NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

A newsletter covering bank legal and compliance information.

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BANKRUPTCY

Before You Sign the Bank's Release Request, You Better Investigate [BKR D MT]

A business owner (Debtor) who owned a series of restaurants had multiple lenders for his business, including the two defendants, First Interstate Bank (Creditor 1) and Prairie Mountain Bank (Creditor 2). The Debtor merged its multiple restaurant companies into a single LLC and then filed a chapter 11 bankruptcy case for which a Trustee was appointed. The Trustee moved to sell substantially all property of the bankruptcy estate. Because the proposed purchase price totaled less than the aggregate value of all liens on the property, the Trustee sought the consent of various secured creditors, including Creditors 1 and 2, to the sale. However, before giving consent to the sale, the Creditors requested a broad, mutual release of claims. The Trustee agreed, and the bankruptcy court entered an order approving the asset sale. Years later, the Trustee sued, alleging that the Debtor had been engaging in a check-kiting scheme and that both Creditors were aware of and participated in the scheme. The Trustee sought a declaratory judgment that the previously agreed-to release of claims be null and void because the Trustee's agreement was procured through fraud. The Creditors separately moved to dismiss the complaint on numerous grounds, including that the release bared the Trustee's asserted claims.

In FOSTER v. FIRST INTERSTATE BANK (IN RE SHOOT THE MOON, LLC), 635 B.R. 568 (Bankr. D. Mont. 2022), the court granted the Creditors' 12(b)(6) motion to dismiss the complaint with leave for the Trustee to amend. In its decision, the court noted that a key and common component of many settlements in connection with bankruptcy cases is a claim release like the one the parties entered into here. These releases further the goals of finality and certainty by providing a way to achieve "global peace" among competing parties. The court also discussed that the speed associated with bankruptcy transactions and the level of uncertainty in which these types of agreements are struck occasionally result in terms that a party may regret in hindsight. Nevertheless, courts rarely allow relief from a bankruptcy-court-approved deal because of the demanding standards required for such relief and the general need to let parties form settled expectations around these final orders. The court held that the Trustee's allegation of fraud was not enough to invalidate the release. The court reasoned that creditors do not have a duty to volunteer unsolicited information to a bankruptcy trustee. Only affirmative acts to mislead, hinder, or otherwise create misimpressions are the basis for determining that a release was obtained by fraud. If the Trustee wanted additional information before agreeing to a complete release, he could have requested the information, or the release language could have been altered to accommodate any uncertainty. The Trustee negotiated, agreed to, and convinced the bankruptcy court to approve an extremely broad, general release of all known and unknown claims without having been misled by the Creditors. Thus, the court found no facially plausible basis on which to invalidate this release. By Riley Caraway rcaraway@ttu.edu.

ELECTRONIC TRANSFER

*Despite Language in Form, Bank Did Not Agree to Wire Only Funds Collected in Account [TX]

The debtor, an attorney, received email correspondence from a scammer that claimed to want his representation in a collection matter. The debtor agreed to represent the scammer, at which point the scammer claimed the other party agreed to settle. The scammer mailed the debtor a check in the amount of the alleged settlement. The scammer instructed the debtor to deposit the check at the bank, which the debtor did, and ask the debtor to wire the money to Japan immediately. The debtor deposited the cashier's check into his account at the bank and submitted the wire transfer through the bank. The bank required the debtor to fill out a wire transfer request form. The document

contained notes that advised the debtor that the bank could not guarantee delivery of the wire, among other things. Part of the form stated, ·'Collected Balance/Cash," which included the entirety of the cashier's check. The document also required that the bank officer sign it and provided "[b]before signing off, be sure you "know your customer" and have verified the collected balance and documented any exception approvals." The document did not define "collected balance." Later, the cashier's check was not honored, the debtor's account was overdrawn, and the bank demanded that the debtor pay the overdrawn funds, which the debtor refused to do. The bank sued the debtor for various breach of agreement claims. The trial court granted summary judgment for the debtor, which the court of appeals affirmed.

In CADENCE BANK, N.A. v. ELIZONDO, 642 S.W.3d 530 (Tex. 2022), the court evaluated the deposit agreement, which stated that the bank could remove funds from the debtor's account in the event of any issues with the transfer. The debtor's counterclaims assert that the bank had a contractual duty to transfer funds based upon the "collected balance" language on the wire transfer form. The court discussed that the bank would have fulfilled its commitment to the debtor if it had examined the funds before making the transfer. However, the court concluded that the wire-transfer form did not create any agreement like the one alleged by the debtor. The completed form did not meet the standards of a contract, and it only acted as a transfer request. The court also decided that the form did not provide enough information to show that the bank intended to enter into a contract only to send a wire with funds that were a "collected balance". The court therefore reversed the lower courts and remanded the case for the entry of judgment. By Avery Bertagna abertagn@ttu.edu.

