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Banking & Finance Case Summaries

Ms. Callahan has had a rich career handling primarily business / financial / real property disputes in state and federal courts around the country. The following are case summaries about her experience in banking and finance disputes.

BANKING

When Ms. Callahan started practicing law, she was assigned to a case where the client was a bank seeking to recover over $10 million from a "con" artist who had created "straw borrowers" to purchase numerous residential properties in Southern California using the bank's money, who of course did not service the loans and thus resulted in foreclosures and a dramatic increase in the bank's REO portfolio.

While she was an associate at Buchalter Nemer, Ms. Callahan represented large institutional banks in large-dollar / mixed collateral loan default matters. These representations included prosecuting actions to recover against the borrowers (on the loan agreement) and guarantors (on their guarantees), and initiating proceedings to foreclose and/or take possession of real and personal property collateral through both judicial and nonjudicial means. It also included prosecuting nondischargeability and objection to discharge claims against the bank's borrowers and guarantors.

From 1986 through the mid-2000's, Ms. Callahan's practice was focused on Chapter 11 reorganizations and out-of-court workouts, and related litigation. Ms. Callahan represented debtors, creditors and purchasers of assets. While Ms. Callahan never represented "the bank," there almost always was at least one bank and/or bonding company to be dealt with and included in the restructuring plan and negotiations. The following is a notable case example:

Ms. Callahan represented a Japan-based manufacturer of Lasik equipment and its U.S.-based distributor subsidiary. The U.S. subsidiary entered into a master agreement with a Japanese bank pursuant to which the bank would provide lease financing to eye surgeons and physician groups who purchased Lasik equipment. The U.S. subsidiary and its Japanese parent were

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obligated to guaranty all lease financing transactions funded by the Japanese bank, for which the bank handled all of the credit review and underwriting pursuant to a general power of attorney provision in the master agreement. Shortly after the lease financing program was put into place, the bank was sold to Rabobank, which used a less stringent set of criteria to evaluate credit worthiness than what had been used by the Japanese bank. Over the course of two years, the bank underwrote over 100 equipment lease financing transactions, many of them involving sales of multiple machines to the same buyer / borrower. Over 60 percent of the portfolio of loans failed and the bank filed suit in numerous jurisdictions to enforce the guaranty given by the U.S. subsidiary and Japanese parent. The U.S. subsidiary and Japanese parent counter-sued for breach of fiduciary duty concerning the minimal level of credit-worthiness required by the bank in making the loans. Rather than spend millions of dollars litigating the guaranty dispute around the country, Ms. Callahan persuaded the bank to participate in a three-day mediation with representatives of the U.S. subsidiary and Japanese parent. A negotiated resolution was reached due in part to the reality that any U.S. judgments the bank might obtain would be difficult to enforce in Japan. Ms. Callahan's client paid $2 million and received an assignment of the defaulted lease portfolio in return. Ms. Callahan's client then pursued enforcement actions against some of the equipment lessees and recovered between $5 and $6 million.

As a follow-on to the above case, one of the "recoveries" Ms. Callahan's client received in the settlement with Rabobank were the 5 or 6 defaulted equipment leases of a laser eye clinic in Los Angeles that was a debtor in a Chapter 11 bankruptcy proceeding. At the time Ms. Callahan's client received the assignment of the leases, the bankruptcy case had been pending for over a year. The owners of the laser eye clinic were from the Middle East and were believed by the attorney for the Creditor's Committee to have transferred millions of dollars into off-shore accounts. Ms. Callahan's client was the single largest creditor in the estate and she successfully petitioned to have her client appointed to the committee based on that status. Once on the Creditor's Committee, Ms. Callahan persuaded the attorneys representing the other committee members – two of whom were banks - that before pursuing expensive cross-border litigation, an examiner should be appointed to do an evaluation of the operating business. The examiner's report showed that the company was making money and was generating sufficient revenues to fund a plan that, over a 5 year period, could pay creditors 50 to 60 percent of the allowed amount of their claims, depending upon how many filed claims were eliminated through the claims review and objection process. All committee members preferred that result and, with Ms. Callahan in the lead, worked with the debtor's attorney to draft a joint debtor / creditor's committee plan. That plan was confirmed, and ended up paying creditors about 60% of the allowed amount of their claims.

