NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

A newsletter covering bank legal and compliance information.

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S.D. Federal Court Looks at Multistate Ag Financing

Says First to File is the Rule, and SD Law doesn't Protect Subsequent Creditor from Conversion Liability

A federal district court in South Dakota has used the basics to sort through and decide competing creditor claims to an ag producer's Minnesota and South Dakota collateral. Metabank financed C&B Farms, a big Minnesota ag operation, in 2014 and secured repayment of the debt by filing a financing statement in Minnesota and a separate effective financing statement in Minnesota and South Dakota. When the 2014 debt was not repaid, the bank informed the borrower it would have to provide more collateral if the borrower wanted to obtain bank financing for 2015. The borrower then consulted with a South Dakota "agriculture consultant" who introduced the borrower to Interstate Commodities, Inc., a business that financed farm operations using "advance purchase contracts" negotiated between the consultant and ICI. Under the advance purchase contract arrangement, ICI provided funds to borrowers in exchange for ICI later receiving the crops under grain purchase contracts together with a percentage of the farmer's profits.

The plan was for ICI to fund C&B's 2015 operations. ICI performed UCC searches and determined it would need a subordination agreement with the bank in order to fund 2015 operations. After negotiations by the consultant who asked MetaBank to issue a subordination letter with an amount of "$326K ish," MetaBank indicated it was not sure $920,000 was the right number, expressed concern the consultant's proposal was for an amount approximately $600,000 less than that which MetaBank expected C&B Farms to need for the 2015 growing season. After more discussion and information about expenses from the borrower, MetaBank revised its numbers to arrive at $825,784.57 and issued a subordination letter agreeing to release proceeds and subordinate up to that amount. ICI relied on the subordination letter to fund 2015 operations.

2015 was another bad year. ICI purchased grain from C&B Farms that was worth in excess of $825,784.57. Although ICI originally concluded Metabank would be paid before ICI received 2015 crop proceeds, ICI eventually contended it was not required to submit any additional 2015 proceeds to Metabank. MetaBank's loans to C&B Farms exceeded $825,784.57. MetaBank obtained judgment against C&B Farms in the amount of $2,492,006.95 and sued ICI for $480,514.25, as the difference between $825,784.57 (the number contained in the May 21 subordination agreement) and the actual amount Metabank received from C&B Farms' 2015 crop year. ICI, relying on C&B Farms' accountant's analysis, asserts only $324,213.80 of MetaBank's financing to C&B Farms went toward 2015 expenses, and contends that MetaBank is entitled to no more. Separately, ICI sued C&B Farms and others for the amounts that C&B Farms failed to repay to ICI.

On these facts, the district court concluded Metabank held the priority lien position and was entitled to sue ICI for conversion despite ICI's claim it was an innocent third party purchaser of farm products under South Dakota law. The court rejected the ICI claim on the grounds ICI was a financier, not a purchaser of crops, and that it was not "innocent" because it was fully aware of Metabank's security interests. The court also noted the South Dakota statute is to protect innocent third parties from a debtor's criminal conduct, a circumstance that was not present in this case. Accordingly, the court granted the Metabank summary judgment. If you would like to have additional details, here's one access point for the opinion and case documents: https://www.leagle.com/decision/infdco20171122i80.

The NDBA Legal Update is designed to provide accurate and authoritative information in regard to the subject matter covered. It is provided with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional service. If legal advice or other expert assistance is required, the services of a competent professional person should be sought.

U.S. Supreme Court Upholds Arbitration Requirements of Employment Agreements

In May, the U.S. Supreme Court concluded by a vote of 5-4 arbitration agreements which are included in employment agreements are enforceable. The case was a consolidation of three lower court cases in which circuit courts of appeal had split on the issue of the enforceability of class action waivers and mandated arbitration in employment cases. The title case, *Epic Systems v. Lewis*, was a putative class or collective action against an employer. The Epic Systems plaintiff-employees contended their employer violated the Fair Labor Standards Act by failing to pay overtime as required under federal and Wisconsin law. The employer moved to dismiss the case or to require individual arbitration. The trial court granted the employer's motion to compel individual arbitration and dismissed the case. On appeal, the 7th Circuit Court of Appeals affirmed the dismissal and referral for individual arbitration. The second case, *Morris v. Ernst & Young, LLP*, involved the same basic issue, but the 9th Circuit Court of Appeals reversed the lower court case dismissal and referral to arbitration. The third case, *Murphy Oil USA, Inc. v. NLRB*, was a petition for review of an agency order finding the employer violated the National Labor Relations Act by requiring employees to sign an employment agreement that included a class action waiver and mandatory arbitration provision. The 5th Circuit Court of Appeals had both granted and denied the petition in part. In each case the employees argued the class action waivers/mandated arbitration provisions violated the NLRA and were covered by the "savings clause" of the Federal Arbitration Act which eliminates the requirement to enforce mandatory arbitration agreements if they violate another federal law.

