



# 2021 DAKOTA SCHOOL OF BANKING

# **BANKING LAW**

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# WHO IS YOUR CUSTOMER?

## I. KNOW YOUR CUSTOMER

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Pursuant to the anti-money-laundering (AML) obligations under the Bank Secrecy Act (BSA; 31 U.S.C. §§ 5311 et seq.), banks must have in place a Customer Identification Program (CIP) that has procedures for verifying the identity of each customer that opens a new account. The definition of customer includes individuals, partnerships, corporations, and any other entities recognized as legal persons.

## II. TYPES OF LEGAL ENTITIES

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### A. INDIVIDUALS

Natural persons.

### B. SOLE PROPRIETORSHIPS / D.B.A.

Businesses owned and run by one person. The person may conduct business using his/her personal name or, more commonly, use a **trade name** (e.g., Gladys Jones d.b.a. Happy Hinder Chair Repair) (d.b.a. = “doing business as”). **Doing business under another name does not create an entity distinct from the person operating the business.** The individual who does business as a sole proprietor under one or several names remains one person, personally liable for all his debts and obligations. Similarly, the assets of the individual are the assets of the business, and vice versa.

### C. PARTNERSHIPS

A partnership is formed when two or more persons, as co-owners, operate a business for profit. Unlike sole proprietorships, partnerships are considered separate entities from the individual owners of the partnership (the “partners”). There are four types of Partnerships: (1) the General Partnership; (2) the Limited Partnership; (3) the Limited Liability Partnership; and (4) the Limited Liability Limited Partnership.

## **1. General Partnerships**

Creating the General Partnership requires no formalities, though partners may choose to create a partnership agreement to govern the arrangement. A General Partnership must include the partners' names or own a registered trade name. In a General Partnership, all partners are general partners and therefore have equal rights in the management and conduct of the partnership business. Partners are entitled to an equal share of profits and losses. They are also jointly and severally liable for all obligations of the partnership.

## **2. Limited Partnerships**

The Limited Partnership (LP) is simply a partnership with one or more general and one or more limited partners. In a Limited Partnership, a general partner has obligations, powers, and rights like those of a partner in a regular partnership (meaning the general partner manages the business and has personal liability to third parties for the recourse debts of the business), but a limited partner's rights and obligations are much different than a general partner's. A limited partner has no right to participate in the management of the business and has no liability beyond capital contributed. A limited partner's role is essentially "investor" and nothing more.

## **3. Limited Liability Partnerships**

Recall that a general partnership consists of general partners that both own and manage the business. Limited Liability Partnerships (LLPs) are general partnerships, but the LLP status limits the liability of partners for the debts/obligations of the partnership.

## **4. Limited Liability Limited Partnerships**

The Limited Liability Limited Partnership (LLLP) is essentially a limited partnership (having both general and limited partners) that provides all partners – *including* general partners – limited liability.

## **D. LIMITED LIABILITY COMPANIES**

The Limited Liability Company (LLC) is a separate business entity and its owners or members are not exposed to personal liability for the entity's debts unless there are personal guarantees. Members of an LLC can participate in management of the company without becoming personally liable for the entity's debt.

## E. CORPORATIONS

A business corporation is created by one or more people and legally recognized as a separate entity with its own rights, privileges, and liabilities distinct from those of its shareholders. It offers the strongest protection to its owners from personal liability, but requires more extensive record-keeping and operational processes.

## III. WHAT DOCUMENTS YOU WILL NEED TO GET FROM YOUR CUSTOMER

<b>ENTITY</b>	<b>DOCUMENT(S)</b>
<b>Individual</b>	None
<b>Sole Proprietorship / D.B.A.</b>	Trade Name Registration (if using one)
<b>General Partnership</b>	Fictitious Name Certificate (if using one) Partnership Agreement (if one exists)
<b>Limited Partnership</b>	Fictitious Name Certificate (if using one) Certificate of Limited Partnership Partnership Agreement
<b>Limited Liability Partnership</b>	Fictitious Name Certificate (if using one) LLP Registration
<b>Limited Liability Limited Partnership</b>	Fictitious Name Certificate (if using one) LLLP Registration
<b>Limited Liability Company</b>	Articles of Organization Bylaws Operating Agreement Member-Control Agreement
<b>Corporation</b>	Articles of Incorporation Bylaws Other Agreements

Banks should also obtain Resolutions to Act from the entity which are signed by the person designated in the document(s) listed above. For example, a resolution may name a specific bank the depository and specify authorized signers on the account.

# CONFIDENTIALITY

## I. BANK DUTY

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Section 6-08.1-03 of the North Dakota Century Code prohibits banks from disclosing customer information to a person, governmental agency, or law enforcement agency unless the disclosure is made in accordance with any of the following:

- (1) Pursuant to consent granted by the customer in accordance with this chapter.
- (2) To a person other than a governmental agency or law enforcement agency pursuant to valid legal process.
- (3) To a governmental agency or law enforcement agency pursuant to valid legal process in accordance with this chapter.
- (4) For the purpose of reporting a suspected violation of the law in accordance with this chapter.
- (5) For the purpose of notifying the agriculture commissioner a financial institution has notified a customer of the availability of the North Dakota mediation service.
- (6) As part of the disclosure made of deposits of public corporations with financial institutions in the security pledge schedule verified by the custodian of securities pursuant to section 21-04-09.
- (7) For purposes of reporting suspected exploitation of an eligible adult as defined by section 12.1-31-07. This subsection may not be construed to impose a duty on a financial institution to investigate an alleged or suspected exploitation of an eligible adult or to make a report to a governmental agency or law enforcement agency.
- (8) For purposes of reporting suspected financial exploitation of an eligible adult under chapter 6-08.5 to a law enforcement agency or the department of human services. This subsection may not be construed to impose a duty on a financial institution to investigate a suspected financial exploitation of an eligible adult or to make a report to the department of human services or law enforcement agency.

