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BANK & LENDER LIABILITY

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BREACH OF CONTRACT

Judge dismisses mortgage lender's suit over ex-employee's business

A New York state court judge has ruled that restrictions in an employment contract are unenforceable and do not prevent a mortgage lender's former employee from pursuing his own lending business.

Greystone Funding Corp. v. Kutner et al., No. 651926/2013, 2013 WL 5951793 (N.Y. Sup. Ct., N.Y. County Nov. 7, 2013).

Judge Charles E. Ramos of the New York County Supreme Court said the restrictive covenants in Ephraim Kutner's contract with Greystone Funding Corp. ended when the company terminated him without cause.

The judge said Greystone, which specializes in multifamily property loans, cannot prevent Kutner from running his own mortgage banking firm, Harborview Capital Partners LLC.

Judge Ramos also dismissed Greystone's claims against Harborview and another former employee, Kutner's brother Jonathan, finding that those allegations were conclusory.

Greystone is appealing the ruling to the Supreme Court's Appellate Division, according to court records.

"Greystone will be perfecting its appeal to address the court's clear errors of fact and law, including the court engaging in impermissible fact finding before any discovery was had and prior to the complete factual development of the evidence in the case," Greystone attorney **Y. David Scharf** of **Morrison Cohen LLP** in New York said in an email.

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FIRREA: The Justice Department's expansive (and expensive) tool of choice

Allyson B. Baker and Andrew Olmem of Venable LLP warn that federal regulators plan to use a series of favorable court rulings to dramatically expand their use of a little-known provision of the Financial Institutions Reform, Recovery and Enforcement Act to accelerate investigations and prosecutions of bank officials for financial crisis claims.

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FIRREA: The Justice Department's expansive (and expensive) tool of choice

By Allyson B. Baker, Esq., and Andrew Olmem, Esq.
Venable LLP

A series of recent court rulings has effectively expanded the Department of Justice's authority to investigate and prosecute banks for claims related to the financial crisis.

These rulings have broadly interpreted a little-known provision of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 to allow the DOJ to seek millions of dollars in penalties from federally insured financial institutions for violations of criminal fraud statutes. Under Section 951 of FIRREA, codified as 12 U.S.C. § 1833a, the DOJ need only rely on a civil burden of proof to prove criminal fraud, provided that the alleged fraud "affects" a federally insured financial institution.

Although the provision was originally viewed as a measure to protect banks from fraud by third parties, three separate courts have recently construed this "affects" requirement broadly and affirmed that a bank can be both a "victim of" and a "participant in" the predicate fraud that gives rise to a FIRREA claim. As a result, FIRREA has become the DOJ's statute of choice when proceeding against financial institutions. Given the serious consequences of a FIRREA suit, financial institutions should be aware of its unique reach and legal standards.

REUTERS/Chip East

The Justice Department's use of FIRREA suits has been linked closely to its role on the Financial Fraud Task Force, which comprises more than 20 federal agencies, including the SEC and the IRS.

FINANCIAL CRISIS FRAUD FORCE

The DOJ's use of FIRREA suits has been linked closely to its role on the Financial Fraud Task Force. President Barack Obama formed the task force in 2009 in response to the financial crisis. The task force comprises more than 20 federal agencies, including the Department of Justice, the Consumer Financial Protection Bureau, the Securities and Exchange Commission, the Internal Revenue Service, and the banking regulatory agencies and consists of several working groups on areas including consumer protection and mortgages.

A recent press release describes the task force as "the broadest coalition of law enforcement, investigatory and regulatory agencies ever assembled to combat fraud." Although the task force comprises numerous federal agencies, it operates under the leadership and guidance of the Department of Justice, as Attorney General Eric Holder serves as its chair.

RELYING ON FIRREA

The DOJ has relied on FIRREA heavily in conjunction with its work on the Financial Fraud Task Force because of the statute's broad reach, lower burden of proof, substantial penalties and long limitations period. Specifically, FIRREA provides that the DOJ may seek civil penalties for violations of 14 different federal criminal laws, including mail and wire fraud statutes, 18 U.S.C. §§ 1341, 1343. Certain of those violations, including the most commonly alleged predicate violations, such as mail and wire

Allyson Baker (L), a partner in the Washington office of **Venable LLP**, is a trial attorney and was, until recently, an enforcement attorney with the Consumer Financial Protection Bureau, where she served as lead counsel on one of the first enforcement actions that also resulted in the largest agency settlement to date. Venable partner **Andrew Olmem** (R) just finished up a seven-year tenure as Republican chief counsel and deputy staff director at the Senate Banking Committee. He was lead Senate staff negotiator during the passage of Dodd-Frank and he was involved with the Housing and Economic Recovery Act and the TARP Act.

fraud, must also affect federally insured financial institutions. *See* 12 U.S.C. § 1833a.

Under FIRREA, however, the DOJ need only prove that there was a violation of one of these 14 predicate criminal offenses "by a preponderance of the evidence," which is a civil evidentiary burden. 12 U.S.C. § 1833a(f). If the DOJ successfully proves a violation of one or more predicate offenses, then under FIRREA, a court can impose a civil penalty that is as much as $1 million for each violation. But in the case of continuing violations a civil money penalty can be imposed that is the lesser of $1 million a day or a total of $5 million. *See* 12 U.S.C. §§ 1833a(b)(1), (2).

