UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF FLORIDA
TAMPA DIVISION

SECURITIES AND EXCHANGE COMMISSION

Plaintiff,

v. **CASE NO.: 8:09-0087-T-26TBM**

ARTHUR NADEL,
SCOOP CAPITAL, LLC,
SCOOP MANAGEMENT, INC., et al.

Defendants.

REPLY IN SUPPORT OF MOTION FOR TURNOVER OF RENTS [DOC. 1332]

Wells Fargo Bank, N.A. ("**Wells Fargo**" or the "**Bank**"), hereby files its reply brief in support of its *Motion for Order Directing Receiver to Turnover Rents from Rite Aid Property* [Doc. 1332] (the "**Rents Motion**") and states:

SUMMARY OF ARGUMENT

During the receivership, the Receiver collected $1,322,923.20 in rent (collectively, the "**Rents**") from a tenant occupying Wells Fargo's real estate collateral, a Rite Aid store in North Carolina (the "**Rite Aid Property**").[1] Pursuant to a pre-receivership absolute assignment of rents granted to the Bank and governed by North Carolina law, the Rents – which were additional security under the loan – became the Bank's exclusive property upon default, which occurred prior to the commencement of this receivership. As a result, the Rents are not property of the receivership estate and, pursuant to binding Eleventh Circuit precedent, this Court does not have authority to impair the Bank's state-law property rights to them. Moreover, pursuant to United States Supreme Court and Eleventh Circuit precedent

[1] Prior to the Receivership, the Borrower leased the Rite Aid Property to a tenant, who paid rent to the Borrower, and the Borrower/Landlord made loan payments to the Bank, just like any other commercial operation. In the Response, the Receiver asserts that the Bank was paid with "Ponzi scheme funds" but there is absolutely no evidence to support that claim. Indeed, it defies logic that the Bank was paid with anything but the Rents, and it demonstrates the Receiver's fast and loose approach to his recitation of the "facts" in this case.

(including one appeal from this very case), property rights are indisputably governed by state law and a receivership court does not have authority to do what the Receiver seeks here: to impair the Bank's state-law property rights by using its general equitable powers. Thus, because the Receiver's arguments have already been soundly rejected by the Eleventh Circuit, the Receiver has no valid basis for withholding the Rents from the Bank.

1. <u>North Carolina Law Requires Turnover of the Rents</u>

Long before the commencement of this receivership, Scoop Real Estate L.P. ("**Scoop**") borrowed $2,655,000 from Wells Fargo, and secured that debt by, among other things, absolutely, irrevocably, and unequivocally assigning all rents to Wells Fargo. *See* Assignment of Rents [Doc. 1332-3], ¶ 2. At the same time Scoop assigned the rents to Wells Fargo, Wells Fargo gave Scoop a limited, conditional, revocable license to collect the rents; but under the terms of the Assignment of Rents, that license terminated automatically upon default. *See id.* at ¶ 7. The rights in and mechanics of this property interest are governed by North Carolina law. *See id.* at ¶ 16; *see also Butner v. U.S.*, 440 US 48 (1979) (holding that questions regarding an assignment of rents are to be determined by the law of the state where the property is located, not federal rules of equity). Because North Carolina is a "title theory" state, North Carolina law is clear that, upon default, the Rents became the exclusive property of Wells Fargo. *See* N.C. Gen. Stat, § 47-20(c); *see also In re Grandfather Mountain L.P.*, No. 2:96CV85, 1997 WL 34740256, at *3 (M.D.N.C. Jan. 29, 1997); *Eleven Hundred First Fidelity Bank, N.A. v. Eleven Hundred Metroplex Associates*, 190 B.R. 510 (S.D.N.Y. 1995).

