NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

A newsletter covering bank legal and compliance information.

Volume 18 • Issue 03

April 12, 2018

ABA Wins Partial Victory in Case Over Credit Union Field of Membership

The American Bankers Association has won a partial, but significant, victory in its legal challenge to NCUA-approved regulations that allow substantial and important expansions to federal credit union fields of membership. *American Bankers Association v. National Credit Union Administration.*

On March 29, the federal district court judge invalidated two key provisions of the National Credit Union Administration's 2016 change to the definition of "local, community, or rural district" to dramatically expand the fields of membership from which a federal community credit unions can draw customers. The rule change allowed federal community credit unions to treat a "Combined Statistical Area" or a contiguous portion of a CSA to qualify as a local community if the population did not exceed 2.5 million and allowed a population limit of 1 million for a qualifying rural area. In states such as North Dakota, the changes allowed state-wide "community" credit unions. The court concluded these changes were "manifestly contrary to the [Federal Credit Union] Act."

The lawsuit also challenged the ability of credit unions to serve Core-Based Statistical Areas without serving the urban core that defines the area and the ability to add "adjacent areas" to existing well-defined local communities on a case-by-case basis. The judge upheld both of those provisions, concluding that "neither [are] in excess of the agency's statutory authority nor arbitrary and capricious." She added, however, that "the approach to Core-Based Statistical Areas pushes against the outer limits of reasonableness."

ABA has brought three previous, successful lawsuits to challenge the NCUA, arguing repeatedly that the regulator has overstepped its limits. ABA says it will continue to pursue a level playing field with credit unions both in and outside the courts. Recently, several tax experts and Senate Finance Committee Chairman Orrin Hatch (R-Utah) have questioned the relevancy of credit union tax preferences given NCUA regulatory action to expand powers. Access the opinion at http://www.dcd.uscourts.gov/district-court-opinions?utm_campaign=ABA-Newsbytes-032918-SPECIAL&utm_medium=email&utm_source=Eloqua. (Substantive information for this article provided by ABA)

ND Bankruptcy Court Addresses Competing Priorities of Bank Security Interest and Ag Supplier's Lien Concludes its all in the Dates

Turtle Mountain State Bank v. McDougall, 572 B.R. 239 (Bankr. D.N.D. 2017), is a case of a bank's perfected security interest versus the agricultural liens of suppliers and a landlord.

After Turtle Mountain State Bank (TMSB) lent more than $1M to the bankruptcy debtors and secured the loan by perfected security interests in farm products, livestock and their young, the debtors "set up" Twin Creek Ranch, LLC which they "implemented" as their "operating entity" in 2014. According to evidence, after that time, the debtors ran their cattle operation, including buying cattle and supplies through Twin Creek Ranch, the LLC. When cattle were sold, proceeds were deposited in LLC accounts established by the debtors with TMSB or another bank. Expenses were also paid from those accounts.

Much of the operating activity was financed through credit accounts with suppliers such as the North Central Grain Cooperative. The credit accounts were established by at least April 2016 and were in the name of Twin Creek Ranch, LLC.

In early 2016 debtors sold cattle under the name Twin Creek, LLC, even though there had been no actual transfer of cattle ownership from the debtors to the LLC. On October 19, 2016 the debtors filed for bankruptcy.

Although there were no allegations of fraud, the debtors' bankruptcy schedules and testimony were confusing about the actual ownership of various assets. For example, prior to the bankruptcy, the debtors' "regularly" sold cattle in the name of the LLC. After filing for bankruptcy, they "consistently testified" they, not the LLC, were the owners of the cattle, even as they continued to sell cattle under the name of the LLC, listed LLC creditors as their creditors, and

allowed LLC creditors to be listed on cattle proceeds checks. The debtors also included LLC accounts on the Schedule B and then claimed the accounts as being exempt, suggesting the debtors own them.

Proceeds from cattle sales in 2016 and early 2017 totaled more than $599K. In the bankruptcy proceeding, the proceeds were claimed by TMSB citing its perfected security interest and by the cooperative citing agricultural liens as a supplier, and by an owner of pasture land leased to the debtors in April, 2016.