However, many of the larger FIRREA cases the DOJ is currently prosecuting against banks alleging mortgage fraud seek penalties well in excess of these numbers, because FIRREA also imposes a penalty if there is a finding that "any person [including any corporation] derives pecuniary gain from the violation," or if the violation results in a loss to a person other than the violator. "[T]he amount of the civil penalty may exceed the amounts [described above] but may not exceed the amount of such gain or loss." 12 U.S.C. § 1833a(b)(3).

NEW POWERS

Furthermore, under FIRREA, the DOJ can gather evidence through formal process in advance of filing a civil action. FIRREA allows the DOJ to issue administrative subpoenas seeking documents and testimony in connection with a civil investigation initiated "in contemplation of a civil proceeding under" FIRREA. 12 U.S.C. § 1833a(g)(1). This investigative authority is akin to the enforcement authority of other agencies like the SEC, the CFPB and the Federal Trade Commission.

In addition, FIRREA has a 10-year limitations period; this allows the DOJ to investigate conduct alleged to have occurred several years earlier during the financial crisis, further enhancing the appeal of FIRREA in the eyes of the DOJ. In recent years, the DOJ has brought numerous FIRREA cases and pursued even more investigations under FIRREA.

> A series of recent court rulings has effectively expanded the Department of Justice's authority to investigate and prosecute banks for claims related to the financial crisis.

The DOJ's current use of FIRREA has, in many ways, strayed from the statute's origins. Congress passed FIRREA in response to the savings and loan crisis of the late 1980s. The statute's legislative history suggests that Congress focused little if any debate on Section 1833a. Rather, the congressional debate indicates that Congress was focused more on expanding authority to bring enforcement actions against individuals and related parties whose fraudulent activities caused the failure of savings and loan institutions.

CONCLUSION: LIMITING FIRREA?

As the DOJ has increased its use of FIRREA suits, courts have increasingly examined the question of whether there are limits on its scope and application. In several high-profile matters pending in the U.S. District Court for the Southern District of New York, banks that are defendants in FIRREA cases have contended that their cases should be dismissed on grounds that the banks could not — as a matter of FIRREA's plain language and intent — engage in self-inflicting conduct. In other words, they could not engage in alleged wrongdoing that "affects" themselves.

The courts, however, have disagreed. On Sept. 24, in *United States v. Wells Fargo Bank*, No. 12-civ-7527, 2013 WL 5312564 (S.D.N.Y. 2013), a case alleging that Wells Fargo engaged in fraudulent mortgage underwriting, the court held that a "financial institution, through its own misconduct, can affect itself within the meaning of FIRREA." This holding builds on an earlier and even more expansive opinion issued by Judge Lewis Kaplan in *United States v. Bank of New York Mellon*, 2013 WL 1749418 (S.D.N.Y. Apr. 24, 2013), and has further validated the DOJ's expansive use of FIRREA and made it the tool of choice for bringing civil fraud cases against banks in the aftermath of the financial crisis. WJ

Credit union breached contract by not buying checks from vendor, suit says

A Birmingham, Ala., credit union is violating the terms of an agreement with an Alabama-based check vendor by not purchasing any checks from it, according to a state court lawsuit.

Main Street Checks v. Guardian Credit Union, No. 2013-CV-904570, complaint filed (Ala. Cir. Ct., Jefferson County Nov. 12, 2013).

The complaint, filed in the Jefferson County Circuit Court, says Guardian Credit Union purchased checks and check-related products from another vendor since the execution of its agreement with plaintiff Main Street Checks.

The agreement was for a three-year term scheduled to begin Aug. 1, 2012.

After signing the contract, Guardian allegedly purchased 100 percent of its checks and other check products from another vendor, in violation of the terms of the contract. The plaintiff says Guardian has not ordered any checks or check products from Main Street to date.

Guardian Credit Union's CEO has admitted that, despite contracting with Main Street Checks, the bank had renewed an agreement with its former check vendor, the suit says.

According to the complaint, Main Street Checks operates in Birmingham and provides personal checks, business checks, and deposit checks and services such as online ordering to financial institutions such as credit unions and community banks throughout the United States.

Guardian entered into a contract with Main Street in June 2012 to purchase 95 percent of its checks and check-related products and services from the company, the suit says.

Main Street says it has contacted Guardian several times to discuss the breach and asked that it remedy the situation. Guardian has failed to respond to these attempts, the suit says.

Main Street President and COO Douglas Deeter sent a letter to Guardian CEO Heath Harrell on June 26 detailing the previous attempts to contact Guardian, according to the complaint.

Harrell replied to the letter Sept. 19 acknowledging the breach and informing Deeter that Guardian would not be complying with the terms of the contract, the suit says.

Harrell admitted in the letter that, despite contracting with Main Street, Guardian had renewed an agreement with its former check vendor, Main Street says.

Main Street filed the complaint in response and is claiming one count of breach of contract. It is seeking compensatory damages plus interest, attorney fees and litigation costs. WJ

Attorney:
Plaintiff: James L. Mitchell, Maynard, Cooper & Gale, Birmingham, Ala.

Related Court Document:
Complaint: 2013 WL 5985710

See Document Section B (P. 23) for the complaint.

FAIR DEBT COLLECTION PRACTICES ACT

Debt collector violated deceptive-practices laws, class action says

Alliant Capital Management did not identify itself as a debt collection agency in scripted messages to consumers in violation of federal law, a class action lawsuit says.

Fiorenza v. Alliant Capital Management LLC, No. 13-CV-02081, complaint filed (D. Nev. Nov. 12, 2013).