Because Wells Fargo is a secured creditor whose rights arise under and are governed by North Carolina law, the Receiver and this Court cannot modify, impair, or extinguish Wells Fargo's state-law property rights using the Court's general equitable powers. Indeed, the Eleventh Circuit held in this very case that this Court could not impair the Bank's security interests in its collateral through issuance of an administrative order. *See SEC v. Wells*

Fargo Bank, N.A., 848 F.3d 1339 (11th Cir. 2017) ("In this appeal, we are called upon to decide whether… a district court may extinguish a non-party's preexisting rights to property under the administration of the equity receivership if that non-party fails to comply with the court's orders regarding filing of proofs of claim. We conclude a district court may not").[2] Instead of addressing the relevant issues head on, the Receiver makes several irrelevant and erroneous arguments in an attempt to obfuscate the issues. He also completely ignores the applicable Assignment of Rents and fails or refuses to acknowledge that Wells Fargo's state-law property rights to the Rents are governed by North Carolina law.

If there was ever any doubt about whether the Rents are the exclusive property of the Bank, the Eleventh Circuit resolved that doubt last month when it rendered its decision in *Title Max v. Northington (In re Wilber)*, no. 16-17467, *4 (11th Cir. Dec. 11, 2017) (reaffirming the deference federal courts owe to state-law regulations of property rights).[3]

In *Title Max*, Gustavius Wilber, a "pawnee" in a pawn transaction under Georgia law, filed for chapter 13 relief on the eve of the expiration of his state-law redemption period. *See id.* at *4-5. The petition tolled the redemption for an extra 60 days, and both the collateral (car) and the right of redemption became property of the estate. *See id.* After the bankruptcy filing, the state-law redemption period expired with no redemption. *See id.* When the pawn broker sought relief from stay to repossess the car, the bankruptcy court denied the motion and ruled that the Bankruptcy Code precluded the relief sought. *See id.* at *6-7. The District Court agreed, holding that the Bankruptcy Code gave the bankruptcy court the authority to

[2] *See also* Oral Arg. Trans. at 14:16 – 15:20, *SEC v. Wells Fargo*, Case No. 16-10942 ("**Oral Arg. Trans.**") [Doc. 1345-1]. "It can terminate security interests for failure to comply with an administrative order that preexisted the bankruptcy estate?... If you have a case to that extent, that is against all authority in the United States. I think you misapprehended the issue… I'm flabbergasted by this case. I really am. I can't believe that this happened… I am really, really troubled by this case."

[3] A copy of *Title Max v. Northington (In re Wilber)*, no. 16-17467 (11th Cir. December 11, 2017) has been filed with the Court under the Notice of Supplemental Authority (Doc. 1344).

modify the pawn broker's state law rights through treatment of its "claim" in a chapter 13 plan. *See id.* The Eleventh Circuit reversed.

The Eleventh Circuit held that although the car and the right of redemption became property of the bankruptcy estate upon the filing of the petition, the car "dropped out" of the estate — "pursuant to the 'automatic' operation of Georgia's pawn statute — when the grace period lapsed." *See id.* at *12. Under Georgia's pawn statute, following the maturity date, Wilber had a conditional right to redeem the car during the statutory period, "[b]ut after the expiration of the prescribed period, Wilber had no rights in the car, possessory or otherwise. Rather, his rights had been 'automatically … extinguished' and 'automatically forfeited to [Title Max].'" *See id.* at *24. The Court recognized and reaffirmed the deference that federal courts owe to state-law regulations of property rights, and held that when state-law property rights operate automatically, they cannot be stopped by a court of equity. *See id*. at *25.

Applying the *Title Max* holding here, the Rents automatically became the Bank's exclusive property upon default, by operation of the Assignment of Rents and North Carolina law, before this receivership commenced and well before the Court entered its orders approving the sale of the Rite Aid Property. Simply put, following the pre-receivership default under the Rite Aid Loan Documents, Wells Fargo did not have a mere "claim" to the Rents that could be administered in this receivership – it had absolute title to the Rents. Just like the debtor in *Title Max*, upon default, Scoop no longer had any rights to the Rents, possessory or otherwise; rather Scoop's rights to the Rents had been automatically extinguished and forfeited to the Bank. Therefore, the Rents are not property of the receivership estate and this Court does not have the authority to impair the Bank's state-law property rights to them.