Note that “customer information” is broadly defined as either: (a) any original or any copy of any records held by a financial institution pertaining to a customer’s relationship with the financial institution; or (b) any information derived from such a record. N.D.C.C. § 6-08.1-01(2).

In South Dakota, [SDCL § 51A-1-17](#) states: “Any regulated lender...has no duty to disclose

information about its customers and has no duty to provide an opinion about the creditworthiness of its customers unless such information or opinion is required pursuant to a valid subpoena, court order, statute, or other legal process, or unless the customer authorizes the release of such information or opinion. A regulated lender may restrict the dissemination of information and creditworthiness of its customers by written policy or agreement.”

## II. EXCEPTIONS – REPORTING SUSPECTED FINANCIAL EXPLOITATION

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In 2019, the North Dakota legislature passed laws authorizing banks to report suspected financial elder abuse with less concern for violating customer confidentiality. Section 6-08.1-03(8), N.D.C.C., specifically amends a bank’s duty of confidentiality by allowing for the disclosure of customer information for purposes of reporting suspected financial exploitation of an eligible adult (anyone over 65 or anyone who has a substantial mental or functional impairment). Importantly, the new laws DO NOT make banks mandatory reporters. Chapter 6-08.5, N.D.C.C., permits banks to:

- (1) refuse or hold a financial transaction on an account that the adult is a beneficiary of, or an account that belongs to the vulnerable adult or the individual perpetrating financial abuse;
- (2) report, in good faith, suspected financial exploitation to the department of human services, a law enforcement agency, or individuals who have been authorized by the eligible adult to be notified; and
- (3) have immunity from lawsuits for disclosure of the vulnerable adult’s information.

South Dakota similarly allows banks to share information about suspected cases of financial exploitation or abuse with law enforcement with immunity from civil or criminal liability. [SDCL § 37-24-57](#). Further, banks “shall cooperate with any lead investigative agency law enforcement, or prosecuting authority that is investigating the abuse, neglect, or exploitation of an elder or adult with a disability and comply with reasonable requests for the production of financial records” and “is immune from any civil or criminal liability that might otherwise result.” [SDCL § 37-24-58](#).

# LEGAL LOAN DOCUMENTS

## I. LOAN AGREEMENT

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The loan agreement is a contract between the lender and the borrower governing particular aspects of the lending relationship. It operates in conjunction with promissory notes, mortgages, security agreements and other collateral documents, each serving a particular purpose in the loan transaction.

## II. PROMISSORY NOTE

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The promissory note is the contract representing the borrower's promise to repay the loan. It evidences the debt and specifies the terms under which the borrower will repay the debt.

The promissory note (and/or the loan agreement) will provide the terms of repayment, interest rate(s), default interest rate(s), maturity date, late charges, terms of default, and many other provisions governing repayment. It also usually provides a list of the collateral documents securing the note.

## III. GUARANTY

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The guaranty is a contract wherein a "guarantor" promises to be responsible for the debts or performance of another. A common example is where a corporation takes out a loan and one of the corporation's owners provides the bank with a guaranty, which the bank may enforce against the owner if the loan is not paid. There are three parties involved: the guarantor, the creditor, and the borrower.

## IV. SECURITY AGREEMENT

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The security agreement is a contract between the bank and the "debtor" or "grantor" which grants the bank a security interest in personal property (collateral) to secure the debt. In other words, the security agreement represents the grantor's promise to give up the identified collateral in the event that the debt is not paid. *See* section on [Secured Transactions](#) for more information.

## V. MORTGAGE

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Much like the security agreement, a mortgage is a contract securing the debt with property. The contract is between the lender (referred to as the “mortgagee”) and person pledging *real property* (referred to as the “mortgagor”).

# PROPERTY

## I. REAL PROPERTY

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**Definition:** Real Property is land and whatever is affixed to it

### **Types of Ownership:**

1. Sole ownership
2. Joint tenancy
3. Tenancy in common

**Fixtures:** chattels which become affixed to real estate and integrated with it

1. Examples: fences, furnaces, silos, grain bins (sometimes), light fixtures, air conditioners (sometimes)
2. Severance agreements: preserve the chattel nature of the item despite affixation
3. Found in Mortgages and Security Agreements

### **Mortgages**

1. Purpose to secure loan indebtedness with consensual lien on real estate
2. Homestead Waiver Clauses

### **Contracts for Deed**

1. Seller agrees to accept payments from buyer over time, and when payments complete, seller gives deed vesting true legal title in buyer (until deed is given, buyer only has “equitable” title)
2. Assignment of contract for deed as collateral
  - a. Seller’s interest – right to receive payment and obligation to give deed
  - b. Buyer’s interest – right to make the payments and obtain the ultimate deed title
3. Execution and recording requirements.

