit agencies.

#### **Chapter 7 may be Better than a Liquidating Chapter 11**

Many times insolvency professionals will recommend a liquidating Chapter 11 instead of Chapter 7 to wrap up a corporate debtor's financial affairs. This may not always be the best choice and there are several reasons why. First, the debtor's management usually remains in place during the Chapter 11 and these may be the managers and personnel who created the financial turmoil. Second, operating the business in Chapter 11 will not always equate to a larger recovery because of the expense of debtor-in-possession operations. Third, a Chapter 7 trustee has more flexibility in dealing with environmental and tax issues because there may be lender liability issues arising out of debtor-in-possession financing. If there is no need to sell or liquidate the debtor as a going concern, Chapter 7 may be a more efficient and less costly option.

#### **Summary of Recent Decisions Regarding Whether "Negative Equity" Financing Qualifies as a Purchase-Money Security Interest**

Please click the link below to a recent article by Mackall, Crouse & Moore, PLC, attorney Andrew P. Moratzka published in the American Bankruptcy Institute Journal. The article summarizes recent court decisions regarding the bankruptcy implications of an automobile lender financing the negative equity of a customer's trade-in vehicle.

[Please click here to read the full article.](#)

## FACING THE ISSUES®

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

### Creditors' Corner

Wednesday, October 01, 2008  
Volume 8, Number 10

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

**Timothy D. Moratzka**  
(612) 305-1456  
[tdm@mcmlaw.com](mailto:tdm@mcmlaw.com)

**Allen E. Christy, Jr.**  
(612) 305-1490  
[aec@mcmlaw.com](mailto:aec@mcmlaw.com)

**Robert S. Lee**  
(612) 305-1448  
[rsl@mcmlaw.com](mailto:rsl@mcmlaw.com)

**Patrick C. Summers**  
(612) 305-1473  
[pcs@mcmlaw.com](mailto:pcs@mcmlaw.com)

**Stacy A. Woods**  
(612) 305-1409  
[saw@mcmlaw.com](mailto:saw@mcmlaw.com)

**Matthew A. Anderson**  
(612) 305-1401  
[maa@mcmlaw.com](mailto:maa@mcmlaw.com)

**Andrew P. Moratzka**  
(612) 305-1418  
[apm@mcmlaw.com](mailto:apm@mcmlaw.com)

**Mychal A. Bruggeman**  
(612) 305-1478  
[mab@mcmlaw.com](mailto: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](mailto:mcmlaw@mcmlaw.com) with the subject of Unsubscribe.

#### IMPORTANT NOTICE:

This email message, including attachments, is covered by the Electronic Communications Privacy Act, 18 U.S.C. 2510-2521, and for the sole use of the intended recipient(s) and may contain confidential and privileged information. Any unauthorized review, use, copying, disclosure or distribution is prohibited. If you are not the intended recipient, please contact sender by phone or reply via email and destroy all copies of the original message. Thank you.

***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](mailto:mcmlaw@mcmlaw.com) · Web: [www.mcmlaw.com](http://www.mcmlaw.com)