FINANCE

Throughout her career Ms. Callahan has been involved with cases requiring accountings, valuations, tracings and consideration of tax consequences. Some of these cases have involved fraud, conversion, misappropriation or fraudulent transfers. Some have been the result of a failed business or disagreement among owners – no tort – and a simple need to dissolve and windup a business. The following are a few interesting cases:

Auto Dealership Profitability and Supporting Demographics (Arbitrator). In connection with the General Motors and Chrysler bankruptcies (a repercussion of the 2008 financial sector meltdown), the manufacturers terminated thousands of dealer franchise agreements. This caused quite an uproar across America. In response, the U.S. Congress passed emergency legislation – Section 747 of the Consolidated Appropriations Act of 2010 – which created the Automobile Industry Special Binding Arbitration Program. Under this program, terminated dealers could petition for reinstatement by filing such a petition with the American Arbitration Association by a set deadline. If such a petition was filed, then it was required that the evidentiary hearing be conducted and an award be issued no later than July 2010. The legislation specified that factors to be considered and allocated burdens or proof between the two sides concerning those matters. Those factors included evaluating the profitability of the dealership and the demographics of the area where the dealership was located in terms of projected profitability. Ms. Callahan presided as sole arbitrator in three such matters through evidentiary hearing and award.

Tracing 50 Year's Worth of Real Estate Acquisition and Sale Transactions to Show Equitable Ownership (Advocate). Ms. Callahan represented an elderly woman (93 years young) in litigation against her eldest son to recover title to a $20 million real estate portfolio she had amassed over a 50-year period of time and, at the son's advice, request and urging, had gradually transferred into the son's name between her 70's and 90's so that she would have no estate to be taxed upon her death. The son paid the elder nothing for the property and, once the entire portfolio was in his name, reneged on his agreement to provide for her support and allow her to sell property as she desired to pay her living expenses. Preparation for trial involved conducting a 50-year tracing with a forensic accountant to show that the source of the current portfolio properties were historical properties that the elder had acquired and improved. It also involved working with an accountant to prepare a tax analysis of the ramifications of the alleged gifting in terms of gift tax liability that would be owed by the elder – who had literally no assets in her name - if in fact the transfers were deemed to be gifts.

Valuation of Converted Partnership Interests (Advocate). Ms. Callahan's client was a wealthy business man who, as part of his compensation, was given small limited partnership interests in projects that his employer developed. Over time, the Ms. Callahan's client held interests in three dozen such investment ventures that produced considerable annual income distributions. When the client was fired from his job, the company "took back" his limited partnership interests. Ms. Callahan's client filed for relief in bankruptcy to protect his home from foreclosure while he looked for another job. The debtor's former employer then filed a claim in his bankruptcy claiming to be owed millions of dollars under various theories. Ms. Callahan initiated claim objection proceedings and was co-counsel in a separate state court lawsuit that sought over $100 million in damages for the converted partnership interests. That lawsuit was the "working asset" that Ms. Callahan then used to confirm a plan of reorganization that allowed the debtor to exit bankruptcy and obtain a discharge. The debtor ultimately won the conversion lawsuit after a three-week jury trial, and that victory then led to a settlement where the partnership interests were returned to Ms. Callahan's client. The "driver" in all of this was the tax impact of the "take-back" / transfer – a tax bill to the IRS of about $12 million.

<u>Partnership Interest Forfeiture Dispute</u> (Advocate). Ms Callahan represented the syndicator and general partner in a partnership that owned and operated a horse racing track. The limited partners filed suit in an attempt to declare of forfeiture of the general partner's interest based upon the allegation that he had not funded his capital contribution. This matter required a forensic accounting analysis of the partnership's records going back 20 years, tracing all partner monies in and distributions out. After a three-week bench trial, Ms. Callahan's client prevailed on all counts and was awarded all of his attorney's fees and costs. Preparation for trial involved dozens of depositions of all of the partners and working with a forensic accountant to do as 20-year tracing to show that the capital contributions over the years matched the partners' respective partnership interests – in particular, the 33% interest held by Ms. Callahan's client.