In *SEC v. Wells Fargo*, the Eleventh Circuit confirmed that the Bank's state-law property rights in its collateral (*e.g.*, the Rents) cannot be extinguished by use of the

receivership court's general equitable powers. In *Title Max*, the Eleventh Circuit confirmed that those state- law property rights continue to operate during a receivership proceeding and, under North Carolina law and the Loan Documents, the Rents automatically became the Bank's exclusive property upon the Scoop's default.

2. The Receiver's Arguments are Irrelevant, Illogical, or Have Already Been Decided by this Court or the Eleventh Circuit.

A. *Wells Fargo Was Not Required to File Any Proofs of Claim, Much Less Multiple Proofs of Claim*

Despite the Eleventh Circuit's ruling *in this case* the Receiver contends that the Bank, a secured creditor, was required to file a proof of claim in order to preserve its rights to its collateral. *See* Response, p. 14 ("Wells Fargo is entitled only to its filed Proof of Claim"). This is clearly wrong because, "a federal district court cannot order a secured creditor to either file a proof of claim and submit its claim for determination by the receivership court, or lose its secured state-law property right that existed prior to the receivership." *SEC v. Wells Fargo,* 848 F. at 1345. As confirmed by the Eleventh Circuit at oral argument, a proof of claim is only necessary if the claimant wishes to participate in distributions from the general fund of receivership property, but it does not affect a secured creditor's state-law property rights in its collateral. *See* Oral Arg. Trans., 15:9-12. Regardless, the Bank *did* file a proof of claim[4] regarding the Rite Aid Property, so this argument simply makes no sense.

Even more curious, however, the Receiver apparently now contends that Wells Fargo was required to file additional proofs of claim regarding the Rite Aid Property as its claim increased pursuant to terms of the Loan Documents. *See* Response, p. 9 ("As a preliminary objection, Wells Fargo's 'New Claim' should be denied as untimely since it was asserted after

[4] *See* Claim No. 502, proving indebtedness as of the date the property came into the Receivership Estate "plus accrued but unpaid interest since 10/27/09 and mortgage late fees, attorneys fees & costs." A further accounting of the Rite Aid Loan indebtedness – through the date of the sale proceeds distribution – has been supplied to the Receiver on several occasions. A sworn affidavit establishing the amount is attached to this Reply as ***Exhibit 1***.

the date set forth in the Claims Bar Date Order"). This contention is completely meritless in light of the Eleventh Circuit's decision in *SEC v. Wells Fargo,* 848 F. at 1345. If the Receiver is correct on this point, then the Bank's state law property interests in the Rents would be extinguished for the Bank's failure to file a second proof of claim; but, as the Eleventh Circuit explained during oral argument, no case in the history of the Country has ever allowed a Federal District Court administering an SEC equity receivership to pierce and extinguish a state law secured property interest for failure to file a Proof of Claim. *See* Oral Arg. Trans. at 26:24 – 27:20. When the Receiver tried it before, the Court was reversed by the Eleventh Circuit; and yet, he is trying it again now.

B. ***Wells Fargo's Property Rights Cannot be Extinguished By Administrative Orders, Particularly Orders that Clearly State they Do Not Apply to Wells Fargo.***

In a similar vein, the Receiver argues that Wells Fargo's interest in the Rents is barred by one or both of the Claims Bar Date Order [Doc. 391] and the Claims Order [Doc. 776]. *See* Response, pp. 5, 14. That argument is incredible in light the Eleventh Circuit's decision in *SEC v. Wells Fargo,* 848 F. at 1345, which held that a secured creditor's claim cannot be barred or extinguished by an administrative order. Even more incredible, however, the Claims Order actually states, "the granting of this motion does not in any way affect any claims or their priority asserted by Wells Fargo Bank, N.A." *See* 776, p. 3. But the Receiver intentionally ignores that part of the Order.

C. ***The Receiver's Interest Argument is Inapplicable and Unavailing.***

In the Response, the Receiver makes a tortuous argument regarding post-receivership interest on the Rite Aid loan. According to the Receiver, the motion for *Rents* should be denied because Wells Fargo is not entitled to post-receivership *interest*. *See* Response, pp. 10-12. As a threshold matter, this argument is a red herring because, as discussed above, the Rents automatically became Wells Fargo's exclusive property by operation of North Carolina

law prior to the commencement of this receivership. Even if the Rents remained the Bank's collateral (not its exclusive property), however, the argument fails for a multitude of reasons.