SECURITY INTERESTS

Creditor That is First to Perfect Has Priority [NY]

The nonparty debtor entered into an agreement with the promisor, which gave the debtor any commissions that resulted from its role as a broker in various real estate transactions. One property sale closed and entitled the debtor to a sum of money as commission from the agreement. Two years before the property sale closed, the debtor granted the first creditor a "continuing first priority security interest in all commissions." After this transaction the debtor gave a second creditor a security interest in all commissions. Earlier in that same year, a third creditor obtained a money judgment in its favor for a large sum that totaled slightly lower than the total commission amount. The debtor sought a commission advance, and by entering into a Notice of Assignment, the debtor assigned its right to the commission to the second creditor. The debtor also advised the promisor to pay the commission to the second creditor. However, the promisor instead commenced this action against all three creditors to determine where the priority interest lies.

In NRT N.Y., LLC v. MIDDLEGATE FUNDING LLC., 202 A.D.3d 427 (N.Y. App. Div. 2022), the second creditor contended that under Uniform Commercial Code (UCC) § 9-330(d), it held the priority interest in the commission because had possession of the commission and it had acted in good faith. The court ultimately determined that the second creditor never had possession of a negotiable instrument by having possession of the actual commission check, and only an assignment of the commission. Therefore, UCC § 9-330(d) did not apply. As a result, the first creditor possessed a better interest in the commission than the other two creditors because the first creditor to perfect a security interest has priority over creditors that perfect their security interests later. Accordingly, the court found in favor of the first creditor. By Avery Bertagna abertagn@ttu.edu.

ARBITRATION

*Court Stayed Proceedings Pending Arbitration After Imposter Hacked a Wire Transfer [ED TX]

The bank's client, the debtor, entered into a contract with a third party, A-1, for services. The debtor was to pay for the services via wire transfer. An imposter hacked into A-1's email systems and misdirected the wire transfer to the hacker's account with the bank. A-1 sent invoices to the debtor via email, which the hacker then intercepted without the knowledge of either party. The debtor received emails from what appeared to be A-1 with updated invoices and instructions to wire the funds to the hacker's account at the bank instead of the originally agreed-upon account. The bank flagged the account and investigated the wires. Eventually, the bank froze the remaining funds after recognizing a problem. At that point, the hacker had already spent a large portion of the transferred funds. The debtor paid the total amount for the first invoice to A-1. The bank then transferred the unused funds from the misdirected transfer back to the debtor's bank. The debtor later paid A-1 in part for the second agreed-upon payment. However, the debtor only sent a wire transfer for the funds left over from the original misdirected transfer instead of for the total amount outstanding. The third-party sought damages from the debtor and the bank for the remaining funds due under the contract. Then, the bank moved to compel arbitration, which the court granted. After the court dismissed one claim against it, the debtor asserted that the court should grant a mandatory stay

of proceedings with under the Federal Arbitration Act (FAA) with respect to the remaining claim pending in court.

In A-1 AM. FENCE, INC. v. WELLS FARGO BANK, N.A., 2021 WL 7184974, 2021 U.S. Dist. LEXIS 254242 (E.D. Tex. Nov. 16, 2021) (opinion not yet released for publication), the court reviewed Waste Management, Inc., and the factors set forth to determine whether a stay under section 3 of the Federal Arbitration Act I is warranted. The factors to consider are "whether: (1) the arbitrated and litigated disputes involve the same operative facts; (2) the claims asserted in the arbitration and litigation are inherently inseparable; and (3) the litigation has a 'critical impact' on the arbitration." Regarding the first factor the court found that the third party's separate claims against both the debtor and the bank arose from the same event. This event occurred when the hacker misdirected funds, leaving the third-party short on payment for the contract. As to the second factor on inherently inseparable claims, the court determined that arbitration and litigation are inseparable because the third-party only suffered one harm. Finally, the court considered that prior decisions from the court might influence an arbitrator. The court also determined that allowing the third-party to sue the debtor and then participate in arbitration with the bank could lead to inconsistent results. Therefore, the court ultimately granted the stay of proceedings pending arbitration. By Avery Bertagna abertagn@ttu.edu.

BANK REGULATIONS

*Singing the Same Old Song is Barred by Res Judicata [5th Cir.]

The FDIC sanctioned the Bank of Louisiana and two of its directors for violating banking laws. Not willing to take its punishment, the Bank engaged in repeated litigation in the federal district court claiming, among other things, that its constitutional rights had been violated. The actions were dismissed on the ground that a federal district court has no jurisdiction to review FDIC determinations. Notwithstanding those rulings, the bank brought three more actions in the district court, which again were dismissed for lack of subject matter jurisdiction. The bank appealed.

In BANK OF LOUISIANA v. FED. DEPOSIT INS. CORP., 33 F.4th 836 (5th Cir. 2022), the Fifth Circuit Court of Appeals affirmed the ruling of the district court that it had no jurisdiction to hear the actions on the basis of res judicata. While the circuit court recognized that the dismissal of a case on the basis of no jurisdiction did not always preclude a later suit on the same subject matter, later suits are precluded if the jurisdictional problem has not been cured. Accordingly, the ruling of the district court was affirmed. By the editors.

Tracy Kennedy
NDBA General Counsel

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.