The complaint, filed in the U.S. District Court for the District of Nevada, says Alliant violated the Fair Debt Collection Practices Act, 15 U.S.C. § 1692, and state deceptive-trade-practices laws by misrepresenting itself in the messages.

The FDCPA prohibits a debt collector from using "any false, deceptive, or misleading representation or means in connection with the collection of any debt," the suit says.

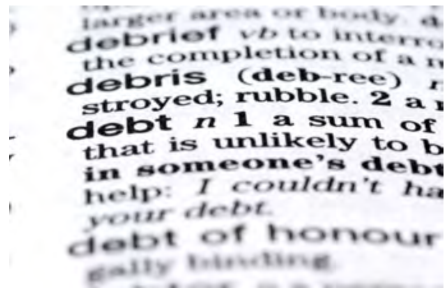
> No litigation existed against the plaintiff for the alleged claim, and the collection agency has since closed his file, the suit says.

According to the complaint, Alliant is a debt collector incorporated in New York whose primary line of business is debt collection.

Plaintiff Vincent S. Fiorenza Jr. allegedly owes a debt that is past due, which Alliant attempted to collect. The amount of the debt is not indicated in the complaint.

A representative of Alliant contacted Fiorenza on Aug. 28 in an attempt to collect the debt by leaving a scripted voice message on his answering machine, the suit says.

The message allegedly informed Fiorenza that it was calling "regarding paperwork" and that there is pending litigation regarding a claim against him.



Alliant did not notify Fiorenza that it was a debt collector or that the message was about collection of a debt as required by the FDCPA, the suit says.

The purpose of the message was "to trick plaintiff into returning the call," Fiorenza says.

No litigation existed against Fiorenza for the alleged claim, and Alliant has since closed his file, the suit says.

Moreover, Fiorenza says Alliant is not registered in Nevada as a debt collection agency and does not have a license to collect debts in the state in violation of Nevada laws.

Fiorenza is seeking to represent all consumers who received a scripted message from Alliant within the year prior to the complaint's filing date of Nov. 12. He is seeking damages, attorney fees, and reimbursement for all litigation costs and expenses. WJ

Attorneys:
Plaintiff: Mark J. Bourassa and Keren E. Gesund, Bourassa Law Group, Las Vegas

Related Court Document:
Complaint: 2013 WL 5985756

See Document Section C (P. 26) for the complaint.

New York check casher pleads guilty to $19 million laundering scheme

A New York check cashing company and its owner will pay the government more than $4 million as part of a plea agreement reached over their roles in laundering $19 million worth of bogus checks and dodging federal income tax laws.

United States v. Belair Payroll Services et al., No. 1:11-cr-00591, pleas entered (E.D.N.Y. Nov. 5, 2013).

Belair Payroll Services Inc. also will forfeit $3.3 million and owner Craig Panzera will pay $946,800 in restitution to the Internal Revenue Service, the Justice Department said in a Nov. 5 statement.

Prosecutors said Belair accepted numerous checks at branch locations in the Flushing, N.Y., area between June 2009 and June 2011 that were written on bank accounts held by various shell corporations. The corporations appeared to be related to health care, billing or office supply companies but did not do legitimate business, according to a June 2012 superseding indictment the U.S. District Court for the Eastern District of New York.

The bank accounts were established in the names of and with the permission of foreign nationals visiting the United States as exchange students but many no longer reside in the United States, the indictment said. The accounts were used by others after the foreign nationals departed the U.S.

Belair knowingly accepted the checks from people who were not the account holders and provided cash in excess of $10,000 to them but failed to report the transactions, prosecutors said.

The Bank Secrecy Act, 31 U.S.C. § 5313-5326, requires financial institutions to file currency transaction reports for any transaction involving more than $10,000.

Prosecutors said the company did file phony CTRs that falsely indicated the checks had been provided by the foreign nationals, although those individuals were rarely present and many were out of the country when the checks were cashed. Some of the transactions involved sums exceeding $100,000, the charges said.

Belair also failed to indicate on the CTRs the full amount of cash provided to the people cashing the checks, according to the indictment. In addition Panzera allegedly would inflate fees for the transactions, record only a portion of the fee on Belair's books and pocket the difference.

He routinely paid employees under the table, instructed staff to squeeze customers for higher fees and filed false tax returns with the IRS, prosecutors said.

> The defendant institution falsely indicated that certain checks had been cashed by foreign nationals even though those individuals were out of the country at the time.

Bank Secrecy Act

The Bank Secrecy Act, 31 U.S.C. § 5313, requires money services businesses such as check cashers to report any transaction or series of transactions with the same individual totaling more than $10,000 to the Department of the Treasury by filing a currency transaction report. The CTR includes information such as the name of the person processing the transaction, the amount processed and the name of the individual who received the cash. Check cashers must retain a copy of the CTR for five years from the date of filing.

The BSA's reporting and record-keeping requirements create a paper trail so law enforcement officials can investigate money laundering and other financial crimes and trace the movement of funds.

Both Belair and Panzera pleaded guilty to one count of failing to maintain an effective anti-money laundering program. Panzera also pleaded to conspiracy to defraud the United States, and Belair admitted its role in filing false CTRs.

A sentencing date has not been set. WJ

Related Court Document:
Superseding indictment: 2012 WL 9511587

See Document Section D (P. 31) for the superseding indictment.

