PRESENTATION ON WORKOUTS AND CHAPTER 11 BANKRUPTCY

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Restructuring Roundtable

Robert D. Katz, CTP, CPA MBA, Managing Director

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- Streamline for success – Quick positive exit is key!

The Turnaround Consultants Role

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The Turnaround Consultants Role

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- Assisting the Company to handle the pressures.
- Streamline for success - Quick positive exit is key!
- Teamwork/coordination/exit
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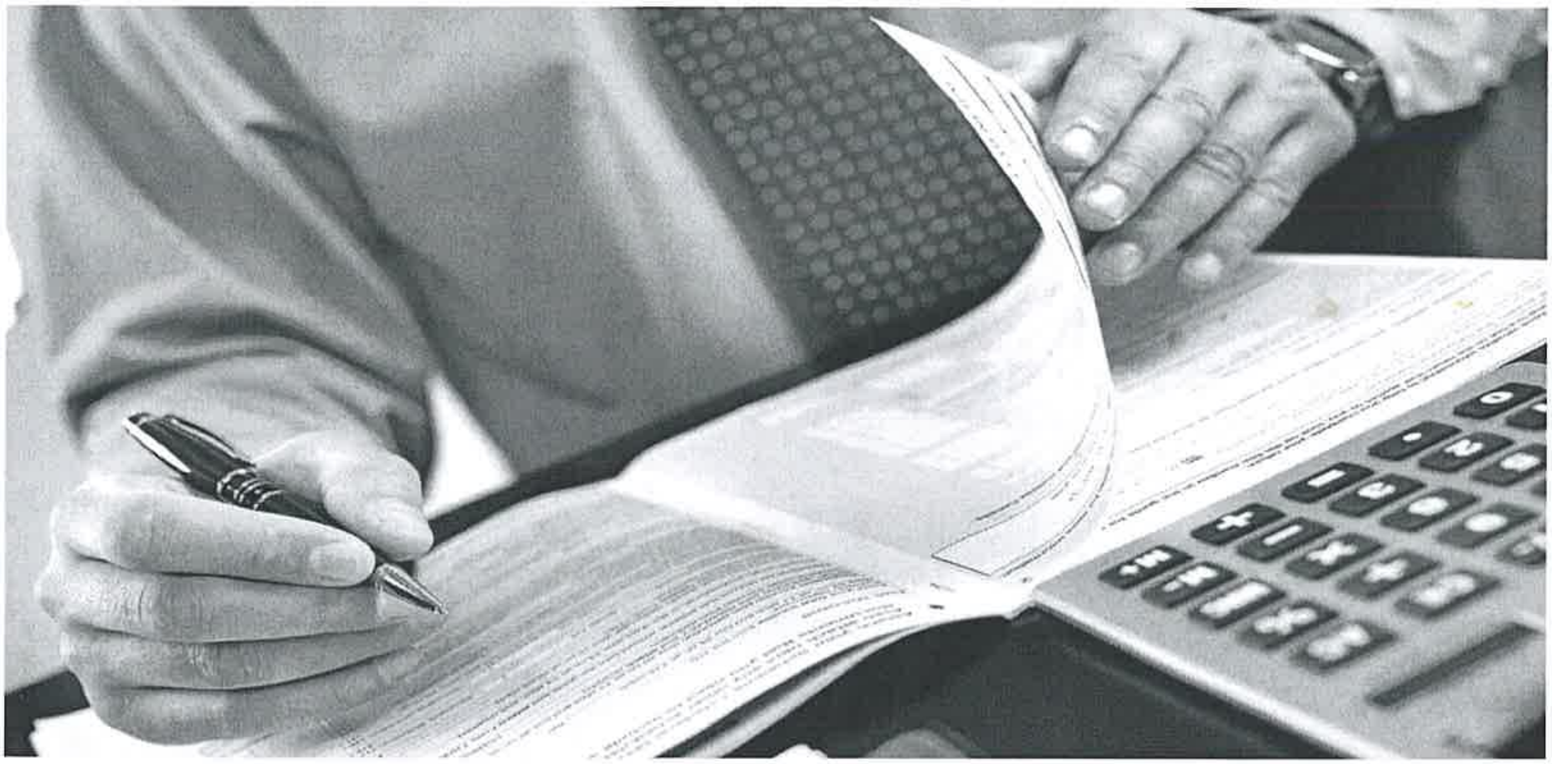
WORKOUTS AND FORBEARANCE AGREEMENTS

BY MICHAEL J. LICHTENSTEIN



Comprehensive underwriting, coupled with careful documentation, typically minimizes a financial institution's risk when extending credit or making loans. However, when lending officers make loans, they don't always think about the consequences in the event of a default at some point down the line. Accordingly, sometimes a lender fails to pay attention to details that could ultimately have an adverse effect when the bank needs to exercise its legal remedies. For example, a lender might not notice that guarantors live in one jurisdiction while the borrower is incorporated in another state. As a result, the guarantees might not contain the requisite language for the bank to confess judgment in the jurisdiction where the guarantors live. When reviewing a file in anticipation of making a loan, a lender might not focus on all of the information contained in tax returns or credit reports. Ultimately, this inattention might have adverse consequences, for example in a non-dischargeability proceeding in an individual guarantor's bankruptcy.

After a loan goes into default, rather than simply litigating, which is expensive and time consuming, often a lending institution will attempt to work out or restructure the debt so as to have a performing loan on its books. This workout option, typically in the form of a forbearance agreement, provides an opportunity to clean up any omissions in the original loan documents, to add protection (like cross defaults and cross collateralization) and to obtain additional collateral to secure the loan.

Details to Which Attention Should Be Paid

It is imperative that when making a loan, a lending officer should pay careful attention to detail. For example, failing to notice that a signature has been notarized or accepting signatures outside of the presence of a guarantor can lead to affirmative defenses when suit is filed. Borrowers and guarantors may assert that the signature is not really theirs or that they did not see the entire guaranty and were only presented with a signature page, believing they were signing a different document. Similarly, in loan documents that contain confessed judgment[1] language, it is crucial to pay attention to where the guarantors live because different jurisdictions have different requirements for entering judgments. For example, in Maryland, one can use generic language providing for any attorney to appear on behalf of the defendant to enter judgment. On the other hand, Virginia requires specific language naming a particular person who is authorized to enter confessed judgment (and that person actually has to go to court to file the judgment).

