FINANCIAL newsletter

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RELIEF FROM BANKRUPTCY?

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Is the failure to turn over property taken lawfully before the filing of bankruptcy petition a violation of the automatic stay?

A lender recently filed a replevin action to obtain possession of collateral securing a loan. Shortly after picking up the large farm equipment, the borrower filed for Chapter 12 bankruptcy. The borrower then requested the collateral be returned to the borrower. The lender, believing the stay meant the status quo needed to be maintained, denied the borrower's request to return the property. Instead, the lender, acting with the utmost good faith, told the borrower that it could not return the property because the bankruptcy had been filed and the bankruptcy trustee needed to be consulted. Did the lender client act according to the law?

Upon the filing of a bankruptcy petition, section 362 of the Bankruptcy Code imposes automatically a stay upon most actions by creditors to satisfy their claims against the debtor. Creditors are prohibited or stayed from taking any action which has the purpose and result of collecting a debt or taking possession of property or assets of the debtor. 11 U.S.C. § 362(a) sets forth a list of activities which are subject to the automatic stay, including, but not limited to:

1. The commencement or continuation of legal proceedings against the debtor to recover a claim against the debtor that arose before the debtor filed the bankruptcy petition;
2. The enforcement of a pre-petition judgment against the debtor or against property of the debtor;
3. Any act to obtain possession of, or to exercise control over, property of the estate;

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Bankruptcy

4. Any act to create, perfect, or enforce any lien against property of the estate;
5. Any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a pre-petition claim;
6. Any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title; and
7. The setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor.

The automatic stay is fundamental to the reorganization process and its scope is intended to be broad. Most importantly, in certain types of bankruptcy filings, the automatic stay prohibits secured creditors from denying the debtor access to the debtor's property. Any actions in violation of the automatic stay risk the lender being found in contempt of court, paying attorney's fees and costs to opposing party, and other significant sanctions, including paying punitive damages.

Courts across the country have ruled that a violation of the automatic stay occurred when a secured creditor refused to return collateral to the debtors or the bankruptcy trustee in certain circumstances. The duty to turn over property is not contingent upon any predicate violation of the stay, any order of the bankruptcy court, or any demand by the creditor.

Generally, in a Chapter 7, if the debtor claims the property as exempt and requests that it be returned, the property must be returned. A creditor can confirm the exemption with the bankruptcy schedules and that the trustee is not making a claim to the property prior to returning the property to the debtor, but should do so quickly. *Westman v. Andersohn,* 300 B.R. 338 (Bankr. D. Minn. 2003).

In a Chapter 11, 12 or 13 case, the creditor must return collateral over to the debtor. In the case above, the lender made the equipment available for the debtor to come pick up. Additionally, a creditor cannot put a hold on funds belonging to the debtor rather than turn them over to the bankruptcy trustee as demanded. *SBA v. Rinehart,* 887 F.2d 165 (8th Cir. 1989).

The automatic stay may be "lifted" by the bankruptcy court based on the lender's motion in certain circumstances. Under Section 362(b), the court is authorized to grant relief from the stay if the moving party can show (i) cause, including lack of adequate protection, or (ii) no equity in the property and the property is not necessary to an effective reorganization. A lender must make a request for relief from the stay and receive court approval lifting the stay to pursue collection efforts.

Thus if you have control over property of a bankruptcy debtor, quickly determine who has a right to the property and return it. Then move the court for an order lifting the stay before pursuing any additional collection efforts.

MINNESOTA'S NEW LLC STATUTE:
Essentials for Lenders

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Minnesota adopted the Revised Uniform Limited Liability Company Act to become effective August 1, 2015. The act completely rewrote Minnesota's limited liability company law. Limited liability companies are now, by far, the most popular form of business entity in the state. Lenders and financial institutions need to be familiar with provisions of the new law that impact loans and other transactions with LLC borrowers.

