NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

A newsletter covering bank legal and compliance information.

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Appeals Court: SCRA Allows Bank Foreclosure Because Mortgage Was Entered During Service

The federal Court of Appeals for the 4th Circuit has decided an important case under the Servicemembers Civil Relief Act (SCRA). Sibert v. Wells Fargo Bank, N.A., 4th Cir. 16-cv-01568, July, 2017. Among other things, if the borrower is then enlisted and serving in the military, SCRA, first adopted by Congress in the 1940's and since expanded, prohibits lenders from foreclosing on a pre-enlistment mortgage or selling mortgaged property without first obtaining a permissive court order. However, by its terms, SCRA does not apply to loans taken out during service. (There's another statute that covers those loans.) In the Sibert case, Wells Fargo purchased the mortgage loan which Sibert had taken out while serving in the Navy. Wells started foreclosure proceedings after Sibert was discharged from the Navy. However, before the foreclosure sale was completed, Sibert enlisted in the Army. He was enlisted in the Army when the foreclosed property was sold. Sibert sued, claiming the Army enlistment triggered the SCRA requirement for a lender to obtain a court order before sale of the foreclosed property and that Wells violated the law by failing to obtain that order. The trial court held in favor of Wells, reasoning SCRA did not apply because the mortgage loan was made while Sibert was serving in the Navy.

The 4th Circuit Court of Appeals affirmed the trial court decision. The majority described Sibert's argument to be that his enlistment in the Army created retroactive protection against foreclosure because the mortgage loan was taken out prior to the second enlistment in the Army. Although one justice dissented citing on the plain language of SCRA, the others concluded acceptance of Sibert's argument "would grant protection based not on the circumstances under which the obligation was incurred, but rather on [a borrower's] subsequent decision to leave and then re-enter the service, treating substantially identical obligations in two different and inconsistent ways."

Read the decision at: *http://law.justia.com/cases/federal/appellate-courts/ca4/16-1568/16-1568-2017-07-17.html*.

Because Bank Didn't Formally Object, It Must Pay Attorney's Fees

A Florida Appeals Court is upholding a judgement that orders a bank to pay attorney's fees as requested in a civil complaint because the plaintiff's/ customer's request for fees was clear and the bank did not respond to it. *Zurro v. Wells Fargo Bank N.A.*, 209 So. 3rd 27 (Fl. 2016). The customer first sued the bank, alleging civil theft and conversion; fees were requested only on the conversion claim. Subsequently the complaint was amended to include a breach of contract claim. The customer didn't specifically ask for fees, but did allege he had to retain counsel as a result of the bank's alleged breach of contract. A second motion to amend, did ask to add a claim for attorney's fees on the breach of contract claim. Ultimately, the court found in the customer's favor on the breach of contract and conversion claims, but denied the customer's claim for attorney's fees. The customer and bank both appealed. The appeals court granted the customer's request to be paid attorney's fees, concluding the bank was well aware fees were being sought and failed to respond or object. The bank did acknowledge the fee request was "abundantly clear" which caused the appeals court to conclude the bank had received fair notice of the claim for fees.

Fraud Detection: Does Bank's Contractual Disclaimer of Liability Violate UCC Duty of Ordinary Care and Good Faith? Appeals Court Says "Maybe"

The 6th Circuit Court of Appeals is giving a second life to a business customer's lawsuit over a bank's refusal to reimburse a customer for 4 fraudulent checks. The decision reverses a district court dismissal of the case on grounds of inadequate pleading, reinstates the case and sends it back for discovery and further prosecution. *Majestic Building Maintenance Inc. v. Huntington Bancshares Inc.*, 6th Cir., 16-cv-04342, July, 2017.

Here are the underlying facts:

The customer's business checking account agreement informed the customer the bank offered "certain products designed to discover or prevent unauthorized transactions" and shifted the bank's entire liability for payment of a fraudulent item to the customer if an "account is eligible for those products" and the customer decides not to use them. The appeals court noted, however, that the agreement did not indicate the nature or cost of the referenced products, the cost to the customer, or what made an account eligible for the anti-fraud services. Within a few years, four fraudulent checks were presented and paid by the bank. The customer notified the bank and asked for reimbursement of $3973.96. The bank declined, telling the customer " "reasonable care was not used in declining to use our Check Positive Pay/ Reverse Positive Pay services, which substantially contributed to the making of the forged items(s)" '. After the failure of additional efforts to obtain reimbursement, the customer sued the bank, claiming the contractual liability shifting provision of the account agreement violated the bank's UCC statutory duties to act in good faith and to exercise ordinary care.

The appeals court set out the UCC basics: Forged items are not "properly payable"; under the UCC parties may contract to vary default rules; BUT, a contract that eliminates a party's obligations to exercise ordinary care and to act in good faith is not allowed.

Emphasizing the effect of its decision is only to allow the case to go forward so that facts and additional facts can be developed, the court concluded the plaintiff's complaint did state a "plausible" case that the bank's account agreement was trying to eliminate UCC duties which the law does not allow to be avoided. Uncontested facts cited by the appeals court included the provision, which the court described as being "hidden" at the end of the agreement, the fact that the agreement did not specify the nature of the anti-fraud products, the types of fraud that would be detected, the cost for the bank's anti-fraud services, what the customer would have to do to use the services beyond paying for it, and how a customer would determine whether an account is "eligible" for the services or not.