First, the Receiver cites case law that is inapposite to secured creditors, like Wells Fargo, who have state-law property rights governed by contract and priority as to their collateral, because the cases involved unsecured creditors or equity investors whose claims are not of equal dignity to those of secured creditors. The Receiver cites *Am. Iron & Steel Mfg. Co. v. Seaboard Air Line Ry.*, 233 U.S. 261 (1914) for the proposition that, "the general rule is that interest is not allowed on claims after the appointment of a receiver where assets are insufficient to pay the debts so as to treat all creditors equally." But he ignores the next paragraph of that decision: "principal as well as interest, accruing during a receivership, is paid on debts of the highest dignity, even though what remains is not sufficient to pay claims of a lower rank in full." *See id.* at 267.[5] And, most important, he ignores the Court's holding: that the secured creditor is entitled to receive interest incurred during the receivership, even if the claim exceeds the value of the creditor's collateral and creditors of lower dignity are not paid in full. *See id.* at 267-68 ("For, manifestly, the law does not contemplate that either the debtor or the trustees can, by securing the appointment of receiver, stop the running of interest on claims of the highest dignity."). Over twenty years after *Am. Iron Steel Mfg. Co*., the Supreme Court again held that post-receivership interest on a secured creditor's claim should be awarded to compensate the creditor for deprivation, even where other creditors might be harmed by the payment because the "obligation to pay interest as damages for the detention of the debt is not cut off by… receivership." *Ticonic Nat. Bank v. Sprague*, 303

[5] Because the Bank's claim is of higher dignity than the investors' claims and the Order determining claim priority [Doc. 776] does not apply to the Bank, the Bank's unsecured deficiency claim for interest should also be paid prior to investors' claims. It is axiomatic that because shareholders expect to take more risk than creditors in return for the right to share in profits, and creditors only expect repayment of a fixed debt, it is not fair to shift risk to creditors because creditors extend credit in reliance on the cushion of investment provided by shareholders. *Id.; see also Am. Broad. Sys. v. Nugent (In re Betacom of Phoenix, Inc.)*, 240 F.3d 823, 829 (9th Cir. 2001).

U.S. 406, 412 (1938) (internal citations omitted). Going one step further, the Court affirmed the Circuit Court of Appeals, which had held that although a pro rata distribution is desirable in a receivership, the general creditors have no rights in the collateral until after the secured claims, including interest, are paid. *See id.* at 410. In this case, like *Am. Iron Steel Mfg. Co*. and *Ticonic Nat. Bank*, the Bank is indisputably entitled to post-receivership interest on its claim up to, at the very least, the entire value of all of its collateral (**real estate *plus* the Rents**). *See In re Lichtin/Wade, LLC*, 486 B.R. 668, 681 (Bankr. E.D.N.C. 2013) (holding that, under North Carolina law, the value of rent-producing real property subject to a mortgage and an assignment of rents is equal to the value of the real property plus the rents).

Second, undercutting the Receiver's entire argument, the "Claims Order," on which he relies, does not even apply to the Bank. *See* Doc. 776, p. 3. Third, attempting to bar payment of interest to a secured creditor is contrary to long-standing Supreme Court precedent and improperly impairs the Bank's vested state-law property rights in its collateral. *See Am. Iron & Steel Mfg. Co.*, 233 U.S. at 267; *Sexton v. Dreyfus*, 219 US 339, 346 (1911) (allowing post-petition interest to a creditor because "there is no more reason for allowing the bankrupt estate to profit by the delay… than there is for letting the creditors"). Fourth, the Receiver's argument is inconsistent with positions he has taken during these proceedings, including when he obtained Court authority and paid post-receivership interest totaling $270,140.29 on the Bank's Sarasota loans up to the value of the collateral.[6] *See* Doc. 1296. Finally, the Eleventh Circuit has held that a creditor's state-law property rights cannot be impaired by use of a receivership court's general equitable powers, which is precisely what the Receiver is asking the Court to do, by attempting to impair the Bank's contractual