When dealing with an LLC borrower, lenders will want to freshly examine at least three essential questions about their LLC borrower.

WHO?

Who has authority to act on behalf of the LLC? Lenders will need to know what individual or group of individuals exercise authority on behalf of an LLC. Under the former law, LLCs were most commonly managed by a board of governors, like the directors of a corporation. Often a borrowing resolution adopted by the board was sufficient to demonstrate an LLC's authority for a loan or other transaction. Under the new statute, an LLC can be member-managed, manager-managed or board-managed. Depending on the LLC's choice of management

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structure, authorization for transactions may need to be provided by the members, by one or more managers or by a board. The operating agreement determines this, so it will need to be obtained and reviewed to determine who has authority (see more below.)

Also, signatures on documents need to be obtained from a person specifically authorized to act on behalf of the LLC. The LLC can appoint officers or agents by action of the appropriate management (member, manager or board). To clarify signing authority LLCs can file with the Secretary of State a Statement of Authority. The Statement of Authority names who holds executive power either by describing a position (such as president, treasurer, CEO, etc.), or designating named individuals with authority. Once a Statement of Authority is filed, third parties, including lenders, can rely on that filing to demonstrate who has authority to bind the LLC to an agreement. It would be wise for lenders to require their LLC borrowers to have a valid Statement of Authority on file with the Secretary of State's Office and to check those filings to confirm that persons signing LLC documents are authorized to do so.

WHAT?

Under the new LLC statute, the operating agreement of the LLC takes on greater significance. The operating agreement may be oral, written, or implied by conduct or a course of dealing. An LLC operating agreement addresses the relations between and among the members of the LLC, the rights and duties of persons with management authority, the purposes and activities of the LLC, and the means and conditions for amending the agreement. Given its broad scope, it is essential that lenders obtain and review the operating agreement of any LLC borrower. If an LLC borrower does not have or cannot produce an operating agreement, consider carefully whether the adoption of a valid written operating agreement (by all the members) should be a condition to closing any transaction with the LLC.