L.A. businessman dodged taxes by stashing cash in Israeli bank

A Los Angeles businessman has pleaded guilty in federal court to conspiracy to defraud the United States for hiding millions of dollars in undeclared funds in an offshore account.

United States v. Raminfard, No. 2:13-cr-00725, guilty plea entered (C.D. Cal. Nov. 4, 2013).

David Raminfard is the latest in a recent string of Americans to plead guilty to ferreting money away in undeclared accounts in Israel, according to a statement by the Justice Department.

U.S. citizens are required to declare any funds held in a foreign account in excess of $10,000 on their individual income tax returns and notify the U.S. Treasury of the account's existence.

Prosecutors say Raminfard, who has several real estate companies in the Los Angeles area, maintained multiple secret accounts at an unnamed bank in Tel Aviv, Israel, from the 1980s through April 2011. Between 2005 and 2010 he allegedly failed to report about $521,000 in income associated with the accounts.

Prosecutors say David Raminfard hid about $3 million from the IRS in Israeli bank accounts.

In order to avoid detection, the accounts were held in the names of "nominee" entities, according to the charges. When used in tax evasion schemes, these entities are usually set up in countries with favorable banking secrecy laws and are intended to conceal financial information from other countries, according to a criminal information filed in the U.S. District Court for the Central District of California.

Sea coast and the view of the Tel Aviv from Old Jaffa at the evening

Prosecutors say Raminfard created a nominee entity in the Turks and Caicos Islands under the name Westrose Ltd.

Raminfard also avoided having bank statements for the accounts mailed to his address in the United States. Instead, they were personally delivered by an international accounts manager working for the Tel Aviv bank during meetings at a Los Angeles hotel, prosecutors say.

Sometime in 2000 Raminfard began using the funds in the undeclared accounts as collateral for loans from the Los Angeles branch of the Israeli bank. The loans allowed him to access his offshore funds while keeping them secret from the U.S. government.

These loans, including $1 million used to purchase real estate in Los Angeles, also allowed Raminfard to claim the interest paid as a business expense on corporate tax returns while failing to report the interest earned in Israel as income on his individual U.S. tax filings, the charges say.

Raminfard faces up to five years in prison, a $250,000 fine and a civil penalty equal to half the highest balance of the undisclosed money. Prosecutors put the highest balance in the Tel Aviv accounts at about $3 million.

Sentencing is scheduled for Jan. 13 before U.S. District Judge John F. Walter. WJ

Related Court Document:
Criminal information: 2013 WL 6164066

Plea agreement: 2013 WL 6164067

See Document Section E (P. 40) for the criminal information.

Morgan Stanley bet against customers' securities, lawsuit says

A Singapore-based company says in a New York state court suit that Morgan Stanley and a Cayman Islands note issuer defrauded it on a securities sales deal.

Hong Leong Finance Ltd. v. Morgan Stanley et al., No. 653894/2013, summons and complaint filed (N.Y. Sup. Ct., N.Y. County Nov. 7, 2013).

The summons and complaint, filed in the New York County Supreme Court, says Morgan Stanley marketed the securities to plaintiff Hong Leong Finance Ltd. as a "safe and conservative" investment for its customers. In reality, Morgan Stanley structured the notes so that they would fail and it would profit, the suit says.

Hong Leong is a retail financial institution similar to a savings and loan association that provides investment opportunities to Singapore workers and businesses, the complaint says.

According to the suit, Hong Leong entered into a distribution agreement with Morgan Stanley to sell credit-linked notes on Morgan Stanley's behalf.

The notes were securities tied to a credit event, such as a default or credit rating downgrade, of selected collateralized debt obligations. CDOs are securities with claims to cash flows from pools of loans or bonds. The principal and interest payments are distributed to the security holders with varying maturities, balances, rates and prepayment risks.

Morgan Stanley created Pinnacle Performance Ltd. as a special purpose vehicle to issue the notes. The Caymans-based Pinnacle purchased CDOs and then entered into a credit default swap with Morgan Stanley against the CDOs, the suit says.

A credit default swap is a financial contract that functions like insurance against investment risk.

Under the swap, Pinnacle assumed the risk that the underlying CDOs would default. It received periodic payments from Morgan Stanley in return for its promise to pay a lump sum if the underlying CDOs defaulted.

The Singapore firm says Pinnacle knowingly invested in risky CDOs selected by Morgan Stanley that were destined to default to the detriment of Hong Leong and its customers.

Hong Leong claims the defendants breached their contracts and committed fraud, fraudulent inducement of contract and negligent misrepresentation.

The suit says note issuer Pinnacle Performance Ltd. knowingly invested the notes in risky CDOs selected by Morgan Stanley that were destined to default, to the detriment of the plaintiff and its customers.

The risk that the underlying CDOs would default was distributed by Pinnacle through the credit-linked notes it issued. The note investors in turn received interest payments based on Morgan Stanley's periodic payments to Pinnacle and the interest accrued on the underlying CDOs.

Hong Leong sold notes to customers for $72.4 million under its distribution agreement with Morgan Stanley, the complaint says.

The notes failed when the underlying CDOs defaulted. The investors lost the right to the periodic payments, and their principal on the notes was used to pay Morgan Stanley its lump sum, the plaintiff claims.

Hong Leong's regulator, the Monetary Authority of Singapore, has made the company pay $32 million to its customers so far, the suit says.

It is seeking repayment of its losses, punitive damages, and attorney fees and costs.