### **Other Liens Affecting Real Estate**

1. Judgment lien

2. Mechanic's liens
3. Tax liens
4. Vendor's lien and vendee's lien
5. UCC fixture filing liens

## **Title Letters, Title Opinions and Title Insurance**

1. **Title Letter/O & E Report:** A Title Letter or Ownership and Encumbrance Report is a statement of the current ownership and encumbrances affecting the property. However, not all encumbrances are covered and the individual creating the report will not examine the chain of title for the property. The individual creating the Report will only look at the last deed recorded to assess who is the apparent record title holder. The information in the report varies depending on who completes the Report. They are often not attorney prepared.
2. **Title Opinion:** A Title Opinion is prepared by an attorney. A Title Opinion will assess the chain of title and provide an opinion of the validity of the title vested in the current owner and any other parties having an interest in the property. An updated abstract is usually required to complete the opinion, which is not ordinarily prepared by the attorney providing the opinion. An abstract is simply a summary of the deeds, mortgages and other documents of public record affecting title to the real estate covered. The Title Opinion also details any encumbrances.
3. **Title Insurance:** Title Insurance is a form of casualty insurance that pays for damages incurred by the insured party for defects in the title and/or invalidity or unenforceability of mortgage liens. Title Insurance may be underwritten by a title agent (who may or may not be an attorney) approved by the company through which the insurance is placed and licensed by the State in which the property is located. Title insurance is retrospective, it covers defects in title that may have already happened, whereas most other insurance protects from a situation that may happen in the future.

## **II. PERSONAL PROPERTY**

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**Definition:** movable chattels, intangibles, and anything else not real estate.

### **Types of Liens Affecting Personal Property:**

1. UCC security interests
2. Crop mortgages (UCC)

3. Pledge
4. Agricultural processor lien (against crops)
5. Agricultural supplier's lien (against crops for input supplies furnished)
6. Repairman's lien
7. Garagekeeper's storage lien
8. Miner's lien
9. Hospital lien
10. Innkeeper's lien
11. Well or pipeline construction lien
12. Attorney's lien
13. Protection, storage and safekeeping lien

# SECURED TRANSACTIONS

Article 9 of the Uniform Commercial Code (“UCC”), Secured Transactions, applies to all transactions in which the parties intend to create a security interest in *personal* property or fixtures.

## I. DESCRIBING COLLATERAL

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Banks create security interests in personal property through the use of a specific type of contract (the Security Agreement), which must provide “a sufficient description” of the personal property collateral.

It is not sufficient to simply claim an interest in “all the debtor’s personal property.” Banks must reasonably identify the collateral either via specific listing or, more commonly, by using the categories of collateral recognized and defined in Article 9:

1. Consumer Goods
2. Inventory
3. Farm Products
4. Equipment
5. Fixtures
6. As-Extracted Collateral
7. Accounts
8. Certificates of Deposit
9. Chattel Paper
10. Commercial Tort Claim\*
11. Deposit Accounts
12. Documents
13. Instruments
14. Investment Property\*
15. Letter-of-Credit Rights
16. General Intangibles

## II. SET-OFF RIGHTS VS. SECURITY INTEREST IN DEPOSIT ACCOUNTS

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A security interest in a deposit account is different than the right of set-off. Generally, a bank with which a deposit account is maintained may exercise its right of set-off against a secured party holding a security interest in the deposit account. However, if the secured party holding a security interest in the deposit account has perfected by control (i.e., has a control agreement), the maintaining bank cannot exercise its right of set-off. N.D.C.C. § 41-09-60.

## III. UCC-1/CNS FINANCING STATEMENTS

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To protect its interest in pledged personal property as against other lien holders, purchasers, and bankruptcy trustees, the bank should “perfect” its security interest. Most, but not all, types of security interests may be perfected by the filing of a UCC-1 Financing Statement with the Secretary of State.

Separately, filing in the **Central Notice System (CNS)** provides notice of perfected liens filed against **farm products, including crops and livestock**. In North Dakota, this can usually be done on a combined UCC-1/Central Notice form. Doing so is necessary to get your Bank’s name as a payee on a check for crop or livestock purchases.

> ***Does your financing statement contain the correct debtor name?***

UCC-1 Financing Statements must include the name of the debtor, the name of the secured party or its representative, and a description of the collateral. Failure to use the correct debtor name may result in losing a priority position with respect to the collateral!

***Where the debtor is an individual and has been issued a driver’s license by the state,*** the correct debtor name will be the name provided on the license.

***Where the debtor is an entity registered or incorporated by the state,*** the correct debtor name is the name stated as the registered organization’s name on the “public organic record” most recently filed with the secretary of state (i.e., Articles of Incorporation).

> ***Where do you file the UCC-1?***

With the North Dakota Secretary of State.

> **Where do you file the CNS?**

As stated above, banks that want to protect their rights to get their name on checks for crop or livestock purchases must file in the Central Notice System. The relevant state to file in is the “*destination state*”. *E.g., if your farmer borrower herds his cattle across state lines to sell them in another state, you must file in the destination state; filing only in North Dakota will not protect you.* If you have filed in the wrong place, your bank’s name will not be on the check issued by the livestock or crop buyer. You might very well have a properly perfected UCC security interest in the livestock because you filed your UCC-1 back home in the right debtor location state, but if your CNS is not filed in the state where the slaughterhouse cattle buyer is located, your name will not be on the check and your cash collateral check might get spent at a casino without you even knowing the check existed.

