NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

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HOMESTEAD

Debtor Fails to Establish Elements for Homestead Protection Under Texas Law *[5THCIR]

A debtor leased a first property ("first property") with his first wife, and shortly after divorcing the first wife, closed on the purchase of a second property ("second property") with his second wife. Not long after the closings, the debtor and his second wife separated. During the separation, the second wife lived in the second property, while the debtor lived in the first leased property. After divorcing the second wife, the debtor filed a Chapter 11 bankruptcy petition and claimed a homestead exemption for the second property. One of the debtor's creditors filed an objection to the debtor's designation of the second property as his family homestead. The bankruptcy court sustained the creditor's objection, concluding that the second property was not the debtor's primary residence, and that the debtor could not claim the second property as a homestead.

In MORGAN v. REGIONS BANK (IN RE MORGAN), 2021 WL 1165996, (5th Cir. 2021), the Fifth Circuit held the debtor did not undertake the requisite acts and had failed to display the requisite intention to establish a homestead at the second property. First, the court examined whether the property was a homestead. Under Texas law, an individual who seeks homestead protection has the initial burden to establish the homestead character of his property. To meet this initial burden of establishing a family homestead, the claimant must show "(1) overt acts of homestead usage, and (2) the intention to claim the property as a homestead." The court found that the debtor's time spent at the second property was fleeting at best. Although the debtor argued that he had moved some furniture and clothing to the second property, the lower court correctly noted that the debtor did not clearly indicate whether this happened before or after the closing on the first property. Second, the lower court also relied on the fact that, shortly after the purchase of the second property, the debtor and his second wife had separated. During this time, the debtor had stayed primarily at the first property, and the former wife had lived in the second property. Additionally, for three years, the debtor claimed the first property as his homestead for property-tax purposes. Even though the debtor kept some belongings at the second property, visited on weekends, and conducted some business there, that infrequent activity was insufficient to convert the second property into a homestead. Therefore, the court affirmed the lower court's factual finding that the debtor failed to show any intent, supported by overt acts, to make the second property the family homestead. *[By Carlos Gracia carlos.gracia@ttu.edu]*

BANKRUPTCY

Is Everyone "Engaged in Commercial or Business Activities" for Subchapter V? [BKR CO]

A debtor owned a limited liability corporation that indirectly owned 30% of the business that the debtor had managed. The debtor personally guaranteed most of the business's financial obligations. When financial difficulties caused the business to close, the debtor filed for Chapter 11 bankruptcy. Before filing, the debtor had to find a new job but continued with the "wind down" of the failed business. When filing for bankruptcy, the debtor elected to file under Subchapter V of the Bankruptcy Code - a new subchapter that is designed to streamline bankruptcy cases for small businesses. Eligibility for the subchapter is limited to debtors "engaged in commercial or business activities." See 11 U.S.C. § 1182(a)(l). The Office of the United States Trustee objected to the debtor's "Subchapter V" election on the grounds that the debtor was not "engaged in commercial or business activities" and thus did not meet the requirements of § 1182(a)(l). The trustee's argument rested on the fact that at the time of the bankruptcy filing the debtor was employed and not actively managing the failed business.