A group of Singapore investors has also filed suit against Morgan Stanley and Pinnacle, and a Manhattan federal judge recently certified a class of plaintiffs. *GE Dandong et al. v. Pinnacle Performance Ltd. et al.*, No. 10-CV-8086, 2013 WL 5658790 (S.D.N.Y. Oct. 17, 2013). WJ

Attorneys:
Plaintiff: David S. Stellings, Jason L. Lichtman and Douglas I. Cuthbertson, Lieff Cabraser Heimann & Bernstein, New York

Related Court Document:
Summons and complaint: 2013 WL 5949993

Delaware justices seek debt-security opinion from New York's high court

A lawsuit against a credit-default-swap underwriter, its officers and directors, and its largest equity holder must await guidance from New York's highest court, the Delaware Supreme Court has decided.

Quadrant Structured Products Co. Ltd. v. Vertin et al., No. 338, 2012, 2013 WL 5962813 (Del. Nov. 7, 2013).

The Delaware Supreme Court will await the New York Court of Appeals' answer to certified questions it has sent before ruling on Quadrant Structured Products' appeal of a Chancery Court opinion dismissing the complaint.

The New York high court must interpret a no-action clause in documents that are central to Quadrant's case, the Delaware Supreme Court found.

The clause, which New York state law governs, identifies the circumstances under which Quadrant can sue Athilon Capital Corp., its corporate affiliates and its executives.

Quadrant obtained an ownership interest in Athilon debt securities in 2011, the opinion says.

According to the Delaware Supreme Court's opinion, until the 2008 financial crisis, Athilon's business was underwriting credit default swaps, a kind of financial insurance policy for debt securities. Its corporate documents limited its business to underwriting these swaps.

The New York Court of Appeals must interpret a no-action clause in documents that are central to the case.

In the years before the crisis, Athilon underwrote more than $50 billion in credit default swaps. The company's leverage ratio on the swaps reached a high point of 506-to-1, meaning a 0.2 percent loss on its swaps could put the company out of business, according to the Delaware high court's opinion.

Athilon began experience problems during the financial crisis when it lost its investment-grade credit rating and had to pay millions of dollars to swap counterparties. In 2010 the company entered a permanent "runoff" mode: It could not contract new business and could only pay off previous swaps.

The same year, investment firm EBF & Associates acquired 100 percent of Athilon's equity and put in place its own board of directors, according to the state court's opinion. EBF also bought a majority of the Athilon debt securities, which were trading at a fraction of their original value.

Quadrant sued in the Delaware Chancery Court, accusing EBF, through the Athilon board, of embarking on a risky business strategy that might benefit junior note holders like EBF in the short term but which harmed Quadrant as a senior note holder.

Final Focus Photography Wilmington, Del.

The Delaware Supreme Court: (seated L-R) Justice Randy J. Holland, Chief Justice Myron T. Steele and Justice Carolyn Berger and (standing L-R) Justice Henry duPont Ridgely and Justice Jack B. Jacobs

That is irresponsible and self-serving, Quadrant said, arguing that Athilon should be protecting its senior note holders by preserving its value for an orderly liquidation in 2014.

Athilon moved to dismiss Quadrant's complaint, claiming the investor could not overcome the no-action clause in the note agreements.

The Chancery Court agreed, dismissing the suit. Quadrant appealed the decision to the state Supreme Court.

Instead of deciding the motion in its Nov. 7 opinion, Delaware's high court found that New York law governs the note agreements and sent certified questions to the New York Court of Appeals asking it to determine whether the no-action clause bars Quadrant's litigation. WJ

Attorneys:

Appellant (Quadrant): Lisa A. Schmidt, Catherine G. Dearlove and Russell C. Silberglied, Richards Layton & Finger, Wilmington, Del.; Harold S. Horwich, Sabin Willett and Samuel R. Rowley, Bingham McCutchen LLP, Boston

Appellee (Athilon): Philip A. Rovner, Potter Anderson & Corroon, Wilmington; Philippe Z. Selendy, Nicholas F. Joseph and Sean P. Baldwin, Quinn Emanuel Urquhart & Sullivan, New York

Appellee (EBF): Collins J. Seitz Jr., Garrett B. Moritz and Eric D. Selden, Seitz Ross Aronstam & Moritz, Wilmington

Related Court Document:
Opinion: 2013 WL 5962813

Lienholder's nonrecourse loan allowable in Chapter 11, panel says

By Keith Harris, Senior Content Writer, Westlaw Daily Briefing

A lienholder's "nonrecourse" claim against a shopping center's bankruptcy estate was valid even though the underlying loan was no longer secured by equity in the shopping center, the 7th U.S. Circuit Court of Appeals has ruled in a case of first impression.

In re B.R. Brookfield Commons No. 1 LLC et al., No. 13-2241, 2013 WL 5881565 (7th Cir. Nov. 4, 2013).

Under the Bankruptcy Code's plain language, the existence of a valid lien is the only prerequisite for a nonrecourse debt to be treated as a recourse debt for claims-allowance purposes, the panel said.

A recourse debt is one for which a lender can sue for any deficiency in the event the borrower defaults, while for nonrecourse debts, the lender's only remedy is repossessing the property used as collateral.

A SHOPPING CENTER WITH 2 MORTGAGES

According to the appellate opinion, B.R. Brookfield Commons No. 1 LLC owns a shopping center securing two mortgages. TS7-E Grantor Trust holds an $8.9 million first mortgage. ValStone Asset Management LLC holds a $2.5 million second mortgage secured by a lien on the property.