Faced with this tangle of facts and recognizing the strength of North Dakota's agricultural lien laws for suppliers substantially complying with the legal requirements, the bankruptcy court concluded:

- The cooperative's lien was superior to the TMSB security interest for sales made under the LLC name and dated October 18, 2016, just after the debtors filed for bankruptcy because the cooperative made a timely, substantially compliant, CNS lien filing, and, according to the court, the greater weight of the admittedly unclear evidence was that the LLC owned the sold cattle prior to that date.
- For sales made after October 19, the petition date, the court concluded the cooperative's lien filing was not substantially compliant because Twin Creek Ranch, LLC, the purchaser of the supplies, did not own the cattle. For cattle sold on or after October 19, 2016, TMSB held a priority, perfected security interest.
- The supplier's lien claimed for unpaid land rent is junior to the TMSB security interest because the lessor failed to file a timely lien.

Among the places the opinion may be found: https://www.leagle.com/decision/inbco20170602700.

UCC: Assigning a New Number to a Loan is not a Material Change

Under UCC 3-407 (N.D.C.C. 41-03–44) an unauthorized "alteration" of a note may discharge a party whose obligation was changed by the alteration. In *Settle v. Bank of America*, N.A., 2017 WL 2572288, (E.D. Mo, June, 2017), a defaulting debtor tried to use the statute to advantage. The debtor sued B of A claiming a violation of UCC 3-407 because the bank had changed the loan number of the promissory note. The new loan number related to the bank's adoption of a new recordkeeping system.

The bank responded to the lawsuit with a motion to dismiss arguing the borrower failed to state a claim upon which relief could be granted. The court agreed, concluding the act of changing the loan number did not constitute a material alteration to the note as no obligation, interest or right of the borrower was affected by the changed loan number.

CEO is Personally Liable for Corporate Debt; Signed Without Indicating Representation

Genesis Capital Venture LLC finances construction companies' which are involved in restoration projects. Genesis funded defendant Apex's restoration of a facility in Alabama. Genesis was to finance supplies and receive the final payment for the project. However, the project was never completed because Apex failed to obtain proper licenses and the owner refused to pay for unlicensed work. As a result, Genesis was not repaid.

Genesis then sued Apex and its CEO on theories of breach of contract, breach of implied warranties, breach of personal guarantee, and unjust enrichment. The CEO moved to dismiss the complaint, arguing he was neither a party to nor personally responsible for the contract at issue. Although he signed the contract, the CEO claimed his signature was given in a purely representative capacity.

The district court judge was not impressed. In the opinion denying the motion to dismiss, the court held a CEO can be held personally liable for a contract unless the signature on the contract unambiguously sets out a representative capacity. This is done by a specific indication of agency status with the signature. Genesis Capital Venture LLC v. Restore with Apex, Inc., 2017 W.L. 4679824 (D. Co., October 2017). A recent North Dakota case to the same effect is Zavidil v. Rud, 2014 ND 38.

Look for the opinion at: https://law.justia.com/cases/federal/district-courts/colorado/codce/1:2017cv00711/169777/44/.

With Bank Statute of Fraud Loan Modification Requires More than Mediation

Wells Fargo Bank, N.A., v. Richards, 226 So. 3rd 920 (Fla. Dist. Ct/App. 2017) arises out of a Florida foreclosure and mediation. In many respects it is a familiar story. The homeowners defaulted on their mortgage loan. Wells foreclosed, but before trial, the parties attended mediation. The homeowners left mediation feeling it had been successful and that there was an agreement for a permanent modification to the involved loan. When the bank did not follow that agreement, the homeowners sued to enforce it. The trial court granted enforcement and the bank appealed. On appeal, the trial court order was reversed simply because Florida law includes a "bank statute of frauds" which requires loan modifications to be in writing, something that did not exist. Find the short opinion

at http://caselaw.findlaw.com/fl-district-court-of-appeal/1872672.html.

North Dakota also has a bank statute of fraud, N.D.C.C. 9-06-04(5). Here's a link: http://www.legis.nd.gov/cencode/t09c06.pdf. Under the section, a loan modification that changes the terms of repayment or forgives a debt must be in writing if the aggregate amount of the change is $25,000 or more. This requirement of the statute of frauds has been litigated several times and has been very helpful in reducing claims of oral agreements to modify loan obligations.

Marilyn Foss
NDBA General Counsel

Role of the General Counsel

North Dakota Bankers Association is extremely fortunate to have the expertise of Marilyn Foss on staff. Marilyn has been with the association for over 19 years as general counsel and has served our members and staff with great professionalism.

NDBA's general counsel serves as the attorney for the association. Although she is pleased to be able to serve as a resource for NDBA members in responding to their questions, she is providing general information, not legal advice. Banks must obtain legal advice from counsel who has been retained by the bank to represent the bank's interests in a specific matter.

To contact Marilyn Foss, NDBA General Counsel, call 701.223.5303 or email at marilyn@ndba.com.