In IN RE IKALOWYCH, No. 14527, 2021 WL 1433241 (Bankr. D. Colo. Apr. 15, 2021), the court found that the debtor was "engaged in commercial or business activities" and therefore satisfied the requirements of a Subchapter V under § 1182(a)(l). In reaching this conclusion, the court first analyzed the "exceedingly broad" language of "commercial or business activities." The court turned to dictionary definitions and statutory analogs, determining the language is broad and encompassing. The dictionary definitions of the statutory language indicate sweeping definitions that show many activities may be "commercial" or "business." The statutory analogs found in other sections of the Bankruptcy Code demonstrate a legislative history of using this language to encompass a wide swath of situations. Accordingly, the same meaning should be used in this section of the Bankruptcy Code. Next, the court addressed whether a debtor was "engaged in commercial or business activity" when the debtor was not managing the failed business when it filed for bankruptcy. The court viewed the totality of the circumstances surrounding the bankruptcy petition and determined that the debtor was "engaged in commercial or business activity" because the debtor owned the limited liability corporation at the petition date, and this LLC owned a portion of the failed business. Additionally, the "wind down" work that the debtor performed to tie up the loose ends of the failed business weighed in favor of finding that the debtor satisfied the "engaged in commercial or business activities" requirement. The court acknowledged that this broad interpretation implies that "employees flipping burgers at fast food restaurants" could file a Subchapter V petition. However, such a situation is limited by other requirements for a Subchapter V election, such as the requirement that the debtor have more than 50% of aggregate debts arising from "the commercial or business activities of the debtor." Thus, the court justified the broad interpretation of the statute, and held the debtor was "engaged in commercial or business activity."
[By Grant Coffey grant.coffey@ttu.edu]

ARBITRATION

Arbitration Agreement Was Drafted Too Narrowly [2ND CIR]

This is a class action suit in which plaintiff, an employee of a software development company, sued on behalf of himself and a putative class of other plan participants of the company's profit-sharing plan ("the plan"). The company hired defendant to manage the investment of the plan's funds in 1973. The plan had several investment management agreements ("IMA") with defendant, which established the relationship. None of these IMAs contained an arbitration clause. ERISA requires the employee plans to furnish a summary plan description of the plan's terms to its participants and provides that fiduciaries of the plan must manage the plan in the interest of the participants. If the fiduciaries mismanage the plan, the participants may seek assistance from the

U.S. Department of Labor, or, in the alternative, may file a lawsuit in federal court, as was explained in the plan summaries provided to plaintiff. The summary plan description also did not have an arbitration clause.

In 2016, the value of the stock in which defendant had invested a majority of the plan's funds plummeted, which caused the value of the plan to drop from $414.7 million to $97 million. Plaintiff subsequently sued both the company and the defendant. The employee and the company settled the dispute out of court and thus the case against the company was voluntarily dismissed. Plaintiff alleged that the defendant's overallocation of the plan's assets in this particular stock was a breach of defendant's fiduciary duties. In response to the suit the employees filed, the defendant moved to compel arbitration based on the employee handbook, which provided that "all legal claims arising out of or relating to employment" must be sent to arbitration. The district court granted the motion to compel arbitration. The plaintiff appealed.

In COOPER v. RUANE CUNNIFF & GOLDFARB, INC., 990 F.3d 173 (2d Cir. 2021), the Second Circuit reversed the motion to compel arbitration. The district court originally granted the defendant's motion because the plaintiff's claims were related to his employment within the meaning of the company arbitration agreement. Also, the claims related to how poorly the company and defendant had managed the plan's assets. Even though the defendant was not a signatory to the agreement, the district court had held defendant was entitled to arbitration. However, the Second Circuit disagreed, concluding that the language did not include claims for breach of fiduciary duty. Relying on analogous Fifth and Eleventh Circuit authority, the court held that the term "relating to" in the arbitration agreement meant that a claim would relate to employment only if the claim involves facts particular to the individual employee's employment. In the present case, the merits of the claim did not involve such facts. Moreover, ERISA provides investment advisors may be sued for breach of fiduciary duty in federal courts. As a result, the arbitration agreement did not apply to plaintiffs' claims against defendant. One judge dissented.
[By Jessica Longoria Jessica.longoria@ttu.edu]

SECURITY INTEREST

No Security Interest in Insurance Proceeds Paid for Stolen Goods in Which Creditor had no Security Interest [11TH CIR]

In 2015, the debtor granted the creditor a security interest in collateral at a specific location. Later that year, the debtor obtained insurance to protect various restaurant locations and collateral, including the location where the creditor had a security interest. Later, after certain fixtures, furniture and equipment were stolen, the debtor filed insurance claims for various restaurants protected by the policy, which excluded the location at which the creditor had collateral. After several attempts by the creditor to get the insurance claim proceeds were unsuccessful, it brought claims against the insurance company, which were dismissed by the federal district court. The creditor then appealed.