The second mortgage is a nonrecourse loan agreement, and therefore ValStone may receive repayment only from the collateral.

In June 2011, Brookfield filed for Chapter 11 reorganization in the U.S. Bankruptcy Court for the Eastern District of Wisconsin.

The parties estimated that the value of the shopping center was less than that of the first mortgage and therefore ValStone's second mortgage was no longer secured by equity in the property.

Brookfield asked the Bankruptcy Court to disallow ValStone's claim under Section 1111(b) of the Bankruptcy Code, 11 U.S.C.A. § 1111(b), saying its loan was now unsecured.

Under Section 1111(b) a nonrecourse loan is treated no differently from other loans, so long as it is secured by a "lien on property of the estate," the panel said.

According to the plain language of the statute, the claim does not have to be secured by any equity in the debtor's property, but only by a valid lien, and Brookfield had not disputed the validity of ValStone's lien, the panel said.

Under Section 1111(b) a nonrecourse loan is treated no differently from other loans, so long as it is secured by a "lien on property of the estate," the panel said.

That section says a claim "secured by a lien on property of the estate" is to be allowed or disallowed the same as if the holder of such claim was a recourse creditor.

The Bankruptcy Court allowed the claim over Brookfield's objection. The U.S. District Court for the Eastern District of Wisconsin affirmed the decision, and Brookfield appealed.

CLAIM ALLOWED

The 7th Circuit agreed with the lower courts that ValStone's claim was valid.

The appellate panel said its decision turned on the interpretation of Section 1111(b), which it noted was an issue of first impression in the circuit.

Consequently, Section 1111(b) treats ValStone's claim as a recourse loan for purposes of Brookfield's reorganization, and the lower courts properly determined that the claim was allowable, the panel said.

The legislative history reinforces this reading of Section 1111(b), which was adopted to prevent a scenario that "left the creditor with neither full payment of the loan nor the right to foreclose on the property, resulting in a windfall for the debtor," the panel concluded. WJ

Related Court Document:
Opinion: 2013 WL 5881565

Banks ask Supreme Court to review application of FIRREA's extender statute

Several banks are asking the U.S. Supreme Court to review the a federal appeals court's application of the Financial Institutions Reform, Recovery and Enforcement Act's "extender statute" to certain securities law claims.

Nomura Home Equity Loan Inc. et al. v. National Credit Union Administration Board, No. 13-576, petition for cert. filed (U.S. Nov. 8, 2013).

The 10th U.S. Circuit Court of Appeals held that the National Credit Union Administration Board may pursue its securities claims under Sections 11 and 12(a)(2) of the act against the banks because the extender statute lengthened the statute of repose period. *Nat'l Credit Union Admin. Bd. v. Nomura Home Equity Loan*, 727 F.3d 1246 (10th Cir. Aug. 27, 2013).

The banks argue in their filing that the extender statute should not be applied to the securities claims because the three-year statute of repose in Section 13 of the Securities Act of 1933 is an "absolute restriction" on the time period in which the NUCA can file.

THE 'EXTENDER STATUTE'

The extender statute, 12 U.S.C. § 1787(b)(14), was enacted in response to the financial crisis to extend limitations periods for actions brought by the NCUA on behalf of failed financial institutions. The statute restarts limitations and repose periods to when the NCUA discovers the alleged violations, the 10th Circuit ruled.

The key distinction between a statute of repose and a statute of limitations is a limitations period begins to run when an injury is or should have been discovered, whereas a repose period is a fixed time limit that does not change based on a plaintiff's knowledge or lack thereof.

NCUA SUITS

The NCUA filed lawsuits on behalf of defunct credit unions for losses they suffered on billions of dollars in mortgage-backed securities (securities backed by pools of mortgage loans whose principal and interest payments are distributed to investors) purchased from the defendant banks.

The agency alleged that the defendant banks violated Sections 11 and 12(a)(2) of the Securities Act of 1933. Section 13 of the statute limits the time allotted for filing such claims to a repose period that extinguishes claims three years after the securities are offered.

U.S. Central Federal Credit Union and Western Corporate Federal Credit Union allegedly purchased $1.7 billion of the securities between 2006 and 2007 from Nomura Home Equity Loan Inc., Wachovia Capital Markets LLC, Novastar Mortgage Funding Corp., Financial Asset Securities Corp. and RBS Securities Inc.

The mortgage-backed securities fell in value and, as a result, U.S. Central and Western Corporate became insolvent, according to the appeals court opinion.

NCUA, under powers bestowed by the Federal Credit Union Act, 12 U.S.C. § 1787(a)(1)(A), appointed itself liquidating agent to U.S. Central and Western Corporate after the credit unions failed, giving the federal agency the right to sue on the banks' behalf as successor to their legal rights.

NCUA filed two lawsuits against the banks, alleging they violated federal securities laws by misleading the credit unions through statements in the offering documents that claimed the securities were "extremely safe."

The defendants sought to dismiss the lawsuits, arguing they were filed too late because the securities were sold to the credit unions in 2006 and 2007, and the repose period expired after three years, before the NCUA filed suit in 2011.

U.S. District Judge Richard D. Rogers of the District of Kansas denied the banks' motion to dismiss, saying the extender statute prolonged the repose period because NCUA could not have known about the alleged violations until it took over the credit unions in 2009.

