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in the news

Loan Enforcement and Creditors' Rights

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Lender's Edge
Newsletter

In this Issue:

Supreme Court Decision Fails to Provide Clarity on ECOA Claims

On March 22, 2016, the U.S. Supreme Court issued its first 4-4 decision following the death of Justice Antonin Scalia, thereby affirming the 8th Circuit in *Hawkins v. Community Bank of Raymore*. The Court's *per curiam* opinion was a simple sentence providing: "The judgment is affirmed by an equally divided Court." Unfortunately, the Supreme Court's decision fails to provide the clarity that creditors were seeking in defending against guarantor ECOA claims and affirmative defenses.

Through the decision, the Supreme Court upheld the 8th Circuit Court of Appeals ruling that guarantors are unambiguously excluded as "applicants" under the Equal Credit Opportunity Act (ECOA), and cannot claim a violation of ECOA as an affirmative defense to avoid liability on guaranties with lenders. In *Hawkins* the central issue was whether Respondent, the Bank of Raymore, improperly required Petitioners, Valerie Hawkins and Janice Patterson, to personally and unconditionally guarantee the repayment of certain loans it made to a company owned by Respondents' husbands, not by Hawkins or Patterson.

Petitioners alleged they were required to personally guarantee repayment of the loans solely because they were the spouses of the company's owners. They contended this violated ECOA and Regulation B, a regulation enacted pursuant to ECOA, which many claim exceeds the purpose and scope of ECOA. In a unanimous decision, the 8th Circuit affirmed the Missouri Western District Court's finding that guarantors are not "applicants" for credit under ECOA's unambiguous definition of that term and are, therefore, not protected under ECOA through its marital discrimination prohibition.

What to Expect Moving Forward

The tie decision from the Supreme Court is significant because the decision has no binding precedent on other courts. Thus, the ruling does not resolve the split of authority among federal and state courts, including the 6th Circuit's contrary finding in *RL BB Acquisitions, LLC v. Bridgemill Commons Dev. Group,* where the court found that guarantors are "applicants" under ECOA. State courts, including the Missouri Supreme Court, have also found that guarantors are applicants under ECOA.

As it stands, the 8th Circuit's ruling is binding among federal courts in Arkansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota. The 6th Circuit's ruling in *RL BB Acquisitions* remains the law for federal courts in Kentucky, Michigan, Ohio and Tennessee. Given the continued split of authority, Polsinelli expects that courts from other circuits will continue to address this issue and provide their interpretation of ECOA.

In state and federal district court cases prior to *Hawkins*, Polsinelli has successfully argued on behalf of financial institutions that ECOA does not apply to spousal guarantors because they are not applicants for loans unless they actually apply for credit. ECOA is an invaluable piece of legislation that very correctly prohibits creditors from discriminating against loan applicants on the basis of race, sex, age, religion, national origin or marital status. (For instance, see *Champion Bank v. Regional Development, et al.*, United States District Court, Eastern District of Missouri, Case No. 4:08CV1807 CDP).

With respect to marital status, ECOA serves the invaluable purpose of prohibiting any archaic thinking that a female applicant for credit is somehow more creditworthy "if she has a husband standing beside her." However, ECOA by its plain terms does not extend its protection to guarantors who do not apply for credit.

Regulation B was enacted by an unelected Board of Governors of the Federal Reserve System—and not by Congress. This board is responsible for promulgating rules to promote the enforcement of ECOA; it is not responsible or authorized to make new laws in addition to ECOA. As many financial institutions have argued, and as the 8th Circuit has agreed, the board reached beyond the language of ECOA in enacting Regulation B and in effectively converting non-applicant guarantors into "applicants."

For questions regarding this information, please contact one of the authors, a member of Polsinelli's Loan Enforcement and Creditors' Rights practice or your Polsinelli attorney.

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A Remedy for Lost Notes

At times, lenders lose the promissory notes on defaulted loans. Lost notes are problematic because, in order to have standing to foreclose, a lender may be required in many states, including in New York, to possess the original evidence of obligation—the original note. However, this situation can be remedied with a "lost note affidavit."

Rules Governing Lost Notes

When an original promissory note is destroyed or lost, the lender needs to furnish satisfactory evidence of the existence of the note. A lost note affidavit allows a foreclosing lender to enforce the note by explaining why the original note

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cannot be produced. Section 3-804 of the New York Uniform Commercial Code governs lost, destroyed or stolen instruments, including promissory notes and provides for their enforcement. A plaintiff seeking to enforce a lost instrument must prove: (1) ownership of the instrument; (2) facts which prevent its production; and (3) its terms. N.Y.U.C.C. § 3-804.