[6] The Receiver is now estopped from taking an inconsistent position. *See Smith v. Avatar Properties, Inc*., 714 So. 2d 1103, 1107 (Fla. 5th DCA 1998) (citing *Am. Nat. Bank of Jacksonville v. Fed. Dep. Ins. Corp*., 710 F.2d 1528 (11th Cir. 1983))*; Muldrow v. Credit Bureau Collection Servs., Inc*., No. 09-61792-CIV, 2010 WL 5393373, *1 (S.D. Fla. Dec. 22, 2010) (judicial estoppel "precludes a party from asserting a position in a legal proceeding inconsistent with a position taken by that party in the same or a prior litigation") (citation omitted).

entitlement to interest payments under the Loan Documents. *See SEC v. Wells Fargo Bank, N.A.*, 848 at 1345.

D. *The "Rite Aid Sale Order" Did Not Adjudicate Wells Fargo's State-Law Property Interests.*

The Receiver asserts that the May 8, 2012 Order [Doc. 842] adjudicated the Bank's interests in the Rents, but that is simply not true. In making this argument, the Receiver relies heavily on a portion of a generic order that he drafted regarding the sale of the Rite-Aid Property, and uses that portion of the order to dismiss Wells Fargo's motion as an improper collateral attack on the same order. According to the Receiver, since the order states that all liens were transferred to the sale proceeds, Wells Fargo somehow lost its vested property right in the Rents. But the Receiver's argument fails for two important reasons. First, Wells Fargo's absolute title to the Rents had already vested prior to the commencement of the receivership, so they were not subject to the Order. Second, the Court's other Order from the same day, written by the Court itself, clearly states that: (i) "Wells Fargo is a secured creditor and the amount of the indebtedness exceeds the purchase price;" and (ii) "Wells Fargo's specific claim with respect to the Rite-Aid property can and will be determined later." *See* Doc. 840. The Receiver does not address *that* Order; instead he just ignores it.[7]

E. *Wells Fargo's Collateral Included and/or Includes The Rite Aid Real Property and the Rite Aid Rents.*

The Receiver argues that Wells Fargo's claim should be limited to the value of its collateral. This argument is irrelevant because the Rents became Wells Fargo's exclusive property pursuant to North Carolina law prior to the commencement of this receivership. In addition, even if the Rents are collateral for the loan, then the "cap" on the secured portion of

[7] The Receiver also ignores this Court's order dated May 7, 2012 – **entered one day before the Sale Orders were entered** – where the Court stated: "After this first interim distribution [the Receiver] will have more than sufficient assets to satisfy Wells Fargo's claim in the amount it has valued that claim in the event the Court rules in favor of Wells Fargo… Wells Fargo's monetary fears are totally unfounded." *See* Doc. 838.

that claim (*i.e.*, the value of the collateral) is comprised of the value of the real property *plus* the value of the Rite Aid Rents. *See In re Lichtin/Wade, LLC*, 486 B.R. at 678 (applying North Carolina law, recognizing that a mortgagee's assignment of rents gives the mortgagee "a separate security interest in the rent derived from the Property, which is distinct from the value of the Property itself," and explaining that, "because the rents increase during the pendency of the bankruptcy case, correspondingly, the value of the total collateral, over and above the value of the Property, also increases. When this occurs, the under-secured portion of [the] claim must then decrease, because the total amount of collateral is increasing."). Thus, if the Rents are not the Bank's exclusive property, the value of the Bank's collateral is actually $3,722,923.20, which is the net sale proceeds of the real estate plus the Rents, and the Bank is secured to that extent. The Receiver intentionally avoids this key point.

WHEREFORE, Wells Fargo respectfully requests that the Court enter an order (i) granting this Motion; (ii) directing the Receiver to disburse $1,322,923.20 in Rents to Wells Fargo, within three days of the Court's Order; and (iii) granting such other and further relief as this Court deems just and proper.

CERTIFICATE OF SERVICE

I hereby certify that on January 12, 2018, I electronically filed the foregoing with the Clerk of the Court by using the CM/ECF system.

Respectfully submitted,

/s/ Steven R. Wirth

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