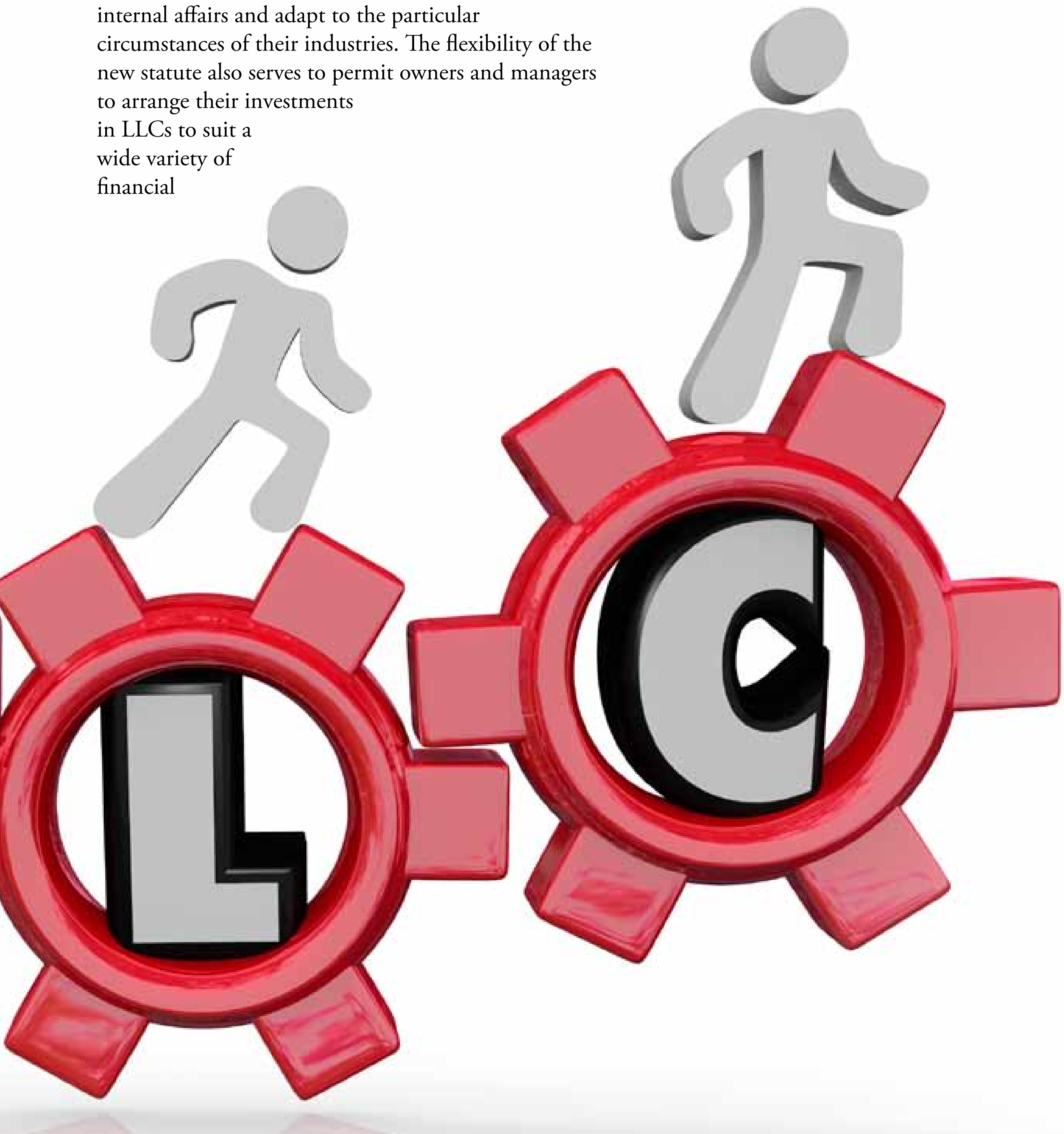
WHEN?

The new statute became effective on August 1, 2015, but there is a phase-in period. All LLCs formed on or after August 1 of 2015 are governed by the new act. Previously existing LLCs can "opt in" to the new statute between August 1, 2015 and December 31, 2017. On January 1, 2018, all LLCs will be governed by the new act and the old statute will no longer be applicable.

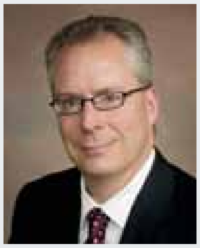
The new act has provisions which "grandfather in" an existing LLC's articles of organization, operating agreement, and member control agreement as the ongoing "operating agreement" of the LLC under the new act. It is not technically necessary that all LLCs adopt, amend and restate their organizational documents to deal with the change in the statute.

Previously existing documents will remain effective and binding on the LLC and can be relied on by lenders. However, it will be very important that lenders obtain and review the existing set of LLC documents and be attentive to whether the documents: (1) adequately and clearly describe the LLC's management structure; (2) designate clearly who has authority to act on behalf of the LLC; and (3) have provisions prohibiting amendments to the documents without written consent of at least a majority of the members.

The new LLC statute provides substantial additional flexibility for business organizations to manage their internal affairs and adapt to the particular circumstances of their industries. The flexibility of the new statute also serves to permit owners and managers to arrange their investments in LLCs to suit a wide variety of financial structures and potential means of prioritizing returns, as well as adopting alternate management structure forms. For lenders, this flexibility means that there should be heightened attention to the organizational structure of each LLC, since lenders cannot rely on a "standard" format, as is typical of a corporation. Detailed attention to an LLC's operating agreement is crucial to putting in place effective and enforceable lending relationships with LLCs under the new act.