The consequences of not being able to enter a judgment immediately in the county where the guarantor or borrower lives can be significant. In most jurisdictions, entry of a judgment operates as a lien on any real estate a judgment debtor owns. If the loan documents do not have the correct confessed judgment language, a lender could lose its priority by the time a judgment is entered in one jurisdiction and then transferred to the judgment debtor's county of residence.

Another item to pay close attention to is what information the borrower and/or guarantors provide in support of a loan application, like personal financial statements or credit reports that should alert a lender that the applicant is married. Most financial institutions' form financial statements have a box to check whether the statement reflects joint assets or only the applicant's assets. For example (check one):

☐ Individual Financial Statement	☐ Joint Financial Statement (if joint, complete the following)
Spouse: ____________	Date of Birth: ____________
	Social Security No. ____________

However, frequently, lenders do not really insist that the applicant check the box or do not inquire if, in fact, the financial statement reflects only the applicant's assets.

The potential downside of failing to pay attention to this detail is that, after default, an individual borrower or guarantor files for bankruptcy hoping to obtain a discharge of all of his debts. The lender then seeks to have the debt deemed to be non-dischargeable because the financial statement reflected a $10 million net worth while the debtor's bankruptcy schedules show only $4 million in assets (because the schedules do not includes assets owned either jointly or as tenants by the entirety).

Section 523(a)(2) of the Bankruptcy Code provides that a debt will be non-dischargeable if money was obtained by use of a written statement (in this example, a personal financial statement) that is materially false as to a debtor's financial condition on which a creditor reasonably relied that the debtor published with intent to deceive (a creditor must satisfy all of these elements). The key here is the part which requires reasonable reliance. Courts have found that when a lender has had information in its possession indicating that a debtor was married (for example, tax returns or credit reports), and therefore should have known that joint assets could not be relied on as collateral for the loan or guaranty, that lender did not reasonably rely on such financial statement in extending credit.

Forbearance Agreements

In the event that a lender has neglected some of the details discussed above, there is sometimes an opportunity to perform corrective surgery. When a loan is in default, most lenders would rather restructure the loan than spend money on litigation. Often, restructuring terms are memorialized in a forbearance agreement which provides that the lender will refrain from exercising its legal remedies upon the obligor's fulfillment of the obligations set forth in the agreement. This is a golden opportunity to rectify any omissions or errors in the original documents as well improving the lender's collateral position.

If the loan documents have not been executed properly or have not been notarized, a forbearance agreement is a good vehicle to include borrower and guarantor reaffirmations as to the amount of outstanding debt, that the loan documents are valid and binding and also to include a waiver of all defenses and counterclaims. To the extent that the wrong confessed judgment language was used in the original loan documents, or if no confessed judgment was included, the forbearance agreement should include such language.

A lender should also use the forbearance as an opportunity to add collateral if possible (additional real estate or liens on assets) or at least to cross collateralize different loans with existing collateral. When obtaining additional real estate collateral, because of the recordation taxes, it often makes sense to limit the amount of indebtedness secured by the new deeds of trust to the amount of estimated equity in new property added as collateral. For example, rather than adding three new deeds of trust, each of which secures the total outstanding indebtedness in the aggregate amount of $4 million, a lender might choose to obtain deeds of trust in small amounts that will provide the lender equity but not require unnecessarily high recordation fees.

To the extent that existing loan documents do not contain cross-default provisions, a lender should take the opportunity to add in such a provision. An agreement with both cross-collateralization and cross-defaults will broaden a lender's rights and remedies significantly. One final provision that is often added in forbearance agreements relates to bankruptcy. Adding language in which the borrower and guarantors acknowledge that in the event of bankruptcy such obligors will not object to or contest a lender's request for relief from the automatic stay[2] can short circuit any attempt to delay the enforcement of remedies by filing a bankruptcy petition. Many courts have upheld such provisions in granting lenders relief from the automatic stay.

Conclusion

In an ideal world, at the outset of a loan, all of the documents would be executed perfectly and every loan would be oversecured. Unfortunately, reality does not always work that way and therefore it is sometimes necessary to try and correct omissions or to add to a lender's remedies. Upon a borrower's default, drafting a forbearance agreement can remedy deficiencies and can increase the likelihood that a lender will be repaid. Once a borrower has defaulted, the lender is bargaining from a position of strength (in terms of agreeing to forbear from exercising remedies) and should take advantage of this situation to improve its position. TSL

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1. A confessed judgment allows a creditor to enter judgment upon default rather than having to go through an entire trial that could take months or years.
2. Section 362 of the Bankruptcy Code imposes an automatic stay against the commencement or continuation of any legal action or attempt to enforce remedies against a debtor.

Are There Too Many Shades of Gray?

By Robert D. Katz, CTP, CPA, MBA
Managing Director, EisnerAmper LLP

In the turnaround arena, it's always critical to work in a transparent, and open environment with a similar perspective. However, are you noticing that there are more blurred lines and more shades of gray? Are cases being brought on a contingency basis when there's a good chance there may be less, nominal or nothing there, sometimes with tremendous justification and rationalization; is the risk justified? Are people conducting enough due diligence? What is the impact in a time of slowing restructuring work? Or perhaps it's a normalization of activity because we've seen it so often.

Just recently, I was reading court papers with a Chapter 11 petition and first day motions filed regarding a debtor and its affiliated entities. I had come across the debtor and their management team previously. These writings and the ultimate circumstances causing the Chapter 11 petition seemed inconsistent with my recollection and understanding of the situation and driving forces.

In another case, I was working as the interim Chief Financial Officer for a generic pharmaceutical company in Chapter 11. I had discovered that the Vice President of Sales, an executive at one of our largest vendors, was moonlighting for one of the competitors. The VP was recently given equity position in a new company that was a direct competitor of his employer. When I called the president of our vendor he was unnerved to hear the news, yet appreciative of our conversation as he had planned to promote this person and now had to aggressively make other determinations.

Recently, I read that Phil Mickelson, a potential hall of fame golfer, was being investigated for insider trading from a stock tip. Surprising to think he would need to try and gain an inside/illegal advantage in the stock market.