In TOLAND v. PHOENIX INS. CO., 2021 U.S. App. LEXIS 9257 (11th Cir. 2021), the court held that the creditor did not have a security interest in the insurance proceeds because the insurance was not for collateral in which the creditor had a security interest. The creditor argued that the district court had erred by granting summary judgment without providing the time required by the local rules for a response. However, the court rejected this argument because it is not applicable to a district court's sua sponte entry of summary judgment and, in any event, was harmless. The creditor's next arguments regarded the ability to recover the insurance proceeds because it held a security interest in the proceeds. In the alternative, the creditor claimed the proceeds were available to it as an unsecured creditor. Both of these arguments were rejected because the creditor's evidence did not establish that its security interest extended to the insurance proceeds. Therefore, the court held the creditor's failure to establish a security interest in the insurance proceeds made summary judgment appropriate. *[By Colton Sniegowski colton.sniegowski@ttu.edu]*

TRUTH IN LENDING

Truth in Lending Act Does Not Require Notification of Transfer of Collateral [ED MO]

A debtor obtained a loan from the bank ("Bank One") secured by a deed of trust recorded against the property. The promissory note the debtor signed in connection with the loan was then transferred to a Home Equity Loan Trust. Thereafter, a deed of trust assignment was recorded reflecting Bank One's assignment of the deed of trust to another financial servicing corporation. Several years later, when the debtor defaulted on the loan by failing to make the required monthly payments, an assignment of mortgage/deed of trust was recorded reflecting the Financial Servicing Corporation's assignment of the deed of trust to another bank ("Bank Two") as trustee for the trust. The debtor filed complaints against both banks, alleging invalid appointment of the trustee and violation of the Truth in Lending Act ("TILA"). Bank Two moved for summary judgment.

In BRUNK v. CONSECO BANK, No. 62670, 2021 WL 1222115 (Bankr. E.D. Mo. 2021), the court granted the bank's motion for summary judgment. First, the court evaluated whether the promissory note had been properly transferred to the trust. The debtor's argument pertained to the initial formation of the trust. The debtor's promissory note, however, had been transferred several years later to the trust and was governed by a pooling and servicing agreement ("PSA") that identified Bank Two as the trustee. Although years had passed between the formation of the trust and the recording of the re-assignment, the debtor offered no evidence to refute the fact that the promissory had not indeed been transferred to the trust. Because the debtor did not provide any evidentiary support of an invalid appointment of trustee, the court granted the bank summary judgment on the first complaint. Second, the court evaluated whether Bank Two failed to notify the debtor that it was the new owner of the debt pursuant to the TILA. The debtor relied on Section 1641(g) of the TILA, which was enacted in 2009, seven years after the promissory note had been transferred to the Trust. The debtor argued that Section 1641(g) of the TILA required Bank Two to send the debtor notice when the assignment of mortgage/deed of trust was recorded. Numerous courts however, have rejected this interpretation, holding the notice requirement in Section

1641(g) is only triggered upon a transfer or assignment of the underlying debt- not the security instrument (i.e., deed of trust). Because the promissory note was transferred into the Trust in 2002, well before the TILA's notification requirement became law, the court held the bank had not violated the TILA. As a result, the court granted the bank's motion for summary judgment on the complaint.
[By Carlos Gracia carlos.gracia@ttu.edu]

DEPOSIT ACCOUNTS

The Term "Item" in a Deposit Account Agreement May Be Ambiguous [SD NY]

Account holder and bank entered into a deposit agreement. Part of the agreement authorized an overdraft if an item was returned in an Automated Clearing House transaction. On multiple occasions the account holder's deposit account experienced multiple overdrafts due to insufficient funds. After refusing one withdrawal from a third party on the account because of a lack of funds in the account, the bank charged an overdraft fee. When the third party attempted to initiate the transaction again, the bank denied the withdrawal and charged a second overdraft fee. The account holder claimed that the term "item" was ambiguous and did not allow the bank to charge multiple overdraft fees for a transaction involving the same merchant on the same obligation. As a result, the account holder sued for breach of contract. The lower court denied the bank's motion to dismiss, and the bank appealed.