The decision was authored by Justice Gorsuch. It upholds both class action waivers and mandatory individual arbitration under the FAA, meaning these agreements in the context of employment do not violate the NLRA. Dissenters asserted the decision ignores many years of NLRB precedent.. Find the whole opinion at https://www.supremecourt.gov/opinions/17pdf/16-285_q8l1.pdf.

Variable Annuities Failures Cost Bank $6 Million in FINRA Fines

Without admitting liability or misconduct, Fifth Third Bank has entered a settlement with the Financial Industry Regulatory Authority (FINRA) that requires the bank to pay $6 million in fines and restitution to resolve allegations relating to the way its registered representatives handled exchanges of variable annuity exchanges. According to FINRA, Fifth Third reps failed to appropriately consider and accurately describe the costs and benefits of variable annuity (VA) exchanges and recommended exchanges without a reasonable basis to believe the exchanges were suitable. Specifically, FINRA found Fifth Third overstated the total fees of the existing VA or misstated fees associated with various additional optional benefits, known as riders, failed to disclose that the existing VA had an accrued living benefit value, or understated the living benefit value, which the customer would forfeit upon executing the proposed exchange, and represented that a proposed VA had a living benefit rider even though the proposed VA did not, in fact, include a living benefit rider. This is the second significant FINRA enforcement action against Fifth Third involving the firm's sale of variable annuities. More details about the case can be found at http://www.finra.org/newsroom/2018/finra-sanctions-fifth-third-securities-6-million-va-exchange-violations.

Federal Court Gives Relief to Besieged South Dakota Payday Lender

Dollar Loan Center, a South Dakota payday lender, has convinced a federal judge to overturn a decision by the director of the South Dakota Division of Banking to revoke the company's operating license. The director acted after concluding the lender violated the State's interest rate limits by its imposition of late fees ranging from 350.83% to 487.64%. However, the federal court concluded the revocation violated the payday lender's rights to due process and considerations of alternative remedial actions as required by South Dakota law and, beyond that, did not further the State's interests as it "needlessly compromised the private interests of DLC".

Dollar Loan is pursuing the voter-imposed interest rate limits in state court. It lost its case before the trial court but is appealing to the South Dakota Supreme Court. The payday lender is hoping for a broad, favorable decision because, although the revocation of its license was relatively short-lived, its business has been substantially and adversely affected by the 36% limit. To learn more, go to https://www.open-public-records.com/court/south-dakota-14712881.htm.

Updated TRID Compliance Guides Now Available

The Consumer Financial Protection Bureau has issued new versions of the small entity compliance guide for the TILA-RESPA integrated disclosures, as well as the guide to the loan estimate and the closing disclosure, the two TRID forms. All guides reflect a recently issued final rule that addressed the TRID "black hole" problem.

There are two versions of each guide, one that reflects both 2017 and 2018 TRID updates, and one that only reflects the 2018 update. Early compliance with the 2017 TRID amendments is optional between now and October 1, 2018. Find the new guidance at https://www.consumerfinance.gov/policy-compliance/guidance/implementation-guidance/tila-respa-disclosure-rule/?utm_campaign=ABA-Newsbytes-051718&utm_medium=email&utm_source=Eloqua.

Marilyn Foss
NDBA General Counsel (retired)

Thank You for your Service

North Dakota Bankers Association is extremely fortunate to have had the expertise of Marilyn Foss on staff for over 19 years as general counsel. She has served our members and staff with great professionalism. Marilyn's official retirement date is June 30.

Tracy Kennedy
NDBA General Counsel

NDBA Welcomes Tracy Kennedy

NDBA is pleased to welcome Tracy Kennedy, partner at the law firm of Zimney Foster P.C., Grand Forks, as General Counsel as of July 1.

Role of NDBA General Counsel

NDBA's general counsel serves as the attorney for the association. Although Tracy 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 Tracy Kennedy, NDBA General Counsel, call 701.772.8111 or email at tracy@ndba.com.