I recently judged submissions for an organization that awards recognition for Turnaround of the Year, Transactions of the Year, Contributors of the Year, 40 under 40, and so forth. As I read one, I thought….wow that was a lot to accomplish in one year.

In a cautionary tale, after having some ups and downs a prominent professional moved to a new company run by industry leaders and visionaries. While not positive, the conversations among the leaders of the new company may have gone something like this: "The person coming on board can do great things and has a huge knack for developing opportunities and business, no question. But keep him/her focused within a very, very narrow box. If they stray a little bit….

Anonymity is another factor that may be making the interpretation of ethics and accountability more and more cloudy. It wasn't long ago that if you made a comment regarding a certain person or situation you had to attach your name to it. Today there have never been more anonymous quotes attributable to a story or circumstances.

Then there is the other side of the spectrum.

Take this stories of refreshing honesty for example in certain cases I have been involved with.

After a lackluster first quarter, the president of a lender's ABL division asked a CEO why their first quarter's performance was worse than budgeted. The owner replied: "we took our eye off the ball and let our competitor take two of our slots. However, we corrected that in the second quarter, positioned ourselves better with new products, and are in the process of regaining those slots." He later asked me how I thought the meeting went. I told him he probably said some things that I might not have, but it was impossible not to respect him because he always says what actually happened, good and bad and unfiltered.

In another situation, very shortly after a company closed on new financing with a new lender, one of their main cooking ovens exploded. Within a few hours, the company's owner had called a meeting with the lender to walk them through what happened. They agreed to have weekly calls and/or meetings to continue the open line of communications while the company addressed and went through remediation. In other cases, the panic might have incurred. However, in this case the lending institution had previously performed extensive due diligence, including on the character of the ownership and management team and had found that they were beyond reproach. They chose to stay the course and weather the storm with their borrower. A year later availability has reached an all-time high, performance exceeded budget and the lender allowed the owner to take an additional distribution, earning the lender additional income in conjunction with it.

There are certain professionals that leave an unbelievably positive impression because even though they may lose the deal they do the right thing. They are the ones you will always keep in mind for future call backs or to recommend to others.

Think about your own cases. If you are participating in a deal, do others have the same motivation, goals, or agendas that you do? Pardon the cliché, but are all the participants paddling in the same direction? Or is one party significantly improving its position and squeezing cash flows out of the entity to the detriment of the other constituencies.

With interest rates continuing at record lows and increasing sources of capital chasing fewer deals, pressures mount to find opportunities. So with these issues becoming more and more glaring, problematic and/or opportunistic depending on your perspective; how do you determine whether you are being presented a fair and accurate picture? Are you looking deep enough? Or might you be looking too deep creating something that may not be there? And is there a situation that really is obvious, there for the taking, but you have so much going on that you can't see the forest through the trees?

Here are some characteristics, some strengths, weaknesses opportunities and threats to think about.

- Consider the bigger picture for better successes don't give up the forest through the trees.

- Listening sometimes has become a lost art. Leaders that listen twice as much as they speak, respecting co-workers, colleagues and employees by listening to ideas that may even contrary to their own often find success
- Those who are part of the humble minority versus the arrogant majority. This could better position the organization for the future.
- Ponder focusing on the long term rather than the push and pull of quick fixes for shorter term successes. At the end of the year you may be better off deferring some of your wins to next year. It may cause a short fall for 2016 but may establish a great foundation for 2017.
- Sift through the morass and clearly articulate why something went right or wrong, their success or shortcomings. If it can't be communicated in a focused manner, it usually raises other concerns.
- Think about what is best for their customers and clients, not just their own firm. Have you maximized client value and reaped all the rewards for both you and them? This may help you get to your year-end goals and still leave the runway and foundation for the coming year.
- Reward employees for going above and beyond who are part of your success. Have you taken the time to say thank you and let them know that you appreciate it?

Perhaps these thoughts keep us moving toward a successful conclusion to the year pondering fewer shades of gray. Have a great holiday season.

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The Banking Law Journal

Established 1889

AN A.S. PRATT & SONS PUBLICATION SEPTEMBER 2013

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THE BANKING LAW JOURNAL (ISBN 978-0-76987-878-2) (USPS 003-160) is published ten times a year by Matthew Bender & Company, Inc. Periodicals Postage Paid at Washington, D.C., and at additional mailing offices.

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POSTMASTER: Send address changes to THE BANKING LAW JOURNAL LexisNexis Matthew Bender, 121 Chanlon Road, North Building, New Providence, NJ 07974.

Commercial Loan Officers' Authority to Bind a Bank

MICHAEL J. LICHTENSTEIN

The author believes that banks need to be cautious about actions taken without actual authority which could bind a bank. If an agent's actions can be construed as being taken with the approval of a bank or the bank has manifested some indication that such action was authorized, a bank could find itself liable for such agent's actions. Also, if a bank ratifies actions, even if unauthorized, the bank will be held responsible.

Every bank has lending policies and procedures, part of which identify and define a commercial lending officer's authority to make loans and to extend credit. That is known as actual authority and is based upon parameters that have been memorialized and approved by the bank's management and board of directors. Actual authority defines the extent to which a commercial lending officer is authorized to bind the bank. However, even in the absence of actual authority, a commercial lending officer's actions might still bind a bank under the doctrines of apparent authority, implied authority, agency by estoppel, or ratification.[1] While the common theme in each of these approaches is that an agent cannot expand his own authority, courts have found that institutions can be bound by an agent's unauthorized actions if third parties have been led to believe that such bank officer had authority. Agency by estoppel and ratification also require that the third party's reliance on such actions be reasonable.

