

Judge: Bank breached good faith

Lenders could recover \$73M after years of fraudulent transfers

Bankruptcy Court

By Douglas J. Levy

A federal bankruptcy judge ruled that Huntington National Bank failed to act in good faith when it allowed a company's money to continue funneling through Huntington accounts months after fraud was suspected.

In *In re: Teleservices Group Meoli v. The Huntington Nat'l Bank* (Lawyers Weekly No. 04-75741, 127 pages), Hon. Jeffrey R. Hughes, of the U.S. Bankruptcy Court for the Western District of Michigan, said that the Columbus, Ohio-based bank could be required to pay up to \$73 million in recoverable transfers to a trustee representing lenders defrauded by the now-defunct CyberNET Engineering.

What's significant about the opinion was how Hughes defined breach of good faith in his March 17, 2011, opinion, said Douglas A. Donnell of Mika Meyers Beckett & Jones PLC in Grand Rapids,

"We were arguing that it should have been a higher standard, that court should apply an 'objective standard,' which would have placed a higher burden on the bank to prove its defense," said Donnell, who,

along with John E. Anding of Grand Rapids-based Drew, Cooper & Anding, P.C., represented the creditors group.

"But nonetheless, the judge accepted the most lenient standard he could have adopted [Bankruptcy Code sections 548(c) and 550(b)(1), on good faith] — one that the bank, in fact, had advocated. And, yet, still the bank's conduct failed to pass muster.

"[T]his wasn't a case where the judge set the bar extraordinarily high; he did not. But when looking at the facts of the case, the bank's conduct did not measure up."

'Willful blindness'

From September 2002 through October 2004, a Grand Rapids Huntington branch administered a commercial loan for Grand Rapids-based Cyberco Holdings, Inc., d/b/a CyberNET.

The credit line started at \$9 million, and within a year grew to approximately \$17 million.

A year later, Huntington learned Cyberco was receiving most of its cash through an interest called Teleservices Group, Inc. When Huntington inquired about the company, Cyberco said Teleservices was a related company that was

collecting Cyberco's receivables.

The funds, however, were actually proceeds of a Ponzi scheme on unsuspecting equipment finance companies, with Cyberco and Teleservices working together on it.

While the fraudulent deals started out small — less than \$1 million — by 2003 and 2004, they rapidly got larger. In all, up to 40 finance companies and banks were bilked out of up to \$90 million.

In November 2004, the FBI raided Cyberco's offices, shutting down the business. Barton Watson, who founded the company in the 1980s when it did legitimate business, committed suicide shortly after.



"That's almost a textbook definition of willful blindness. You can't stick your head in the sand and pretend like you don't know anything when, in fact, in this case, you did know it."

— Douglas A. Donnell, Mika Meyers Beckett & Jones PLC



Photo by Douglas J. Levy

A bankruptcy judge ruled that Huntington National Bank is required to pay millions to a trustee representing defrauded lenders, who were lending funds to a Ponzi scheme that targeted unsuspecting equipment finance companies.

Donnell said that enough red flags sprouted up along the way to give Huntington cause to drop Cyberco's credit line. One of them was highlighted in Hughes' opinion, where the bank's then-regional security officer, Larry Rodriguez, discovered in April 2004 that Watson had served three years in prison for securities fraud, but didn't tell his superiors or others investigating Cyberco until four months later.

"That's almost a textbook definition of willful blindness," Donnell said. "You can't stick your head in the sand and pretend like you don't know anything when, in fact, in this case, you *did* know it."

Not meeting its burden

Hughes wrote that, had Rodriguez not withheld information about Watson's fraudulent past from John Kalb, Huntington's regional credit officer, "Kalb and others at Huntington would have undoubtedly concluded that absolutely nothing at Cyberco could be accepted at face value, including the increasingly suspicious story of who Teleservices was and why it was transferring huge amounts of money to Cyberco."

Because he did withhold knowledge, at that point Sections 548(c) and 550(b)(1) — Huntington's advocated defense for value, good faith and lack of knowledge — became null.

By the end of the affair, Hughes recounted in his opinion, Huntington was doing whatever it could to be repaid for the money it was owed, and that the bank "really didn't matter where the money came from."

The total amount of all recoverable fraudulent transfers, according to Hughes, amounted to approximately \$73 million over a 13-month period. That sum could increase if Hughes awards pre-judgment interest once all remaining issues in the case are adjudicated.

Comparisons to leprosy

Anding said that it was evident why Hughes ruled as he did.

"As a lawyer who has been suing banks since 1985," Anding said, "this is a pretty tough standard, and it would make it difficult to pursue a bank on the theories that are available under Sections 548 and 550. ... It's really a reflection of how egregious the bank's behavior was in this case that [Hughes] would find that that sort of standard has been satisfied by the bank."

He said that one of Hughes' footnotes was very telling, "that banks shouldn't be fearful of this ... standard. Then he analogizes it to having leprosy, saying it's a very contagious disease; however, if you take appropriate precautions, you don't have the slightest chance of catching it."

Following an April 21 status conference, Donnell said his motion for summary judgment, which he filed a year ago, will have an amendment addressing issues that Huntington raised as to whether the transfers were deposits themselves.

He said he plans to have it done by early to mid-June, and expects a decision from Hughes about a month after that. If the motion is successful, the case will be over and an award will be set; if not, another trial before Hughes could be scheduled for about six months later.

James Moskal, Jeffrey O. Birkhold and Robert H. Skilton III of Warner Norcross & Judd LLP, who are now handling the bankruptcy case from previous counsel at Pepper Hamilton LLP, did not return requests seeking comment.

In a statement, Huntington said that it "plans to aggressively contest the claims of this complex case."

Anding also has a lawsuit against Huntington pending before Hon. Janet T. Neff in U.S. District Judge for the Western District of Michigan, on behalf of two creditors, with claims of aiding and abetting fraud and conversion, as well as unjust enrichment.

If you would like to comment on this story, please contact Douglas J. Levy at (248) 865-3107 or douglas.levy@mi.lawyersweekly.com.