To gain protection under the CNS, the financing statement must include a reasonable description of the property, including the county in which the property is located, and any other additional information required by the Food Security Act of 1985

## **IV. REPOSSESSING COLLATERAL**

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The safest way to repossess collateral on a loan in default is via a Voluntary Collateral Surrender Agreement.

### **A. SELF-HELP REPOSSESSION**

*Self-help repossession of collateral* (i.e., no court order or sheriff needed) is allowed, but if there is a potential for *breach of the peace*, you must proceed by court action to repo the collateral.

**What is “breach of the peace”?** *Violence* or physical resistance, *threat of violence* or physical resistance, *atmosphere* or words which are *conducive to* or which risk *violence* or physical resistance. If any of this happens, the secured creditor must “back off,” stop trying to repossess, and see a lawyer to do the repossession using the court. *Example: If the debtor is present and says “If you take my stuff, I’ll hurt you,” you must stop.*

### **B. NOTICE OF DISPOSITION**

You must give written notice of the time, place and manner of the sale of repossessed collateral **at least ten (10) days prior to the sale**. The law provides that notification should be sent “within a reasonable time,” explicitly stating that *ten days before the earliest time*

of disposition constitutes notice within a reasonable time. N.D.C.C. § 41-09-109. \*Please note in a consumer repossession outside North Dakota, while 10 days advance notice is usually permissible, a consumer has the option to contest whether it was in fact reasonable advance notice. North Dakota eliminated this consumer contest privilege.



**Important: 25 Day Notice Needed for the IRS!** Notwithstanding the 10-day notice rule set forth in Revised Article 9, if the IRS has a tax lien filed against the debtor (which attaches by law to everything the debtor owns), you must send the Notice of Disposition to the IRS *at least 25 days* in advance, or else your sale will not cut off the tax lien. Internal Revenue Code, Section 7425. Federal tax law pre-empts state UCC law.



Such notice must be sent to the *debtor, guarantors* and other secondary obligors, and *all other secured parties and lienholders*.

**This latter point is very important to remember.** You must send the Notice of Disposition to all other secured parties and lienholders disclosed in a UCC search of the filing office where you filed your UCC-1 (assuming that is the proper office). Notification must be made to liens superior to yours as well as all liens inferior to yours. The bottom line is after you repossess collateral, you must always do an up-to-date lien search so you can notify all these other secured parties and lienholders. Revised UCC §9-611(c)(3)(B).

# EXEMPTIONS

All state legislatures have enacted laws containing lists of property or categories of property which debtors and their families are allowed to shield against any collection action, judgment, or bankruptcy. In short, these laws provide a list of property “untouchable” by creditors. The unfortunate reality of exemptions is that they make it extremely difficult, in many cases, to collect anything from a defaulting debtor, because he or she is able to shield so much property under the protective umbrella of the exemption laws.

North Dakota exemptions for the debtor are applicable in any prejudgment proceedings, as well as all types of post-judgment proceedings and collection activities. N.D.C.C. § 28-22-01. Not only are the exemptions applicable in all North Dakota State Court proceedings, but they are also applicable to shield assets of the debtor in a Federal Bankruptcy proceeding. N.D.C.C. § 28-22-17; 11 U.S.C. § 522. South Dakota has a substantially similar approach.

## I. NORTH DAKOTA EXEMPTIONS

North Dakota exemptions are found in the following sections and chapters of the North Dakota Century Code: [Ch. 28-22](#) (General Comprehensive Exemption Statute); [Ch. 47-18](#) (Homestead Exemption Statute); N.D.C.C. § 32-09.1-03 (Garnishment Wage Exemption Statute); and [Ch. 28-24](#) (Redemption Rights Statute).

### A. CHOSEN BY “HEAD OF FAMILY”

- 1. All family pictures.**
- 2. A pew or other sitting in any house of worship.**
- 3. A lot or lots in any burial ground.**
- 4. Family Bible or other family primary religious text**
- 5. All schoolbooks and other books used as part of family library**
- 6. Wearing apparel and clothing of debtor and family (limited to \$5000)**  
(Wearing apparel includes jewelry and anything else worn on the body that is not clothing, while the term clothing goes from underwear out to the winter parka.)
- 7. Food for one year, provided or growing, in kind** (2009 Legislature limited this exemption to food “in kind” meaning it must be in existence at the time it is

claimed exempt and not represented by money, a bank account or something other than the food itself; to qualify as exempt, the food must be frozen in the deep-freezer, dry or canned in the pantry, or growing in the garden or field)

8. **Fuel for one year, in kind, for motor vehicle and for home heating** (2009 Legislature clarified that the fuel exemption is for *both* home heating *and* motor vehicle fuel, but it must be “in kind” fuel, meaning that money or a bank account representing fuel expenses will not be permitted as exempt, and the fuel must be in existence piled in the woodshed or stored in tanks at the time the exemption is claimed)
9. **Homestead up to \$100,000 equity over liens** (This type of homestead is the traditional stick built or brick built house affixed to real estate in which the debtor and his family live. Homestead claims must also be “contiguous” meaning that other tracts of land surrounding the house can be included in the \$100,000 exemption as long as those other tracts touch the tract on which the house is built. Also, the proceeds of the sale of the homestead are exempt for a period of one year after the sale and the proceeds get the same protection as the homestead itself.)
10. **Crops and grain growing on or harvested from 160 acres**
11. **Insurance proceeds from damage to exempt property** (limited to insurance proceeds which are still in cash or which have been invested in property which is, itself, exempt or capable of being exempted)
12. **Mobile home family residence, limited to \$100,000 equity over liens**
13. **\$7,500 “wild card” applicable to any personal property, but not to real estate**