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ACTUAL AUTHORITY

One way to create an agency relationship[2] is for the principal to confer actual authority on the agent.[3] Actual "authority to do an act can be created by written or spoken words or other conduct of the principal which, reasonably interpreted, causes the agent to believe that the principal desires him so to act on the principal's account."[4]

Actual authority is that which is "actually granted by the principal, and it may be express or implied."[5] In *Progressive Cas. Ins. v. Ehrhardt*, the appellees contended that Progressive was obligated to cover losses under an insurance policy because Progressive's chief underwriter backdated an insurance policy and in doing so waived Progressive's ability to not cover losses.[6] The court explained that in order to find that Progressive waived its right to not cover losses, the chief underwriter must have been authorized by Progressive to backdate the policy.[7] The court noted that Progressive did in fact authorize *some* underwriters to backdate policies.[8] However, these underwriters could only do so upon the explicit approval of an office supervisor after the insured had provided a written declaration of no loss, and when the renewal payment was received within five days of the policy expiration.[9] In *Progressive*, the chief underwriter failed to get the approval of the office supervisor or written declaration of no loss, and the renewal payment was not received on time.[10] Therefore, the chief underwriter did not have the actual authority to backdate the insurance policy, and the act of doing so was unauthorized so it could not serve as the reason to bind Progressive.[11]

Agri Export Cooperative v. Universal Savings Association,[12] involved a lawsuit to enforce a letter of credit issued by the defendant bank. The bank president, who was expressly authorized to make loans without further approval from the board of directors, issued a $1 million letter of credit.[13] Upon a demand for payment, the bank refused to honor the letter of credit without providing any reason.[14] The court inferred from the evidence that the president had actual authority to issue the letter of credit.[15]

Similarly in *First Interstate Bank of Texas, N.A. v. First National Bank of Jefferson*,[16] the issue was whether a senior vice president had authority to execute a bond purchase agreement for the defendant. The Fifth Circuit noted that actual authority can be implied or express.[17] The court added that a principal can confer actual authority orally; there need not be a corporate resolution or by-law specifically authorizing a transaction.[18] Because of his status as a senior vice president and his responsibilities, together with corroborating testimony about defendant's authorization that he could sign the bond agreement, the Fifth Circuit concluded that whether he had express actual authority was a jury question.[19]

APPARENT AUTHORITY

Under the doctrine of apparent authority, a principal will be bound by a person purporting to act for him only where the principal's words or conduct cause the third party to believe that the principal consents or has authorized the agent's conduct.[20] In *Iceland Telecom*, the alleged agent shared office space and phone service with the principal and used the principal's fax cover sheet.[21] The court concluded that, notwithstanding these facts, nothing in the record had established a principal-agent relationship between the two; their actions did not manifest any intent to create such a relationship.[22]

"The apparent power of an agent is to be determined by the *acts of the principal*, and not by the acts of the agent." (Emphasis added.) In *Homa v. Friendly Mobile Manor, Inc.*,[23] despite that fact that there was a piece of correspondence on the principal's letterhead, and the purported agent shared office space with the principal, the court concluded that there was "no evidence that [the principal] knew or should have known about this particular transaction."[24] The court held that a principal is responsible for the acts of an agent within his apparent authority "only where the principal by his acts of conduct has clothed the agent with the appearance of authority, and not where the agent's own conduct and statements have created the apparent authority."[25] The court upheld the trial court's determination that the plaintiff had failed to show reliance on agency based on apparent authority.[26]

A principal needs to act in some affirmative way to confer apparent authority which cannot be founded solely upon the agent's acts or statements.[27] In *Roberston's Crab House,* the restaurant sued the bank for improper payment of checks deposited by an accountant who had done work for the restaurant for 21 years and who was authorized to deposit checks but not to his own account. The bank argued that the accountant was the restaurant's agent by virtue of apparent authority and that it was justified in relying on this authority.[28] However, the court found that "it is clear that Hanson had no actual or apparent authority to receive the proceeds of the eleven checks here involved."[29]

Also, as the Maryland Court of Special Appeals noted in *Robertson's Crab House, Inc.*, "[a] third person dealing with a purported agent should communicate with the principal to verify the agent's authority to sign."[30] Nobody from Robertson's restaurant made any manifestation to the bank that the accountant was authorized to divert checks to his own account.[31] The court also determined that the bank had been misled by an appearance of authority not known and acquiesced by the principal and not by apparent authority.[32]

One fact a party seeking to rely on agency relationship based on apparent authority must establish is that the third party knew of the facts and, acting in good faith, had reason to believe, and did actually believe, that the agent possessed such authority. The U.S. Court of Appeals for the Fourth Circuit has explained that under Maryland law the "mere fact that one is dealing with an agent, whether the agency be general or special, should be a danger signal, and like a railroad crossing, suggests the duty to 'stop, look and listen,' and he who would bind the principal is bound to ascertain, not only the fact of agency, but the nature and extent of authority…." (citation omitted.)[33] The court criticized the plaintiff for not availing itself of its right to determine the exact scope of the alleged agent's duties.[34] Finding insufficient evidence of actual or apparent authority, the court rejected the breach of contract claim.[35]

IMPLIED AUTHORITY

Some courts have recognized that an agent with implied authority may bind its principals. For example, "the responsibility of the principal to third persons is not confined to cases where the contract has been actually made under express or implied authority. It extends further and binds the principal in all cases where the agent is acting within the scope of his usual employment, or is held out to the public, or to the other party, as having competent authority, although, in fact, he has, in the particular instance, exceeded or violated his authority…for in all such instances, where one or two innocent persons is to suffer, he ought to suffer who misled the other into the contract, by holding out the agent as competent to act, and as enjoying his confidence." [36]

The U.S. District Court for New Jersey recently described implied authority as follows: "...implied authority — that is to do all that is proper, customarily incidental and reasonably appropriate to the exercise of the authority granted. The New Jersey Supreme Court has explained that implied authority rests upon the nature or extent of the function to be performed, the general course of conducting the business, or from the particular circumstances in the case."[37]

In *First Interstate Bank of Texas, N.A. v. First National Bank of Jefferson*,[38] the Fifth Circuit defined implied authority as "actual authority" which is inferred from the circumstances and notice of the agency. The agent is vested with the implied authority to do everything necessary or incidental to the agency assignment.[39] Implied authority connotes permission from the principal for the agent to act, even though permission is not expressly set forth orally or in writing.[40] In light of a Louisiana statute requiring express actual authority, the Fifth Circuit held that plaintiff could not state a claim for implied authority.[41]