In CHAMBERS v. HSBC BANK USA, N.A., 19 Civ. 10436 (ER), 2020 WL 7261155 (S.D.N.Y. Dec. 10, 2020), the district court evaluated the claims of the account holder and whether it survived the bank's motion to dismiss. The court evaluated the account holder's argument that the term "item" was ambiguous. In looking at the arguments of the parties, the court gave weight to the account holder's theory that "item" holds a well understood industry meaning of referring to payments that follow an accountholder's affirmative instruction for payment, as opposed to a merchant's attempt to withdraw payment. Furthermore, the court evaluated the definition of "item" in Perks v. TD Bank, NA., 444 F. Supp. 3d 635 (S.D.N.Y. 2020). The court stated that, "in Perks, the definition of item held ambiguity on whether it permitted resubmission of a transaction as a separate item or is part of the same initial transaction." Id at 640. In this particular circumstance the district court held that the proposed interpretations of the account holder and the bank were both reasonable. Therefore, it allowed the breach of contract claim to survive. The court dismissed all of the other claims due to their duplicative nature. *[By Jimmy Vaughn jimmyd.vaughn@ttu.edu]*

FAIR CREDIT REPORTING ACT

FCRA and FCBA Claims Dismissed [6TH CIR]

In 2014, the debtor purchased a car and also a vehicle service warranty. The debtor financed the purchases with an installment loan that was immediately assigned to the creditor. Later, in 2016, the debtor concluded the warranty was not very good because she could find no repair shop that would honor it. For that reason, she sought to have the vehicle service warranty and her obligation to pay for it terminated. The creditor agreed to terminate the service warranty from the debtor's obligation at a pro-rated amount but the debtor responded by claiming the creditor had incorrectly calculated the amount that the debtor was obligated to pay as of result of the warranty having been terminated. This dispute had a negative effect on the debtor's credit score. After the debtor failed to pay the amount remaining on this obligation, the creditor repossessed the car in 2018. The debtor filed this complaint, alleging the creditor had violated the Fair Credit Reporting Act ("FCRA"), the Fair Credit Billing Act ("FCBA") and other laws. The district court dismissed the complaint under Fed. R. Civ. P. 12(b)(6) and the debtor appealed.

In RAJAPAKSE v. CREDIT ACCEPTANCE CORP., 2021 U.S. App. LEXIS 6591 (6th Cir. 2021), the circuit court held the debtor's amended complaint failed to state claims for relief under both the FCRA and the FCBA. The court reasoned that 15 U.S.C. §1681s-2(a) does not create a private cause of action for a failure to correctly report information to credit reporting agencies. However, a private cause of action arises if a creditor fails to comply with a notice of dispute under 15 U.S.C.S. §1681s-2(b). Because the debtor did not allege such a claim, her FCRA claim was dismissed by the court. The debtor also asserted the creditor was a debt collector under the FDCPA. However, the court rejected this assertion because the loan was not in default when the loan was assigned, and debt collection was not the creditor's primary business. Other claims the debtor made, under the Truth in Lending Act, the Fair Credit Billing Act, the Magnuson-Moss Warranty Act, the Fourth and Fourteenth Amendments, and fraud, were dismissed as having been time barred, not raised on appeal, below the minimum amount required to be in controversy, a claim against a nonparty, and a claim that was not plead with particularity, respectively, among various other reasons. Therefore, the court held there were no viable claims for relief in the amended complaint and affirmed the district court's dismissal of the complaint.
[By Colton Sniegowski colton.sniegowski@ttu.edu]

GENERAL BANKING LITIGATION

Prohibiting Fees in Connection with Paper Billing Statements Violates Free Speech [NDNY]

Account holder's complaint arose out of bank's practice of charging one dollar for paper billing statements. Account holder claimed this practice was prohibited by New York Business law. Account holder claimed the bank charged her and all other putative class members a monthly $1.00 fee to receive paper account statements in violation of a New York statute. The account holder also claimed that this violation of business law also made it a deceptive practice under Section 349 of New York Gen. Bus. Law. Also, account holder claimed the legislature was acting within its police powers. The bank moved to dismiss the complaint and the account holder opposed the motion to dismiss.