<u>WRONGFUL FORECLOSURE AND LOAN MODIFICATION DISPUTES</u>

Since the financial crisis of 2008, Ms. Callahan has mediated about two dozen wrongful foreclosure / loan modification cases. Three of the more interesting cases are described below:

<u>Unique Property with Tons of Equity</u>. In the 1980's, Plaintiff purchased a unique residential property (for about $200,000) in what is currently the chic part of Los Feliz in Los Angeles. By 2006, the property was owned free and clear and was worth over $2 million. Plaintiff borrowed $500,000, using the home as collateral, to make needed repairs, improvements and upgrades to the home. Plaintiff then borrowed $350,000, using the home as collateral, to invest in a speculative real estate venture with one of his sons that eventually failed. Concurrent with the failure of that investment in 2009-2009, the country experienced a financial crisis of historical dimensions and Plaintiff's income-earning ability was affected because he was a consultant in the financial services business, and he defaulted on the $500,000 loan. Plaintiff applied for and was denied a loan modification. The bank then proceeded to initiate nonjudicial foreclosure proceedings. The issue in this case was whether the bank violated the pre-foreclosure "reach out" requirements of the Homeowner Bill of Rights Act ("HBOR") before commencing foreclosure proceedings. Due to the Plaintiff's significant equity in the property (almost $3 million at the time of the mediation), coupled with his income-to-expense ratio (largely pulled out of proportion by the debt service on the $350,000 loan), none of the loan modification scenarios were available to him. The resolution was facilitated by an old-fashioned "workout discussion" with the bank concerning payment terms for reinstatement of the original loan

(about $80,000), with contributions to be made by Plaintiff's children (who were stakeholders that stood to benefit if the home could be saved because they were going to be left the home at dad's death and would receive the stepped up basis).

<u>Debt Discharged Through Bankruptcy Without Reaffirmation Before Loan Modification Request</u>. The plaintiff in this case was a single mother of one who purchased a modest home in Riverside in 2006 at a time when she had a good-paying job. Plaintiff's mother lived with her and contributed to the household expenses. In 2009, Plaintiff lost her job as part of the "collateral damage" visited upon numerous businesses after the 2008 financial crisis. Plaintiff went into default on the loan and the lender commenced nonjudicial foreclosure proceedings. Plaintiff obtained a stay of those proceedings by submitting several loan modification applications, all of which were denied. When the foreclosure sale was put back on calendar, plaintiff filed for bankruptcy protection under Chapter 13 of the Bankruptcy Code. That case was dismissed and the foreclosure sale was put back on calendar. Plaintiff then petitioned to reopen her Chapter 13 case and requested that it instead be converted to a Chapter 7 case. That request was granted, which meant that Plaintiff received a debt discharge in terms of any personal liability to any of her pre-petition creditors, including the bank. However, the bank's lien remained against the property and the bank still had the right to look to the property for repayment. A discharge order was entered in Plaintiff's bankruptcy case and the case was closed. The bank then lifted the bankruptcy hold and put the foreclosure sale back on calendar. Plaintiff submitted another loan modification application, which the bank denied and Plaintiff then filed a lawsuit to enjoin the sale and seeking damages under various theories, including wrongful foreclosure for failure to give her a loan modification. The resolution in this case was facilitated by focusing on the legal significance of the debt discharge of the loan obligation without reaffirmation before the bankruptcy case was closed. Was there even a loan obligation eligible for modification given the strong wording of the discharge injunction provided by the Bankruptcy Code? Rather than test the issue, the parties settled.

<u>Wild Deed Case</u>. The bank loaned over $500,000 to "Jane Doe" in 2006 to fund the purchase of a home in Orange County. For a variety of reasons, the loan went into default in 2010 and Jane decided to sell the home and negotiated a "short sale" agreement with the bank to sell the home to Bob Brown for $250,000. The short sale requirements were not satisfied because the bank was never given a HUD-1 showing the actual closing costs and expenses. Nevertheless, escrow closed and title was put in the name of Bob Brown, who then deeded title to Sally Doe (Jane's mother). The funds used by Bob to purchase the house were sent to the bank, but the bank returned the funds to escrow, where they were lost and never returned to the short sale lender and eventually escheated to the State. In 2014, Sally Doe sold the house to Jack Jones for $400,000. By 2016, the value of the house had rebounded to the point that it was worth almost what the bank was owed on the $500,000 loan it made in 2006. So, the bank initiated nonjudicial foreclosure proceedings. Jack's title insurer initiated a lawsuit to enjoin the sale on the grounds that the bank had an obligation to reconvey pursuant to the short sale agreement it had agreed to. The resolution in this case was facilitated by focusing in on some of the

unusual events that surrounded the 2010 short sale escrow and, ultimately, making a mediator’s proposal that both sides accepted.