AGENCY BY ESTOPPEL

The Maryland Court of Special Appeals has held that: "Like apparent authority, an agency by estoppel can arise only where the principal, through words or conduct, represents that the agent has authority to act and the third party *reasonably* relies on those representations" (emphasis in the original).[42] The Court of Special Appeals emphasized that "reasonable reliance is a critical element."[43] In that case, the court found that, as a matter of law, it was clearly not reasonable for the plaintiff to believe that the agent had any authority.[44]

Other courts have also recognized the principle of agency by estoppel. For example, in *Jackson v. 2109 Brandywine, LLC*,[45] the court stated: "An agency by estoppel can arise only where the principal, through words or conduct, represents that the agent has authority to act and the third party reasonably relies on those representations." In *Wailes & Edwards, Inc.*,[46] the court noted as follows:... "[A] permissible finding of apparent authority often is based on elements of estoppel: 'like apparent authority [estoppel] is based on the idea that one should be bound by what he manifests irrespective of fault; but it operates only to compensate for loss to those relying upon the words and not to create rights in the speaker. It follows, therefore, that one basing his claim on the rules of estoppel must show not merely reliance, which is required when the claim is based upon apparent authority, but also such a change in position that it would be unjust for the speaker to deny the truth of his words."

RATIFICATION

Ratification occurs when a principal later adopts an agent's unauthorized act, giving it the same effect as if it had originally been authorized.[47] The principal ratifies by simply indicating the intention to treat the act as authorized.[48] Ratification requires an intention to ratify and knowledge of all material facts.[49] In *Integrated Consulting*, the court found no evidence of an intention to ratify. "Inasmuch as knowledge of the material facts is an essential element of ratification, this claim must be rejected."[50] Ratification also requires a knowledge of and acceptance of a benefit without taking steps to disavow it.[51] In *Kuwait Airways Corp. v. American Security Bank, N.A.*,[52] the jury found that the agent's conduct was implicit with apparent authority and the bank asserted a defense of ratification. On appeal, the U.S. Court of Appeals for the D.C. Circuit held that facts did not compel a finding of ratification.[53] The court noted that to ratify an unauthorized act, a principal must have knowledge of the act and may ratify the act implied by, but the conduct implying ratification must be an act that is inconsistent with any other hypothetical.[54]

CONCLUSION

When an agent acts with actual authority, a bank is aware of the scope of his or her actions. Banks need to be cautious about actions taken without actual authority which could bind a bank. If an agent's actions can be construed as being taken with the approval of a bank or the bank has manifested some indication that such action was authorized, a bank could find itself liable for such agent's actions. Also, if a bank ratifies actions, even if unauthorized, the bank will be held responsible. Upon discovery of unauthorized actions, it is imperative that a bank disavow any authority to eliminate any ratification argument.

NOTES

[1] *Agri Export Cooperative v. Universal Savings Association*, 767 F. Supp. 824, 829 (S.D. Tex. 1991) (elementary that bank is bound by acts of its officers while acting within the scope of their authority, either actual or apparent); *see also In re Canal Refining Co.*, 2008 WL 5157458, at * 3 (Bankr. W.D. La. June 13, 2008) (corporate officers' actions bind corporation in same way that acts of any agent would bind corporation through actual authority, apparent authority or ratification).

[2] The cases are uniform that agency is a question of fact and that the party seeking to demonstrate agency relationship has the burden of proof. *See, e.g., Bouffard v. State Farm Fire & Casualty Company*, 162 N.H. 305, 27 A.3d 682, 687 (2011) (agency relationship is question of fact); *National Mortgage Warehouse, LLC v. Bankers First Mortgage Co., Inc.*, 190 F. Supp. 2d 774, 779 (D. Md. 2002) (Question of agency in factual one); *First Union National Bank v. Brown*, 186 N.C. App. 519, 603 S.E. 2d 808, 815 (2004) (where evidence is conflicting, extent of agent's authority is question of fact); *Green Leaves Restaurant, Inc. v. 617 H Street Associates*, 974 A.2d 222, 230 (D.C. App. 2009 (agency is question of fact and party asserting agency has burden of proof).

[3] *Citizens v. Maryland Indus.*, 338 Md. 448, 459, 659 A.2d 313, 318 (1995) (quoting Restatement (2nd) of Agency §26 (1958)).

[4] *Id. See also Trip Mate, Inc. v. Stonebridge Casualty Insurance Co.*, 2013 WL 1628502, at *4 (W.D. Mo. April 16, 2013) (actual authority is created by written or spoken words or other conduct which reasonably causes agent to believe agent is authorized to act on principal's behalf); *Sarkes Tarzian, Inc. v. U.S. Trust Company of Florida Savings Bank*, 397 F.3d 577, 583 (7th Cir. 2005) (principal confers actual authority on agent when he objectively manifests to agent consent to agency).

[5] *Progressive Cas. Ins. Co. v. Ehrhardt*, 69 Md. App. at 440, 518 A.2d 151, 155, quoting 3 Am. Jur.2d Agency §71, at 575 (1986) (footnotes omitted); *see also GGNSC Omaha Oak Grove, LLC v. Pagich*, 2012 WL 2021868, at *6 (D. Neb., June 5, 2012) (actual authority is that which principal expressly grants to agent or that principal consents to); *Bouffard v. State Farm Fire and Casualty Co.*, 162 N.H. 305, 27 A.3d 682, 687 (2011) (actual authority arises when principal explicitly manifests authorization of agent's actions).

[6] *Progressive Cas. Ins. v. Ehrhardt*, 518 A.2d at 155; *See also Three Minnows, LLC v. Cream, LLC*, 2013 WL 1453246, at *4 (Iowa App. April 10, 2013) (actual authority exists if principal has either expressly or by implication granted agent authority to act on principal's behalf).

[7] 518 A.2d at 155.