The decision emphasizes it is not a decision on the merits. However, the court decision is that a plaintiff does have "plausible" claims that it is unreasonable for a bank to "absolve itself of liability for any fraudulent trans that occurs on a customer's account" when anti-fraud services cost extra, the nature of the product is not revealed, and what may be discovered is left unknown. You can read the full decision by going to *http://caselaw.findlaw.com/us-6th-circuit/1868435.html*. As we learn how the case develops, we will keep you posted.

N.D. Court Says Probate Laws Apply to Competency Based Challenge to Will and Trust

Estate of Brakke, 2017 ND 34 (2017), involves a complicated set of facts, a lengthy opinion about the interplay between North Dakota trust and probate laws, and a succinct conclusion: a case challenging the validity of a will and trust on the ground the maker lacked mental capacity to do so is governed by probate laws to the extent those laws differ from trust laws. The decision allows a will contest to be settled via an agreement that includes the deceased maker's wife and other beneficiaries, but does not include the trustee who asserted the settlement violated a material purpose of the restated trust. In accepting the settlement agreement over the trustee's objections, the trial court concluded the settlement did not do so. For those of you who want the details as well as the "upshot", here's a link to the decision: *http://www.ndcourts.gov/_court/opinions/20160045.htm*.

CFPB "Know Before You Owe" Mortgage Disclosure Rule is Finalized

The CFPB has finalized its "Know Before You Owe" mortgage disclosure rule which took effect Oct. 3, 2015. Under the rule, new forms are to be given to consumers at the time of mortgage loan application and closing. With the final rule, there are new items and clarifications; among them:

- Allow the finance charge to be excluded from the calculation for total of payments on the mortgage.
- Require all cooperatives to comply with the "Know Before You Owe" rule.
- Make it clear Closing Disclosure details may be shared with the consumer, sellers, and their real estate brokers or other agents.

The final rules are available at *https://www.consumerfinance.gov/about-us/newsroom/cfpb-finalizes-updates-know-you-owe-mortgage-disclosure/ere*.

Congress Starts Process to Rescind CFPB Arbitration Ban; Success Uncertain

The process for Congressional review of the recent CFPB arbitration rule ban has begun. The new arbitration rule prohibits banks from using a consumer arbitration agreement to prohibit the consumer's participation in a class action and imposes reporting requirements on financial service providers that include mandatory arbitration requirements in their customer agreements.

On July 25, the House of Representatives voted to rescind the rule which rule banks and other financial firms from imposing mandatory arbitration provisions in account agreements, prohibits "class action waivers" and requires the submission of records to CFPB if a financial company and a consumer do enter arbitration. The Senate must also quickly take up and find at least 50 votes in favor of a motion to invoke the CRA and rescind the rule. CRA review requires Congress to act within 60 days of publication of the rule in the *Federal Register*.

Arbitration is also on the Supreme Court docket for the October, 2017 term. The case, *National Labor Relations Board v. Murphy Oil USA*, will have the Court reviewing an arbitration clause that has workers giving up their rights to class action rights.

Appeals Court Says Mortgage Underwriters Must Be Paid Overtime

The 9th Circuit Court of Appeals has decided the Fair Labor Standards Act (FLSA) administrative exemption from overtime does not cover bank mortgage underwriters. *McKeen-Chaplin v. Provident Savings Bank*, 9th Cir., July, 2017. With this decisions, two courts of appeal side with mortgage lenders who want to be paid overtime, while one, the 6th Circuit Court of Appeals, says mortgage lenders are exempt from overtime under the administrative exemption. North Dakota is within the 8th Circuit which has not yet decided the question.

Gina McKeen-Chaplin, a mortgage underwriter for Provident Savings Bank, sued, claiming she was owed overtime pay. She alleged she often worked more than 40 hours per week. In response Provident argued underwriters are exempt from the overtime-pay requirement under the administrative exemption.

Provident's mortgage underwriters analyze loan applications and determine creditworthiness. They review applications for compliance with bank and secondary market guidelines, verify information entered into an automated underwriting system by other bank employees, and compare the potential borrowers' information against guidelines for the particular loan product. Decisions whether to impose conditions on a loan are controlled by the guidelines. After loan approval by an underwriter, funding is arranged through other bank employees.

Under this scenario, the district court granted summary judgment to Provident, determining underwriters qualified for the FLSA's administrative exemption because their work was in the nature of quality control over general business operations. However, the 9th Circuit reversed, concluding the underwriter's tasks constitute production, not administration, and that underwriters must be paid overtime.

The court's decision focuses on two critical elements of the administrative exemption: whether an employee's primary duty is "office or non-manual work related to the management of general business operations of the employer or the employer's customers [ ]" and includes exercises of discretion and independent judgment about matters of significance. The court explained the "administrative-production dichotomy" distinguishes between work related to the employer's marketplace offerings and work contributing to running the business.

According to the decision, the bank's mortgage underwriters did not decide if the bank should take on risk; they applied bank guidelines to decide whether a loan was within the range of acceptable risk. Additionally, the court felt found an underwriter's primary duty was not quality control directly related to general business operations because other employees were charged with quality control review after the underwriter concluded its tasks. Because underwriters followed policies, and did not establish the policies or determine business objectives, the bank could not meet all requirements of the FLSA administrative exemption.

If you would like to read the decision or see the court's examples of qualifying administrative employees, go to *http://www.aba.com/Tools/Function/Legal/Documents/070517Provident.pdf?utm_campaign=Banking%20Docket-201708%20August&utm_medium=email&utm_source=Eloqua*.

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.