## **B. CHOSEN BY “RESIDENT” OF STATE**

14. **In lieu of homestead, \$10,000 additional “wild card” in any property** (but if one member of the family chooses the \$100,000 homestead exemption above, this exemption not available to another member of the family living in the same homestead)
15. **Motor vehicle \$2,950 equity over liens** (Remember this is a “resident exemption. Husband and Wife who are joint debtors can stack this to get \$5,900 applied as an exemption for a car. Exemption for a vehicle goes up to \$32,000 for a specially modified vehicle for a handicapped person with a permanent disability)
16. **\$1,500 in tools, implements, or professional books of the trade of the debtor**

- 17. Professionally prescribed health aides for the debtor or the debtor's dependents**
- 18. Unmatured life insurance contract owned by the debtor (no dollar value limit); debtor's aggregate interest in any accrued dividend or interest under, or loan value of, any unmaturred life insurance contract owned by the debtor under which the insured is the debtor or an individual of whom the debtor is a dependent (not to exceed \$8000)**
- 19. Retirement Pensions, annuities, IRAs, Keogh plans, and other qualified retirement plans and proceeds and values thereof, up to \$100,000 per item, aggregate maximum \$200,000 per debtor, must have been in existence for at least one year prior to execution or bankruptcy (exception: these items are not exempt for spousal and child support claims)**
- 20. Wrongful death award necessary to support surviving debtor or dependents**
- 21. Personal bodily injury award \$18,450 (does not include pain and suffering) plus award for loss of earnings to the extent necessary to support debtor and dependents**
- 22. Social Security (exception: child support claims)**
- 23. Veterans disability (exception: military retirement pay, child support claims)**
- 24. Alimony and support necessary for the support of debtor and dependents**
- 25. Unemployment, disability, or illness benefits**
- 26. Payment under a stock bonus, pension, profit-sharing, annuity, or similar plan or contract on account of illness, disability, death, age or length of service necessary for support of debtor and dependents (unless the plan or contract was established by an insider that employed the debtor, the payment is on account of age or length of service, and the plan or contract does not qualify under IRC §§ 401(a), 403(a), 403(b), or 408)**
- 27. Award under crime victim reparation laws**
- 28. 40x federal minimum wage per week or, alternatively, 75% of take-home pay, whichever is greater**
- 29. Redemption rights during foreclosure of real estate mortgage (foreclosed debtor does not have to pay the foreclosing bank anything during the redemption period, and debtor has exclusive right to rents, profits, use and benefit of the real estate during the redemption period)**

## II. SOUTH DAKOTA EXEMPTIONS

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1. All family pictures;
2. A pew or other sitting in any house of worship;
3. A lot or lots in any burial ground;
4. The family Bible and all schoolbooks used by the family, and all other books used as part of the family library not exceeding \$200;
5. All wearing apparel and clothing of the debtor and his family;
6. The provisions for the debtor and his family necessary for one year's supply, either provided or growing, or both, and fuel necessary for one year;
7. All property in this state of the judgment debtor if the judgment is in favor of any state for failure to pay that state's income tax on benefits received from a pension or other retirement plan while the judgment debtor was a resident of this state;
8. Any health aids professional prescribed to the debtor or to a dependent of the debtor;
9. Any court ordered domestic support award of alimony, maintenance, or support of the debtor which is not a gross or lump sum and does not exceed \$750 per month;
10. Homestead is absolutely exempt or, if sold, the proceeds of such sale, not exceeding \$60,000, is exempt for one year after the receipt of such proceeds by the owner (\$170,000 for persons aged 70+ or unremarried surviving spouse of such person);
11. "Wild card" exemption for other goods, chattels, merchandise, money, or other personal property in the amount of \$7,000 (for head of family) or \$5,000 (if not head of family);
12. Insurance proceeds upon the life of any resident who leaves a surviving widow, husband, or minor child or children, not exceeding \$10,000;
13. Exemption of minimum wage earnings from garnishment process or levy;
14. Exemption of \$1,000,000 for certain retirement benefits but not exempt if debtor owes State of SD.

See SDCL §§ [43-45-2](#) (Absolute Exemptions), [43-45-3](#) (Homestead), [43-45-4](#) ("Wild Card"), [43-45-6](#) (Life Insurance), [43-45-14](#) (Garnishment Process or Levy), [43-45-16](#) (Retirement Benefits).

Exemptions **do not apply** to the following persons or circumstances:

1. To a nonresident;
2. To a debtor who is in the act of removing with his family from the state;
3. To a debtor who has absconded, taking with him his family;
4. To a debtor for the necessaries of life, including only food, clothing, and fuel, provided for the debtor or his family;
5. To a debtor for assistance or services furnished by the state to or on behalf of his children or spouse, by virtue of assignment of support rights to the state;
6. To a debtor for child and spousal support obligation;
7. To a debtor for assistance or services furnished to the debtor by or through the Department of Social Services
8. No exemption for the purchase money of property or for the agreed or reasonable cost of the material furnished or labor performed in the original erection and construction of buildings;
9. No exemptions, except the absolute exemptions, upon a debt incurred for property obtained under false pretenses;
10. No exemptions, except the homestead and other absolute exemptions, on a judgment for fines, penalties, or costs of criminal prosecutions, or for forfeitures of undertakings and bonds, or of recognizance in criminal cases;
11. Federal bankruptcy exemptions not available.