[8] *Id.*

[9] *Id.*
[10] *Id.*
[11] *Id.*; *See Also Dickerson v. Longoria*, 995 A.2d 721, 735 (principal can be legally bound by agent's actions if principal confers actual authority).
[12] 767 F. Supp. 824 (S.D. Tex. 1991); *see also Municipality of Bremanger v. Citigroup Global Markets Inc.*, 201e WL 1294615, at * 20 (S.D.N.Y. March 28, 2013) (apparent authority created only by principal's representations to third party and agent cannot create apparent authority by his own actions or representations); *Farm & Ranch Services, Ltd. v. LT Farm & Ranch, LLC*, 779 F. Supp. 2d 949, 962 (S.D. Iowa 2011) (apparent authority is authority principal has knowingly permitted or held out agent as possessing).
[13] 767 F. Supp. at 825.
[14] *Id.* at 826.
[15] *Id.* at 830.
[16] 928 F.2d 153, 154 (5th Cir. 1991).
[17] *Id.* at 156.
[18] *Id.*
[19] *Id.* at 157.
[20] *Iceland Telecom, Ltd. v. Information Systems and Networks Corp.*, 268 F. Supp.2d 585, 592 (D. Md. 2003); *See also Sarkes Tarzian, Inc. v. U.S. Trust Company of Florida Savings Bank*, 397 F.3d 577, 583 (7th Cir. 2005) (apparent authority is created by principal's words or conduct communicated to third party that give rise to appearance and belief that agent possesses authority to enter into transaction).
[21] 288 F. Supp. 2d at 588.
[22] *Id.* at 592. *See also Trip Mate, Inc. v. Stonebridge Casualty Insurance Co.*, 2013 WL 1628502, at *5 (W.D. Mo., April 16, 2013) (agent acts with apparent authority when principal manifests consent to exercise of authority, person relied on facts and had reason to believe and believed that agent possessed authority and acted to his detriment).
[23] 93 Md. App. 337, 363, 612 A.2d 322, 335 (1992); *see also Sarkes Tarzian, Inc. v. U.S. Trust Company of Florida Savings Bank* at 583 (agent cannot confer apparent authority on himself); *GGNSC Omaha Oak Grove LLC v. Pagich*, 2102 WL 2021868, at *6 (D. Neb. June 5, 2012) (apparent authority is based on principal's manifestations and cannot be established by agent's conduct).
[24] 612 A.2d at 364.
[25] *Id.*
[26] *Id.; see Also Jackson v. 2109 Brandywine, LLC*, 180 Md. App. 535, 568, 952 A.2d 304, 323 (2008) (apparent authority is based upon some action by principal that leads third party to believe that principal has authorized agent's acts); *Integrated*

Consulting Services, Inc. v. LLDS Communications, Inc., 996 F. Supp. 470, 476 (D. Md. 1998) (Maryland law is clear that agent's apparent power is to be determined by the acts of the principal and not by agent's acts) (citation omitted).

[27] *Bank of Southern Maryland v. Robertson's Crab House, Inc.*, 39 Md. App. 707, 713, 389 A.2d 388, 394 (1978).

[28] *Id.* at 715; *See also Mauldin Furniture Galleries, Inc. v. BB&T*, 2012 WL 3680426, at *9 (D.S.C. Aug. 27, 2012) (third party can rely on agent's apparent authority until something occurs that would cause reasonable person to inquire further into circumstances) (citations omitted).

[29] 389 A.2d at 716; *see also Dickerson v. Longoria*, 414 Md. 419, 441-442, 995 A.2d 721, 735 (2010) (agent cannot enlarge actual authority by own acts); *Frederick W. Berens, Inc. v. Fidelity Mut. Life Ins. Co.*, 257 Md. 168, 179, 262 A.2d 556, 562 (1970) (agent cannot enlarge actual authority without some measure of assent or acquiescence from principal whose rights and liabilities to third parties are not affected by any apparent authority agent has conferred on himself by his express or implied representations) (citation omitted).

[30] 389 A.2d at 394; *see also Green Leaves Restaurant, Inc. v. 617 H Street Associates*, 974 A.2d at 230 (apparent authority arises when principal places agent in position that causes third party to reasonably believe principal had consented to exercise of authority agent purports to hold).

[31] 389 A.2d at 394.

[32] *Id.* at 718; *see also Homa v. Friendly Mobile Manor, Inc.*,612 A.2d at 363-64 (plaintiff presented no evidence of any contact with principal that would have established authorization for agent to act on principal's behalf or that would indicate any benefit to principal which received no fees); *First Union National Bank v. Brown*, 186 N.C. App. 519, 603 S.E. 2d 808, 815 (2004) (president of corporation had apparent authority to bind corporation to contracts that were within corporation's ordinary course of business) (citations omitted).

[33] *Integrated Consulting Services, Inc. v. LDDS Communications, Inc.*, 996 F. Supp. at 477.

[34] *Id.*

[35] *Id.* at 478. *See also Bullitt County Bank v. Publishers Printing Co., Inc.*, 684 S.W. 2d 289, 293 (Ky. 1985) (no apparent authority for check drawer because principals did not manifest any apparent authority).

[36] *Wailes & Edwards, Inc. v. Bach*, 265 Md. 274, 277-78 (1972) (citation omitted).

[37] *Derbia v. Access Wealth Management, LLC, et al.*, 2011 U.S. Dist. LEXIS 115992 (USDC NJ 2011).

[38] 928 F.2d 153, 157 (5th Cir. 1991).

[39] *Id.*; *see also Three Minnows, LLC v. Cream, LLC*, 2013 WL 1453246, at *5

(principal is liable under agency by estoppel if he causes third party to believe agent has authority to act or has notice that third party believes agent has authority to act and does nothing to notify third party about lack of authority).

[40] 928 F.2d at 157.

[41] *Id.*

[42] *The Johns Hopkins University v. Ritter*, 114 Md. App. 77, 689 A.2d 91, 96 (1997).

[43] *Id.*

[44] *Id.* at 101; *see also Integrated Consulting Services, Inc. v. LDDS Communications, Inc.*, 996 F. Supp. at 476 (denying estoppel claim because of insufficient evidence of reasonable reliance and holding that third party's reliance on principal's conduct is crucial factor in agency by estoppel).

[45] 180 Md. App. 535, 556 (2008).

[46] 265 Md. 274, 277-78 (1972).

[47] *Wood v. Walter*, 855 F. Supp. 2d 494, 503 (D. Md. 2012).

[48] *Id.* (citation omitted).

[49] *Integrated Consulting Services, Inc. v. LDDS Communications, Inc.*, 996 F. Supp. at 476.