10TH CIRCUIT RULING

The 10th Circuit affirmed the lower court's ruling, saying the District Court properly applied the extender statute even though its statutory language did not specifically say it applies to statutes of repose.

The appeals court said the extender statute "supplants all other limitations frameworks," including the statute of repose in Section 13.

BANKS SEEK REVIEW

Now the banks are challenging the appeals court's ruling by arguing that the statute of repose is an "absolute" limitations period that cannot be modified.

The extender statute does not expressly repeal Section 13's statute of repose as is required by U.S. Supreme Court precedent to displace a previous law, the banks say.

The banks argue that the Supreme Court should review the case because of the "profound and far-reaching consequences" of the 10th Circuit's interpretation of the extender statute.

According to the petition, similar extender statutes govern the Federal Deposit Insurance Corp. and the Federal Housing Finance Agency, and both agencies have filed similar securities actions against the banks.

The FDIC and FHFA claims together with those of the NCUA total four dozen pending cases involving more than $200 billion, the banks say.

The defendants "should not be made to litigate billions of dollars in federal securities claims without a definitive ruling from this court on the threshold legal question of whether the claims are time-barred under [Section] 13," they argue. WJ

Related Court Document:
Petition: 2013 WL 5979194

Freddie Mac defeats lawsuit over pre-crisis disclosures

(Reuters) – A federal appeals court on Nov. 5 upheld the dismissal of a shareholder lawsuit accusing Freddie Mac of concealing its precarious finances and its subprime mortgage exposure prior to the 2008 financial crisis.

Central States, Southeast and Southwest Areas Pension Fund et al. v. Federal Home Loan Mortgage Corp. et al., No. 12-4353, 2013 WL 5911476 (2d Cir. Nov. 5, 2013).

The 2nd U.S. Circuit Court of Appeals in New York said shareholders failed to connect their losses to the alleged inadequate disclosures by the government-controlled mortgage company and its officials, including former Chief Executive Richard Syron.

Freddie Mac lost most of its stock market value when, along with the larger Fannie Mae, it was seized by U.S. regulators in September 2008, and put into a conservatorship under the Federal Housing Finance Agency.

Shareholders led by the Illinois-based Central States, Southeast and Southwest Areas Pension Fund accused Freddie Mac of hiding its potential insolvency even after revealing a $2 billion quarterly loss Nov. 20, 2007.

But a three-judge 2nd Circuit panel said Freddie Mac had made "extensive disclosures" during the class period, and that the shareholders did not show that their losses stemmed from the additional revelations.

"Throughout its complaint, Central States alleges that before July 2008, speculation about Freddie's insolvency based on inadequate capitalization and insufficient internal controls caused the stock price to fluctuate," the panel wrote.

"As a result," it added, "Central States does not plausibly allege a causal connection between the drop of the share price and the information revealed in the corrective disclosures."

The court added that the shareholder losses also "coincided with a marketwide phenomenon — the housing bubble burst," and were not shown to be linked to any concealing of "hundreds of billions of dollars" of subprime mortgage exposure.

The court's decision upheld a September 2012 ruling by U.S. District Judge John Keenan in Manhattan. *Kuriakose v. Fed. Home Loan Mortgage Corp. et al.*, 897 F. Supp. 2d 168 (S.D.N.Y. 2012).

Douglas Wilens, a partner at Robbins Geller Rudman & Dowd representing the shareholders, did not immediately respond to requests for comment. T he lawsuit was originally filed in 2008.

"We are gratified by the 2nd Circuit's ruling, which affirms the dismissal of the case in its entirety," said Jordan Hershman, a lawyer for Freddie Mac and co-chair of the securities litigation group at the law firm Bingham McCutchen.

Frank Volpe, a partner at Sidley Austin representing Syron, did not immediately respond to requests for comment.

Syron and other former Freddie Mac officials still face and have denied charges of wrongdoing in a U.S. Securities and Exchange Commission civil fraud lawsuit tied to the financial crisis. WJ

(Reporting by Jonathan Stempel)

Related Court Document:
Opinion: 2013 WL 5911476

Mortgage lender

CONTINUED FROM PAGE 1

"It has filed counterclaims against Kutner and others that it intends to prosecute vigorously and is looking forward to having a full opportunity to address this matter in a manner that is consistent with the rights it had under its agreements," Scharf said.

Attorney Steven Engel of Dechert LLP in Manhattan, who represents Kutner, said in an email, "We are pleased that the court dismissed Greystone's attempt to prevent its former employees from moving on and look forward to winning a full recovery for Mr. Kutner in court."

Ephraim Kutner is pursuing a related suit alleging Greystone owes him more than $10 million in wages. *Kutner v. Greystone Funding*, No. 652210/2013, *complaint filed* (N.Y. Sup. Ct., N.Y. County June 21, 2013).

Greystone sought dismissal of that case on the grounds that was duplicative of the company's earlier-filed action, but Judge Ramos denied the motion Nov. 25. He said Greystone's request was moot given his decision to dismiss the company's suit against the Kutners.

THE RESTRICTIVE COVENANT

In its complaint Greystone said Ephraim Kutner, who worked as a loan originator, was barred by contract from competing against it in the lending business until April 15, 2015.

Ephraim signed an agreement stating he would not compete with the company while working there or for two years after his employment ended, the suit said.

Greystone alleged that Ephraim and Jonathan, who also worked for the company, left their positions April 15, 2013, and started working at Harborview. Greystone said Ephraim, with the help of Jonathan, stole clients, employees and trade secrets for the benefit of Harborview.