*See* SDCL §§ [43-45-7](#), [43-45-8](#), [43-45-9](#), [43-45-10](#), [43-45-11](#), and [43-45-13](#).

# BANKRUPTCY

The procedure of bankruptcy is governed by the Federal Bankruptcy Code ([Title 11 of the U.S. Code](#)) and the [Federal Rules of Bankruptcy Procedure](#), as well as the local rules of the relevant bankruptcy court ([District of North Dakota](#); [District of South Dakota](#)).

## I. TYPES

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There are two basic types of bankruptcy: **liquidation** and **rehabilitation**.

### A. LIQUIDATION

**Chapter 7 of the Bankruptcy Code is the basic liquidation statutory scheme (a/k/a “straight bankruptcy”).** In liquidation, the debtor’s purpose is to obtain discharge (*i.e.*, cancellation or forgiveness) of his debts. He turns over to the trustee all of his non-exempt property, if he has any, which the trustee sells or otherwise converts to cash. The trustee distributes the cash among the debtor’s creditors. *In short, creditors get paid, if at all, from the sale of the debtor’s non-exempt property.* The debtor keeps his exempt property and once he obtains his discharge, he is able to “start afresh.” His former creditors cannot pursue him on the old debts, as they are deemed to no longer exist, even though the creditors receive very little or even nothing from the trustee’s liquidation and distribution of non-exempt property.

### B. REHABILITATION

**Chapters 11, 12 and 13 of the Bankruptcy Code are the primary rehabilitation statutory schemes.** In rehabilitation, the debtor tries to pay the creditors at least a portion of the debts owed over a period of time. A written plan for the retirement of the debts is required to be filed and approved by the court (or by vote of creditors if the case is a Chapter 11). *In short, in a rehabilitation case the debtor makes payment to creditors from earned income, rather than from liquidation of property as is the primary means of paying creditors in Chapter 7* (although sale of some property is permitted to aid in making some payments under rehabilitation plans). Rehabilitation allows the debtor “breathing space” to rehabilitate (*i.e.*, during the 3-5 year duration of the case, no overzealous creditors can reach the debtor or his property to the detriment of other creditors without court permission).

<b>Chapter 11</b>	Called a “reorganization”; used primarily by corporate and partnership business debtors.
<b>Chapter 12</b>	Called “Adjustment of Debts of a Family Farmer or Fisherman with Regular Annual Income”.
<b>Chapter 13</b>	Called “Adjustment of Debts of an Individual with Regular Income”; used by individual debtors with regular and stable income who meet certain aggregate debt criteria.

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## II. THE AUTOMATIC STAY

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The filing of a bankruptcy petition *automatically “stays” further collection efforts or lien enforcement* by creditors. In other words, everything stops and you are prohibited from taking action the moment the debtor files for bankruptcy. Prohibited creditor activity includes collection lawsuits at any stage jury trials at any stage, foreclosures, enforcing judgments, enforcing or perfecting liens, dunning letters, repossessions and other self-help, set-offs, etc. *A notable exception is that you CAN violate the automatic stay TO PERFECT a purchase money security interest.*

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## III. PROOF OF CLAIM

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In order for a creditor to share in any distribution by the trustee from a bankruptcy estate, the creditor must file a Proof of Claim. *Bankruptcy Code § 501*. (A proof of claim is not required in Chapter 11, however, if the debtor has properly scheduled the creditor claim in the bankruptcy petition, § 1111). Often times, in typical consumer Chapter 7 cases, the Clerk of Bankruptcy Court notifies creditors that no Proofs of Claim should be filed because the case appears to be a “no asset” case where no distribution will be forthcoming, If the Clerk, Trustee, or the Court locates assets later, however, creditors are notified to then file their Proofs.

Where there is a net estate, if all creditors do not file their Proofs of Claim, the ones who do receive a greater pro rata share of the estate. This often happens in bankruptcy cases, where many creditors either neglect or otherwise fail to file their Proofs of Claim (believing that in the end they either won’t get anything or it will be paltry pennies-on-the-dollar recovery). Those who do file, however, then get a windfall benefit from the neglect or failure of the others.

## IV. AVOIDABLE PREFERENCES

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A preference is basically a pre-bankruptcy transaction (within the 90 days directly preceding the filing) that results in a more favorable or preferential treatment of a creditor over other similar creditors. Bankruptcy policy requires equal treatment of similarly situated creditors, so the trustee may avoid certain preferences.

*The trustee has the power to invalidate certain transfers and encumbrances of the debtor's property made prior to bankruptcy.* When transfers of property are invalidated, the property belongs to the estate. When encumbrances (liens) are invalidated, the property belongs to the estate free and clear.

## V. TRUSTEE'S SETOFF AVOIDANCE

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A classic setoff occurs when a borrower owes the bank money on a defaulted loan, and the bank owes the borrower money because the borrower has a checking or savings account with funds deposited at the bank. The bank reaches into the deposit checking or savings account and pulls out money to pay down the defaulted loan.