[50] *Id.*; *see also Huppman v. Tighe*, 100 Md. App. 655, 665, 642 A.2d 309 (1994) (authorities are crystal clear that party cannot be found to have ratified absent knowledge of material facts underlying transaction); *Frontier Leasing Corp. v. Links Engineering, LLC*, 781 N.W. 2d 772, 777 (Iowa 2010) (principal may be liable under ratification theory when he knowingly accepts benefits of transactions entered into by his agent).

[51] *Bakery and Confectionery Union and Industry International Pension Fund v. New World Pasta Company*, 309 F. Supp.2d 716, 729 (D. Md. 204); *see also Progressive Casualty Insurance Company v. Ehrhardt*, 518 A.2d at 156 (intent to ratify includes receipt and retention of benefits of unauthorized transaction).

[52] 890 F.2s 456, 465 (U.S. App. D.C. 1990).

[53] *Id.*

[54] *Id.* (citation omitted).

The Banking Law Journal

Established 1889

An A.S. Pratt® PUBLICATION

OCTOBER 2015

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ISBN: 978-0-7698-7878-2 (print)
ISBN: 978-0-7698-8020-4 (eBook)

Cite this publication as:

The Banking Law Journal (LexisNexis A.S. Pratt)

Because the section you are citing may be revised in a later release, you may wish to photocopy or print out the section for convenient future reference.

An A.S. Pratt® Publication

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201 Mission St., San Francisco, CA 94105-1831 (415) 908-3200
www.lexisnexis.com

MATTHEW BENDER

(2015–Pub.4815)

Editor-in-Chief & Board of Editors

The Banking Law Journal (ISBN 978-0-76987-878-2) (USPS 003-160) is published ten times a year by Matthew Bender & Company, Inc. Periodicals Postage Paid at Washington, D.C., and at additional mailing offices.

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POSTMASTER: Send address changes to THE BANKING LAW JOURNAL LexisNexis Matthew Bender, 630 Central Ave, New Providence, NJ 07974.

POSTMASTER: Send address changes to THE BANKING LAW JOURNAL, A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207.

Violating a Debtor's Discharge Injunction: Lenders Beware

Michael J. Lichtenstein[*]

Failing to adhere to, or simply ignoring, a notice of a debtor's discharge injunction can often lead to the imposition of sanctions, including punitive damages. These kinds of violations, even though not malicious in nature, are frequently deemed to be willful and can be easily avoided. The author of this article discusses bankruptcy discharges and the perils of violating discharge injunctions.

The primary goal of every individual debtor who files for bankruptcy is to obtain a discharge. Once obtained, the debtor is relieved from any debts encompassed in the discharge. Accompanying a bankruptcy discharge is an injunction which prevents creditors from pursuing claims that have been discharged. Unfortunately, sometimes lenders with automated billing systems neglect to adjust the program to terminate invoicing and collection attempts from discharged debts. This can be a costly lesson as courts have held that such violations can subject creditors and their counsel to contempt citations and monetary sanctions.

A DISCHARGE IN BANKRUPTCY

An individual debtor's overall goal is to obtain a discharge will that relieve him from having to pay his outstanding debts in full, either through a Chapter 11 or Chapter 13 reorganization plan or through a Chapter 7 liquidation. In a Chapter 7 proceeding, a debtor can obtain a discharge which "discharges the debtor from all debts that arose before the date of the order for relief under this chapter . . . ."[1] In Chapter 13, a debtor receives a discharge after the debtor has made all payments under a Chapter 13 plan.[2] Similarly, in an individual Chapter 11 proceeding, a debtor obtains a discharge from the court only upon completion of all plan payments.[3]

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[1] 11. U.S.C. § 727(b).

[2] 11 U.S.C. § 1328(a).

[3] 11 U.S.C. § 1141(d)(5).

THE DISCHARGE INJUNCTION

The Bankruptcy Code provides that a discharge: "Operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor."[4] Once a debtor obtains a discharge in bankruptcy, creditors can no longer seek to collect on debts that were discharged. This prohibition constitutes a permanent injunction as supported by the legislative history.[5] Once the discharge is entered, no debts that were discharged may be collected ever.[6]

VIOLATIONS OF THE DISCHARGE INJUNCTION

Several courts have found creditors in contempt for violating the discharge injunction and have imposed monetary sanctions. For example, in *McLean v. Greenpoint Credit LLC*,[7] the debtors filed a Chapter 13 proceeding that was converted to a Chapter 7 proceeding where an order of discharge was entered. Several years later, when the debtors filed a new Chapter 13 petition, one creditor filed a claim seeking payment on account of the same debt that had been discharged in the previous bankruptcy proceeding.[8] The debtors objected to the claim and filed an adversary proceeding (a lawsuit in the bankruptcy) seeking actual damages for emotional distress,[9] legal fees and punitive damages.[10] The bankruptcy court sustained the objection to the claim. The husband testified that the bankruptcy court sent him notice that his plan payments would double after the claim was filed and that he would not be able to complete the Chapter 13 plan.[11] The creditor's representative admitted that the creditor had notice of the discharge but asserted that the filing of the claim was a computer error.[12]

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[4] 11 U.S.C. § 524(a)(2).

[5] *McLean v. Greenpoint Credit LLC*, 515 B.R. 841, 846 (M.D. Ala. 2014) (once debt is discharged, debtor will not be pressured in any way to repay it).

[6] *United States v. White*, 466 F.3d 1241, 1246 (11th Cir. 2006) (discharge injunction is permanent injunction against collection of debts).

[7] 515 B.R. at 844.

[8] *Id.*

[9] The husband was a disabled veteran suffering from PTSD.

[10] *Id.* at 845.