TILA-RESPA Integrated Disclosure ("TRID") Rule Implementation



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The Dodd-Frank Act was enacted on June 21, 2010, and included a mandate for the Consumer Financial Protection Bureau to integrate customer disclosures required under the Real Estate Settlement Practices Act ("RESPA") and the Truth in Lending Act ("TILA"). RESPA was enacted on June 20, 1975, and it was intended to reduce the costs associated with closing a mortgage by eliminating referral fees and kickbacks. TILA was enacted on May 29, 1968, and it was enacted to promote the informed use of consumer credit by requiring disclosures to standardize the manner in which costs associated with residential borrowing were calculated and disclosed. The new TRID disclosures, which went into effect on October 3, 2015, have been enacted by the Consumer Financial Protection Bureau in an attempt to simplify and help residential borrowers understand key mortgage features, costs and risks.

The Board of Governors of the Federal Reserve System issued guidance on October 21, 2015 to banks with assets of $10 billion or less concerning the TRID Disclosure Rule. The guidance indicates insured banks are expected to make good faith efforts to comply with the TRID disclosures in a timely manner. The guidance indicates that during early examinations, examiners will evaluate an institution's compliance management system and their efforts to comply with the new TRID disclosures, and how an institution deals with technical problems or other institutional challenges.

There are two new forms which are included in the new TRID disclosures. The first form is the Loan Estimate ("LE") which replaces the Good Faith Estimate and Truth in Lending Disclosure Statement. The second new form is the Closing Disclosure ("CD"). The CD replaces the HUD-1 form for transactions included in the TRID disclosures. The intent of the CD is to identify all of the transaction costs related to the mortgage. Excluded from the TRID disclosure requirements are banks that make five or fewer loans per year, home equity lines of credit, loans secured solely by mobile homes or dwellings and not attached to real estate, reverse mortgages, and banks that extend credit to customers less than twenty-five times a year. Construction loans and loans of vacant property in excess of twenty-five acres have not been previously subject to RESPA, but are now subject to the TRID disclosures.

The LE is a three-page form. Page one contains a summary of key terms and costs. Page two includes an itemization of the costs and also addresses adjustable rate and adjustable payment provisions where applicable. Page three contains figures that borrowers can use to compare various offers.

An LE is required to be provided to the borrower within three business days after receipt of an application. A bank is in possession of a mortgage application when it receives the following information from a potential borrower: the borrower's name, income, social security number, property address, estimated value of the property, and mortgage loan amount sought. The LE must be in the mail no later than the seventh business day before closing. For purposes of calculating business days, Sundays and legal holidays are not counted. An LE may be provided in person. The borrower is presumed to have received the LE three business days after it is placed in the mail. A borrower may waive or modify the seven-business-day waiting period after receiving the LE in the case of a bona fide emergency. The CFPB example of a bona fide financial emergency is an imminent sale of the home at foreclosure. An interest rate lock requires a revised LE within three business days after the rate is locked, not on the date the rate is locked. If within three days after receiving a loan application a bank determines it will not be able to provide the loan, an LE does not have to be provided. In new construction where the loan is not expected to close within sixty days, the LE must contain a clear and conspicuous statement that the bank may issue a revised LE at any time prior to sixty days before closing.

Other than a bona fide fee to obtain a credit report, a bank cannot impose any fees with respect to a mortgage application before the borrower has received the LE and indicated an express intent to proceed. A bank is no longer

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able to presume an intent to proceed, but must have some express intent from the borrower that they intend to proceed with the loan. A bank cannot require a borrower to submit documents verifying the information in the mortgage application prior to providing the LE.

Banks are permitted to provide borrowers with written estimates or worksheets before providing an LE, but the pre-LE material must not look similar in headings, content or format to the LE. Any pre-LE materials must conspicuously display a disclaimer which states: “Your actual rate, payment and costs could be higher. Get an official Loan Estimate before choosing a loan.”