**A bankruptcy Trustee may undo a setoff by a bank against a debtor's deposit checking or savings account if the setoff occurred within 90 days of bankruptcy (on the so-called "eve of bankruptcy") and if the bank "improves its position" from 90 days before bankruptcy to the date of the setoff. *Bankruptcy Code § 553***

- To determine whether a bank has "improved its position," the Trustee through discovery finds out exactly how much money was in the debtor's deposit checking or savings account exactly 90 days prior to the bankruptcy filing and also finds out exactly how much was owed on the debtor's loan to the bank exactly 90 days prior to the bankruptcy filing.
- Leading up to the day the bank performed the setoff, if the bank during that timeframe "improves its position" in the debtor's checking or savings account, such as by accepting additional deposits, and if the bank "improves its position" on the debtor's loan, such as by accepting from the debtor voluntary payments lowering the balance owed, the Trustee adds the two "improvements" in position together to arrive at the amount he can demand that the bank disgorge to the bankruptcy estate.

## **VI. STRONGARM POWER OF THE TRUSTEE**

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**The ability of the Bankruptcy Trustee to avoid transfers and liens which are not properly recorded or perfected in the same way an innocent purchaser or lien creditor could do so under State Law.**

*Bankruptcy Code §544(a)* gives the Trustee, as of the date of the bankruptcy filing, all of the same rights as would have been available to a “hypothetical bona fide purchaser” or “hypothetical lien creditor” of the debtor’s property under State Law. If a lien upon or transfer of the debtor’s property would have been avoidable by such a purchaser or lien creditor under State Law, the Trustee can avoid it under Bankruptcy law.

## **VII. EFFECT OF DISCHARGE**

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### “DEBTS DIE, BUT LIENS LIVE”

A debtor’s discharge in bankruptcy voids any personal obligation of the debtor to pay the discharged debt.

But otherwise unavowed liens\*, which pre-date the bankruptcy, are not canceled along with the discharge of the personal obligation to pay the debt. In other words, a judgment lien on farm real estate, a mortgage lien on a house, a security interest in a tractor, a mechanic’s lien on a construction project, etc., all will survive bankruptcy, and after the bankruptcy discharge, the secured creditor is entitled to foreclose the lien or repossess the property (although the creditor is no longer allowed to pursue the debtor personally for the obligation).

\*Certain liens do not survive bankruptcy if they are properly avoided and cancelled by the debtor or the trustee. By motion, the debtor in a “fresh start lien avoidance” may cancel non-purchase money security interests and judicial liens on property, which the debtor would otherwise be able to exempt. *Bankruptcy Code § 522(f)*. The trustee is able to cancel liens which were granted to or obtained by a creditor on a preferential basis during the 90 days prior to bankruptcy under the unavoidable preference rule of *Bankruptcy Code § 547*. The trustee can avoid liens that meet the criteria of being a fraudulent transfer under *Bankruptcy Code § 548*. And, under the “strong arm clause” of *Bankruptcy Code § 544(a)*, the trustee can avoid liens that are not timely or properly recorded or perfected. Additional lien avoidance powers are found in *Bankruptcy Code §§ 547(e), 548(d) and 545*.

# CHECK FORGERIES AND ALTERATIONS

## I. THE CHECK COLLECTION PROCESS

<u>PARTIES INVOLVED</u>		
<b>DRAWER</b> (party who writes check)		<b>PAYEE</b> (person to whom check is made out)
<b>DEPOSITARY BANK</b> (initial recipient of check) (a/k/a a collecting bank)	<b>INTERMEDIARY BANK(S)</b> (serve as collecting banks or presenting banks at various points in the collection process)	<b>PAYOR BANK</b> (Drawer's bank) (a/k/a the drawee)

The Drawer writes a check to the Payee, who seeks to deposit the check at Depository Bank. Depository Bank seeks payment from Payor Bank by presenting the check for payment (referred to as “presentment”). (Note that there may be various Intermediary Banks between the Depository Bank and Payor Bank). For Payor Bank to accept the check: (1) there must be sufficient funds in the Drawer’s account at Payor Bank; and (2) the check must be “properly payable” (authorized by the customer and issued in accordance with the agreement between the customer and the bank). If the conditions are met, Payor Bank will accept and pay the check, and deduct the amount from Drawer’s account.

## II. LIABILITY FOR FORGED AND ALTERED CHECKS

In the check collection process, losses often occur due to forged or unauthorized signatures – either drawer’s signatures or indorsements – or due to alterations of the instruments. Articles 3 and 4 of the Uniform Commercial Code (adopted in North Dakota as Chapters [41-03](#) and [41-04](#), N.D.C.C., and in South Dakota as Chapters [57A-3](#) and [57A-4](#), S.D.C.L.) address who, among all the parties who dealt with the check, ought to bear the loss in such instances.

## A. PAYOR BANK LIABILITY

As stated before, Payor Bank may only pay a check that is “properly payable.” (UCC 4-401). A check that is forged or altered is not “properly payable.” In most cases, Payor Bank is liable for charging Drawer’s account for a forged or altered check under UCC 4-401. Drawer is therefore entitled to have its account credited for the amount of the check.