"We are pleased that the court dismissed Greystone's attempt to prevent its former employees from moving on and look forward to winning a full recovery for Mr. Kutner in court," defense attorney Steven Engel of Dechert LLP said.

The suit also alleged Jonathan and Harborview tortiously interfered with the contract between Greystone and Ephraim because Jonathan knew of the noncompetition contract but helped his brother breach the agreement for the financial benefit of himself and Harborview.

Greystone asked the court to issue an order preventing the defendants from competing in the lending business and to impose a constructive trust on any profits they received from deals that were allegedly diverted away.

DISMISSAL IS SOUGHT

The defendants sought dismissal of the suit, arguing that Greystone terminated Ephraim's employment without cause and thereby canceled out the contract's restrictive covenant.

They also alleged that such covenants are generally unenforceable under New York law because courts do not favor the loss of an individual's livelihood.

The defendants further asserted that Greystone did not plead the essential elements of its claims against Jonathan and Harborview.

In response, Greystone said the restrictive covenant must be enforced to protect its business interests from the defendants' allegedly wrongful activities. The company said the defendants were mischaracterizing the suit as an attempt to prevent them from making a living.

Greystone also said the complaint's allegations were sufficient because they placed the defendants on full notice of the claims raised.

THE RULING

Judge Ramos said the evidence showed that Greystone fired Ephraim on March 1, 2013, before the expiration of his contract, and not on April 15, 2013. This termination was without cause and ended the employment restrictions as well, he said.

The contract provided that the restrictive period would not be effective beyond the date of a termination without cause, the judge explained.

In addition, Greystone's allegations against Jonathan and Harborview are vague and do not contain the essential elements of the claims raised, he said. WJ

Attorneys:
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Defendant: Steven Engel and Andrew Levander, Dechert LLP, New York; Dov Kesselman and Jacob Oslick, Seyfarth Shaw LLP, New York

Related Court Documents:
Opinion: 2013 WL 5951793
Greystone complaint: 2013 WL 2356262
Defendants' memo in support of dismissal: 2013 WL 4603790
Plaintiff's opposition: 2013 WL 4603774
Defendants' reply: 2013 WL 4603778
Kutner complaint: 2013 WL 3131816
Defendant's motion to dismiss Kutner complaint: 2013 WL 4603786
Plaintiff's opposition: 2013 WL 4603783
Defendant's reply: 2013 WL 4603780

See Document Section A (P. 19) for the order.

NEWS IN BRIEF

TREASURY ENLISTS 2 NATIONS TO HELP COMBAT TAX EVASION

Costa Rica and the Cayman Islands are joining forces with the U.S. Treasury Department to combat international tax evasion. The Treasury said in a Nov. 29 statement that under newly signed agreements, the two nations will provide the United States with information about accounts U.S. taxpayers hold offshore at financial institutions in Costa Rican or the Cayman Islands. The agreements implement the Foreign Account Tax Compliance Act, which requires foreign banks to report information about accounts held by U.S. taxpayers or foreign entities in which U.S. taxpayers hold a substantial ownership interest. The agreement with Costa Rica is available at http://1.usa.gov/JjlOTs. The agreement with the Cayman Islands is available at http://1.usa.gov/1jTF0F1.

BANKS MUST MANAGE RISKS FROM SPECIALIZED SMALL LOANS, OCC SAYS

The Office of the Comptroller of the Currency said in a Nov. 21 statement that it has issued a final supervisory guidance to help banks manage the risks posed by specialized short term loans in small-dollar amounts. These loans, known as "deposit advance products," are made to customers who have recurring direct deposits and are repaid out of the next direct deposit they receive. The OCC says these loans pose risks to an institution's safety and soundness because their high fees and short repayment periods can sometimes leave consumers in debt. The guidance discusses the types of risks posed and explains how examiners will review banks' underwriting and credit administration policies and compliance with federal consumer protection laws. The guidance is available at http://1.usa.gov/1fnMJbx f.

FDIC TO REVIEW BANKS' LOCAL LENDING IN EARLY 2014

The Federal Deposit Insurance Corp. said in a Nov. 29 statement that it has released a list of the banks that it will examine between Jan. 1 and March 31 for compliance with the Community Reinvestment Act. The statute requires that financial institutions serve the credit needs of low- and moderate-income customers in their neighborhoods, and federal regulators must periodically assess how each bank is complying with these goals. During an evaluation of a bank's local lending efforts, the FDIC can assign ratings of "outstanding," "satisfactory," "needs to improve" or "substantial noncompliance." The examination schedule for the first quarter of 2014 is available at http://1.usa.gov/1fnMPzP.

CASE AND DOCUMENT INDEX

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Hong Leong Finance Ltd. v. Morgan Stanley et al., No. 653894/2013, *summons and complaint filed* (N.Y. Sup. Ct., N.Y. County Nov. 7, 2013) 9

In re B.R. Brookfield Commons No. 1 LLC et al., No. 13-2241, 2013 WL 5881565 (7th Cir. Nov. 4, 2013) 11

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Quadrant Structured Products Co. Ltd. v. Vertin et al., No. 338, 2012, 2013 WL 5962813 (Del. Nov. 7, 2013) 10

United States v. Belair Payroll Services et al., No. 1:11-cr-00591, *pleas entered* (E.D.N.Y. Nov. 5, 2013) 7
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