In MANSHIP v. T.D. BANK, N.A., No. 1:20-CV- 0329 (GTS/DJS), 2021 WL 981587 (N.D.N.Y. 2021), the District Court evaluated the motion to dismiss by the bank. It examined the bank's claim that N.Y. Gen. Bus. Law § 399-zzz violates its first amendment right to free speech. The court also evaluated the claim that Section 399-zzz is preempted by the National Banking Act and the regulations of the Office of the Comptroller of the Currency. Addressing preemption, the court held that states are permitted to regulate the activities of national banks when doing so does not prevent or significantly interfere with the national bank or the bank regulator's exercise of its powers. Here, the banking statement fees do not involve banking practice or service and therefore the issue is not preempted. Turning to the bank's First Amendment claim, the district court held Section 399-zzz regulates how businesses can communicate their fees. This regulation violates the First Amendment. Moreover, no compelling governmental interest justifies the legislation. The de minimis effect on consumer choice failed to rise to a level that advanced an important state interest. In addition, the account holder failed to state a claim for deceptive acts under N.Y. Gen. Bus. Law § 349 because Section 399-zzz unconstitutionally infringed on the bank's First Amendment rights. As a result, the district court granted the bank's motion to dismiss.

[By Jimmy D. Vaughn jimmy.d.vaughn@ttu.edu]

Centralization of Litigation Against Bank Denied for Lack of Convenience [JPML]

Multiple parties brought actions against Bank of American for the failure to properly process applications for loans under the Paycheck Protection Program. One party located in the Western District of Texas filed a motion to centralize the litigation involving California litigants, Texas litigants and Bank of America in the Western District of Texas. At oral argument the Texas litigants switched to support of centralization in the Northern District of California.

In IN RE BANK OF AMERICA PAYCHECK PROTECTION PROGRAM LITIGATION, 481 F. Supp. 3d 1341 (J.P.M.L. 2020), the judicial panel evaluated the movants request to centralize the litigation. The panel held individual factual issues relating to each loan application would greatly diminish the efficiencies from centralization of the actions. The panel reasoned that centralization would fail to serve the convenience of all the parties in part because several case specific factual issues existed. Additionally, because only three actions existed at the time, the movant bore a heavier burden to demonstrate the appropriateness of centralization. The panel proposed an alternate solution, which was that the parties involved voluntarily coordinate the litigation for informal discovery and other potentially duplicate pre trial activities. The panel ultimately denied the motion to centralize.

[By Jimmy D. Vaughn jimmy.d.vaughn@ttu.edu]

Exotic Dance Business May Be Eligible for PPP Loan [SD TX]

A variety of related businesses applied for PPP Loans. The businesses ranged from exotic dancing clubs to a regular club. The Small Business Administration (SBA) denied loans to the exotic dancers but allowed one for the regular dance club. Afterwards, the SBA recalled the loan given to the dance club. The businesses sued the SBA on various theories, including for violation of their free speech and right to equal protection under the laws. The businesses moved for a preliminary injunction and declaratory relief against the SBA.

In D. HOUSTON INC. v. UNITED STATES SMALL BUSINESS ADMINISTRATION, No. H-20-2308 2020 U.S. Dist. LEXIS 201780 (S.D. TX 2020)., the district court evaluated the claims of the businesses and the requests for injunctive and declaratory relief. The court evaluated the merits of the case in order to decide whether injunctive relief was appropriate. The court held that because exotic dancing is within the range of speech that receives First Amendment protection, prohibiting loan applicants on the basis of the nature of their business may violate the First Amendment and Equal Protection Clause. The court held that the SBA's claim of scarcity of resources is not a compelling enough interest to infringe on the rights of these businesses. The court also acknowledged the irreparable harm denying relief may pose. The court held that the unavailability of monetary damages from the SBA paired with the urgency of need for the businesses to have the funds, weighed in favor of granting the injunction. As a result, the court ultimately granted the preliminary injunction for the businesses. It denied the injunction in part for the dance business that was not exotic in nature, because it had already received a PPP Loan.