An exception is where the Drawer has been negligent. Under UCC 3-406, if the Drawer’s failure to exercise ordinary care has substantially contributed to the alteration of the check or to the making of a forged signature on a check, the Drawer is precluded from asserting the alteration or the forgery against a bank that, in good faith, pays the instrument or takes it for value or for collection. *However*, if the bank has failed to exercise ordinary care in paying or taking the check and that failure substantially contributed to the loss, the loss is allocated between the Drawer and the bank according to the extent to which the failure of each to exercise ordinary care contributed to the loss (*i.e.*, the loss is allocated between the bank and the Drawer on a comparative basis).

In the case of the bank, “ordinary care” means observance of reasonable commercial banking standards prevailing in the area where the bank is located, and ***do not require the bank to examine the check*** if the failure to examine the check does not violate the bank’s prescribed procedures and the bank’s procedures do not vary unreasonably from the general banking usage not disapproved by Articles 3 and 4. *UCC 3-103*. In other words, banks are not required to sight examine checks for forged signatures or alterations.

**\*\*\*Note that the customer has a duty to discover and report unauthorized signatures or alterations to the bank within a reasonable time of receiving the statement of account. *UCC 4-406*.** Look at your account agreement.

## B. DEPOSITARY AND INTERMEDIARY BANK LIABILITY

The Payor Bank may assert claims “upstream” against the presenting bank, a collecting bank, and the Depository Bank for the loss associated with the altered check. Payor Bank may also bring a **breach of warranty** action against any party who presented the altered check for payment. Liability is transferred back and forth through the **transfer and presentment warranties** provided for under Articles 3 and 4. Under UCC §§ 3-416, 3-417, 4-207, or 4-208, the party transferring or presenting a check for collection warrants that the check has not been altered.

<b>UCC 3-416</b>	Any party who transfers a check warrants that the check has not been
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	altered.
<b>UCC 3-417</b>	Any party presenting a check for collection warrants that check has not been altered.
<b>UCC 4-207</b>	Customers and collecting banks that transfer a check and receive a settlement/other consideration warrant that the check has not been altered.
<b>UCC 4-208</b>	Depository and collecting banks warrant check has not been altered when presenting a check to the Payor Bank for payment.

# GARNISHMENT

When a plaintiff obtains a money judgment against a defendant, it is essentially a slip of paper ordering the defendant (now the “judgment debtor”) to pay the plaintiff (the “judgment creditor”) x amount. One of the ways the judgment creditor can collect is via garnishment.

Garnishment reaches the judgment debtor’s property held by a third party (known as the garnishee), such as funds in a bank account or the debtor’s wages. To obtain the funds in a bank account, the judgment creditor will issue a garnishee summons against the bank (garnishee).

In North Dakota, when a garnishee summons and disclosure statement is served upon a bank, service must comply with N.D.C.C. § 32-09.1-08(2), which states:

Service of a garnishee summons and disclosure statement upon a bank or credit union must be made by delivery of the summons and disclosure statement to a specifically named president or vice president of the bank or credit union or to the registered agent for service of process of the bank or credit union. Delivery of the summons and disclosure statement to the specifically named individual may be in hand as established by the sworn affidavit of the individual who delivered the summons and disclosure statement or by any form of mail or third-party commercial delivery service, if delivery is restricted to the named individual or registered agent and the sender receives a receipt signed by that individual or registered agent.

Due to bank confidentiality requirements, the bank must ensure service was completed in accordance with the statute before disclosing customer information. *It does not appear that South Dakota has the same requirements for service upon a bank. Rather, [SDCL § 21-18-7](#) simply states that the garnishee summons, affidavit, and garnishment disclosure shall be served in the manner provided for service of a summons in an action, by certified mail, or by registered mail pursuant to [§ 21-18-11](#).*

Whether service was correct or not, bank must respond within 20 days of receipt. If the bank fails to respond, the Court may render judgment against your bank for an amount not exceeding the lesser of the plaintiff’s judgment against the defendant or the retention amount defined under 32-09.1-07.

# LENDER LIABILITY

## I. WHAT IS LENDER LIABILITY?

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Lender liability is usually a combination of tort and breach of contract theories, designed to recover damages by borrowers and other bank customers who claim that the bank has over-reached, broken its commitments, or damaged the borrowers or bank customers in some other way.

## II. THEORIES OF LENDER LIABILITY

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1. **Breach of Contract** (e.g., failure to honor loan commitment, declaring a default without cause, etc.)
2. **Bad Faith** (UCC covenant requiring good faith in all commercial transactions)
3. **Breach of Fiduciary Duty** (however, debtor-creditor relationship generally not considered a fiduciary relationship unless bank controls the borrower's affairs)
4. **Fraud** (a knowing false representation of fact made by one to another, and the other relies upon the falsity believing it true to his loss and damage)
5. **Duress** (pressuring borrower to do something under unreasonable threat)
6. **Misrepresentation**
7. **Negligence** (breach of duty of care owed to other members of society, failure to act reasonably which proximately cause another's injury or loss and results in liability for damages)
8. **Conversion**
9. **Defamation** (false statement injuring another's reputation made to others; oral defamation is slander, while written defamation is libel)
10. **Infliction of Emotional Distress**
11. **Statutory Liability**

# NDBA RESOURCES

[NDBA Compliance Companions](#)

[North Dakota Loan and Credit Review Resources](#)

NDBA Peer Groups

NDBA Endorsed Business Partners

Compliance Alliance (an endorsed business partner)

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