Settlement services on an LE are divided into three categories. The first category is services which are permitted to be shopped. Settlement services for which a borrower is permitted to shop in the LE must be separate from the LE and provided no later than the seventh business day before closing. The bank must provide a written list of available providers (at least one) for that service and indicate the borrower can select a different provider for that service. Services permitted to be shopped may be provided based on an estimated basis if in good faith. Services and estimates are deemed to be in good faith if the aggregate amount of charges for the third-party services and recording fees does not exceed the amount disclosed for those services by more than ten percent, the charge for the third-party services is not paid to the bank or a bank affiliate, and the bank allows the customer to shop for the third-party service.

The second category of settlement services on an LE are those which include charges to the bank or an affiliate for which the borrower cannot shop. These services would include such things as appraisals, fees to the bank, a mortgage broker or an affiliate of either the bank or a mortgage broker. They also include transfer taxes.

The third category of settlement services on an LE are those estimated charges which are deemed in good faith if they are consistent with the best information reasonably available to the bank at the time of the disclosure regardless of whether the amount paid by the borrower exceeds the amount

disclosed on the LE. These charges include such things as prepaid interest, property insurance premiums, amounts for escrow account, charges paid to third-party service providers that the customer could shop for that are not on the list provided by the bank, and charges paid for third-party services not required by the bank even if paid to an affiliate.

Revised LEs are permitted for customer requested changes, an expired LE previously provided, interest rate dependent changes, a delayed settlement date on a construction loan, or valid change to circumstances. Valid change to circumstances can include an extraordinary event beyond the control of any interested party or other unexpected event specific to the borrower or transaction. This would include such things as a property damage claim as a result of a storm, a title insurer going out of business, or a lawsuit affecting certain aspects of the physical condition of the property. Valid change to circumstances can also include when information specific to the borrower of the transaction that the bank relied upon when providing the LE has changed or is inaccurate since the LE was issued. A valid changed to circumstances can also include new information specific to the customer or transaction that the bank did not rely on when providing the original LE.

The CD is a five-page document which must be received by the borrower three business days prior to closing. If it is not delivered in person, receipt is presumed three business days after it is placed in the mail. A borrower does have a right to inspect the CD on the day before consummation of the loan. Each borrower that has the right to rescind the loan under TILA must get a copy of the CD.

A bank must provide a revised CD if changed terms occur before closing because the APR has become inaccurate and outside of specified tolerances, the loan product has changed, or a prepayment penalty is added. The APR becomes outside of tolerances if it is a fixed rate loan and there is an increase in the amount of an eighth of a point or more. For variable rates, if there is an increase in the amount of a quarter point or more, the APR is outside of tolerance. A decrease in the APR will not necessitate a new three-day review if it is based on changes to the interest rate or other fees.

Inaccuracies in the CD are able to be rectified post-closing within thirty days if an event in connection with the settlement occurs that causes the CD to become inaccurate and the inaccuracy results in a change to the amounts disclosed on the CD which is actually paid by the borrower. In that circumstance, the bank must deliver or place in the mail a corrected CD no later than thirty days after receiving information sufficient to disclose the inaccuracy. A bank will not be deemed to have violated the rules pertaining to delivery of a CD if the CD contains non-numeric clerical errors if the bank delivers or places in the mail the corrected CD no later than sixty days after the closing. The listing of the wrong property address in connection with the closing is not considered non-clerical. If the amounts paid by a borrower exceed the tolerance specified under the rules, the bank must refund the excess amounts no later than sixty days after closing.

In conclusion, the TRID disclosures will necessitate the use of two new forms in most typical residential closing transactions. The Loan Estimate and Closing Disclosure forms will need to be provided on a timely basis, and a review of the rules to ensure compliance is highly recommended.

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Banking Services

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- Management & shareholder issues
- Transfer of bank assets
- Bank litigation
- Business planning
- Real estate
- Property foreclosures and repossessions
- Loan and workout agreements
- Collateralizing and securing all forms of loans
- Loan and credit agreements
- Subordination and participation agreements

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