[By Jimmy D. Vaughn jimmy.d.vaughn@ttu.edu]

EMPLOYMENT DISCRIMINATION

Employees Anti-Discrimination Claim Fails to Survive Motion to Dismiss [3RD CIR]

An employee of a large bank posted violent comments towards protestors. In response to an individual having driven into a crowd of protestors, the employee stated that it was, "Too bad he didn't have a bus to plow through." After learning of this post, the bank fired the employee. The employee then filed a reverse racial discrimination action against the bank claiming it fired her because she was white. The lower court granted the bank summary judgment, and this appeal followed.

In ELLIS v. BANK OF NEW YORK MELLON CORP., 837 Fed. Appx. 940 (3d Cir. 2020), the Third Circuit reviewed the district court's decision granting summary judgment. The court reasoned the employee was required to establish a prima facie case of discrimination. The employee must show the adverse employment action gave rise to an inference of unlawful discrimination. In an attempt to do so, the employee provided comparator evidence. This evidence came from the posts of two black co-workers. However, the court evaluated the evidence provided and held those posts lacked the extreme nature the now-fired employee's comment had contained. The other employees' posts were ill-advised but did not condoned mass violence against peaceful protestors. Rather, one other employees' posts expressed frustration against another co-worker in an apparently non-violent manner and the other suggested certain law breakers should commit suicide. There were also a number of other differences between the plaintiff employee and the other two employees, including their positions and their supervisors. The court held the evidence provided failed to indicate differential treatment to similarly situated parties. As a result, the Third Circuit affirmed the district court's grant of summary judgment in favor of the bank.

[By Jimmy D. Vaughn jimmy.d.vaughn@ttu.edu]

North Dakota Retail Association Sues Federal Reserve in ND Federal Court

North Dakota Retail Association and North Dakota Petroleum Marketers Association are Challenging Federal Debit Transaction Fees

A host of North Dakota merchants are contending that they currently pay too high a cost in interchange fees for debit card acceptance. They argue that the current interchange fee ceiling of 21 cents per transaction is costing them billions of dollars and is leaving them paying more than they should as laid forth in the Durbin Amendment of the 2010 Dodd-Frank Act. The merchants contend that the amendment itself is, and has been, ignored by the Federal Reserve. Furthermore, the merchants argue that the banks issuing the cards are disproportionately enriched by the current regulations and costs, stating that the current profit margins for the issuing banks are far too high in comparison to what merchants must pay in interchange fees. The plaintiffs have filed a complaint for declaratory and injunctive relief.

In NORTH DAKOTA RETAIL ASSOC. & NDPMA v. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, No. 1:21-cv-00095-DMT-CRH 2021 (D.N.D. 2021), retrieved July 15, 2021-via PACER., the ND Federal Courts are preparing to decide a challenge from the NDRA and NDPMA to Regulation II of the Durbin Amendment, which governs debit card interchange fees. The plaintiffs are stating the regulation must be vacated due to three separate statutory violations: 1) the Board neglected to separate all associated transaction costs into incremental costs (must be considered by Board for setting ceiling) and miscellaneous costs (must not be considered), instead aggregating the costs to deliver a higher final ceiling, 2) the Board included costs specifically allotted by the Amendment to go elsewhere, and 3) the Board set a single standard for the fees rather than the required case-by-case approach. The Board has responded by filing motions to dismiss based on lack of jurisdiction and failure to state a claim, in addition to a motion to change venue. The courts have yet to rule on this issue, as this is the first direct legal challenge to the validity of the fee regulation itself.

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.