Analysis

A recent decision from Kings County, Supreme Court, New York, *Puryear v. Prokeen Management Co., Inc.*, 49 Misc. 3d 1207(A), 26 N.Y.S.3d 215 (N.Y. Sup. Ct. 2015), is a reminder that a lost note affidavit should include specific facts surrounding the execution of the note and how the note was lost in order to meet the requirements of N.Y.U.C.C. § 3-804. In *Puryear*, the plaintiff produced a lost note affidavit identifying the borrower and payee, the date of the note and the amount of the note.

The affidavit also claimed the lender is the legal and "beneficial owner and holder of the note," which had not been transferred, discharged, satisfied, assigned or paid in full. The affidavit included a paragraph that the note was lost and could not be produced after a "thorough and diligent search." The court noted that the affidavit did not include details surrounding the execution of the note, how the note was lost, where it had been kept and where the search was conducted. Accordingly, the court concluded that the lost note affidavit was inadequate as it failed to establish ownership, the facts which prevented its production and its terms.

Best Practices

In light of *Puryear*, when drafting a lost note affidavit, the following facts should be included:

1. Facts regarding the execution of the note and its terms. This includes the date of the note, the names of borrower (s) and the original payee, and the original amount of the loan. If the borrower is an entity, it should include who on behalf of payee signed the note.
2. A statement that the note has not been forgiven, discharged, satisfied, cancelled or paid in full.
3. Include a clear chain (with dates) of endorsements, transfers or assignment of the note.
4. A statement regarding where the note had been kept before it was lost or destroyed.
5. Facts surrounding how the note was lost, as it is not sufficient to simply state that the note is lost and the owner is unable to locate the note.
6. Details surrounding the search for the note, including who conducted the search, where and how the search was conducted and when the search took place.

While read in the context of New York's Uniform Commercial Code, the level of detail the court demanded concerning the circumstances of the loss is instructive and a lender in any state will be well served by including as much relevant information as possible to avoid a problem with enforcement. Foreclosing lenders seeking to enforce a lost note should consider these best practices when drafting a lost note affidavit. To be enforceable, an adequate lost note affidavit should include detailed facts regarding ownership of the instrument, the reasons why it cannot be produced, and the terms of the note.

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About Polsinelli's Loan Enforcement and Creditors' Rights Practice

Polsinelli has one of the largest creditors' rights practices in the nation. Our lawyers are situated from coast to coast, from New York to Los Angeles, and have practiced for more than 28 years in state courts, federal courts, and bankruptcy courts in more than 40 states. Our lawyers practice law with an eye – always – toward the business objectives of our clients. We realize that lenders enforcing their rights with respect to special assets are looking to remain constantly informed, want to know their alternatives, and want to maximize return in the shortest period of time and in the most cost-efficient manner possible. Accordingly, we can tell you about differences in enforcement procedures from state to state, the amount of control a lender can expect to assert in connection with those procedures, and the expected timing and cost of such procedures. New York, Dallas, Chicago, and Los Angeles are different places, and they bring different experiences to enforcing lenders. We can tell you what to expect in each of those locations, and everywhere in between.

Maximization of recovery – and its flipside, minimization of loss severity – is not simply about foreclosures and suits on promissory notes and guaranties, although those remedies are very important to lenders. It is also about speed, for time of resolution is the single most important contributor to loss severity. It is also about preservation of assets during the period of time that it takes to enforce those ultimate remedies. We know this, and we have assisted lenders with moving quickly to protect their collateral – obtaining the appointments of receivers, obtaining restraining orders, obtaining orders of replevin, and obtaining other forms of extraordinary relief that are designed to preserve collateral, and sometimes even add value to it, pending disposition.

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Polsinelli is an Am Law 100 firm with more than 800 attorneys in 19 offices, serving corporations, institutions, and entrepreneurs nationally. Ranked in the top five percent of law firms for client service*, the firm has risen more than 50 spots in the past five years in the Am Law 100 annual law firm ranking. Polsinelli attorneys provide practical legal counsel infused with business insight, and focus on health care, financial services, real estate, intellectual property, mid-market corporate, and business litigation. Polsinelli attorneys have depth of experience in 100 service areas and 70 industries. The firm can be found online at www.polsinelli.com. Polsinelli PC. In California, Polsinelli LLP.

** 2016 BTI Client Service A-Team Report*

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