[11] *Id.*

[12] *Id.*

The district court affirmed the bankruptcy court's holding that the creditor had violated the discharge injunction and the award of $25,000 in actual damages, $18,355.16 in attorneys' fees and sanctions in the amount of $50,000.[13] First, the court concluded that filing a proof of claim is a violation of the discharge injunction which could subject a creditor to contempt sanctions if the violation was willful.[14] In this case, the court determined that there was a willful violation as the creditor admitted it had known of the discharge injunction.[15] Computer problems did not constitute a defense to the willful violation.[16] The court also concluded that, under Section 105 of the Bankruptcy Code,[17] emotional damages, monetary relief and punitive sanctions were proper.[18] "The discharge injunction is critical to the debtors' fresh start, and violations frustrate the goals of the bankruptcy code."[19]

In the Matter of Hebner[20] is another tale of caution for institutional lenders that violate the discharge injunction. Notwithstanding notice of the debtors' discharge, for three years Wells Fargo continued its collection efforts until the debtors filed a motion to hold the bank in contempt.[21] In addition to its continued collection efforts, Wells Fargo listed the debt associated with the debtors' former residence (that had been foreclosed upon) on credit reports.[22]

The court granted the debtors' motion for contempt and then ruled in the debtors' favor on the damages issue, awarding $2,500 in actual damages, $10,000 in punitive damages and actual attorneys' fees (in excess of $23,000).[23] The court noted that the discharge injunction operates as a permanent injunction that replaces the automatic stay in bankruptcy.[24] The court believed

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[13] *Id.* at 851.

[14] *Id.* at 847.

[15] *Id.*

[16] *Id.*

[17] This section contains generic language allowing a bankruptcy court to enter any order or judgment necessary to carry out the provisions of the Bankruptcy Code. 11 U.S.C. § 105.

[18] 515 B.R. at 848. *See also In re Hardy*, 97 F.3d 1384, 1389 (11th Cir. 1996) (court can hold violating creditor in contempt and can award monetary damages).

[19] *Greenpoint Credit*, 515 B.R. at 851.

[20] Bankr. D. Neb. Jan, 8, 2015.

[21] *Id.*

[22] *Id.*

[23] *Id.*

[24] *Id. See also Waswick v. Stutsman County Bank*, 212 B.R. 350, 352 (Bankr. D. N.D. 1997) (purpose of Section 542(a)(2) is to continue stay imposed by Section 362 when case is filed).

that a willful violation of the discharge injunction warrants a finding of civil contempt and the imposition of sanctions.[25] The court was less than impressed with Wells Fargo's practices and cautioned that: "Three years after entry of the bankruptcy discharge is more than sufficient time for Wells Fargo and its agents to stop the computer generated correspondence and put an end to the contact with the debtors that seem intended, openly or implicitly, to collect the balance owed to it."[26] The court concluded that Wells Fargo's "deliberate and repeated actions" damaged the debtors' ability to have a fresh start and therefore actual and punitive damages were warranted.[27]

In *In re Humphrey*,[28] the Chapter 7 debtors filed a motion for sanctions against Bank of America for violations of the discharge injunction. Inexplicably, Bank of America did not respond to the motion or show up at the hearing.[29] After the debtors received a discharge and their bankruptcy case was closed, they received 38 phone calls from Bank of America tying to collect the discharged debt.[30] When the debtors informed the Bank of America agents about the discharge they responded that "they did not care about the bankruptcy and the phone calls would not stop until the Debtors contacted the Bank of America bankruptcy department and until Bank of America updated its computer system."[31] Notwithstanding two subsequent cease and desist letters by debtors' counsel, Bank of America continued with the collection calls.[32]

Unsurprisingly, the court was not amused and concluded at a hearing that the debtors' "significant aggravation, emotional distress, and inconvenience are readily apparent and do not require the presentation of medical evidence."[33] The court applied Section 105 of the bankruptcy code to find bank of America in contempt for a willful violation of the discharge injunction.[34] The court noted that the creditor's subjective intent or beliefs are irrelevant.[35] The

[25] *In the Matter of Hebner.*

[26] *Id.*

[27] *Id.*

[28] Bankr. M.D. Fla. March 14, 2012.

[29] *Id.*

[30] *Id.*

[31] *Id.*

[32] *Id.*

[33] *Id.*

[34] *Id.*

[35] *Id. See also In re Hardy*, 97 F.3d at1390 (creditor's subjective beliefs or intent are

"knowledge" part of the two part test (the other element is taking collection action) is satisfied by receipt of notice of the discharge.[36] To leave no doubt about its view of the lender's actions, the court wrote: "Bank of America's repeated failures to honor the discharge injunction were intentional, egregious and extreme. It acted with bad faith, its conduct was vexatious, wanton, and oppressive."[37] The court awarded actual damages of $12,500.000, including attorneys' fees of $2,500.00.[38] Surprisingly, in light of its highly critical comments, the court did not award punitive damages.

In yet another case where the debtor sued for an order of contempt for violating the discharge injunction, the lender failed to respond to show up at the hearing. In *In re Wassem*,[39] the court held an evidentiary hearing on the debtor's motion for sanctions for violating the discharge injunction. The court found that the lender, Aurora Loan Services, LLC, had actual notice of the debtor's discharge but thereafter made 44 telephone calls over a five month period seeking to collect the discharged debt, even after receiving notice of the sanctions motion.[40] The court found the lender to be in contempt of the discharge injunction and concluded that the lender had acted in bad faith.[41] Aurora's repeated telephone calls were "vexatious, wanton, and oppressive. Aurora committed forty-four separate willful violations of the Debtor's discharge injunction."[42] The court awarded the debtor $9,400 in actual damages, including $5,000 in attorneys' fees and awarded $20,000 in punitive damages.[43]

CONCLUSION

As can be seen in the above cases, it is advisable to pay attention to notices received when a borrower files for bankruptcy. Failing to adhere to, or simply

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irrelevant); *In re Caffey*, 384 B.R. 297, 307 (Bankr. S.D. Ala. 2008) (no specific intent requirement for willful violation).

[36] *Id.*

[37] *Id.*

[38] *Id.*

[39] 456 B.R. 566, 568 (Bankr. M.D. Fla. 2009).

[40] *Id.* at 569–70.

[41] *Id.* at 570.

[42] *Id.*

[43] *Id.* at 573. *See also In re Ashley* (Bankr. N.D. Ala. Sept. 6, 2012) (concluding that creditor's continued collection actions despite knowledge of bankruptcy were deliberate and willful violations of discharge injunction and awarding sanctions in the amount of $12,011.40, including $5,000 in punitive damages).

ignoring, a notice of a discharge injunction can often lead to the imposition of sanctions, including punitive damages. These kinds of violations, even though not malicious in nature, are frequently deemed to be willful and can be easily avoided.