NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

A newsletter covering bank legal and compliance information.

Volume 23 • Issue 8

August 17, 2023

BANKING REGULATION

Administrative Law 101: Find Legal Error? Remand to the Agency [U.S.]

The banker occupied many prominent positions at the bank where he worked. Under the banker's direction, the bank established a complex loan relationship with a group of related financial entities. The entities, however, stopped paying their loans because of problems created by the Great Recession. The bank and the entities ultimately restructured their agreement to resolve these issues. The Federal Deposit Insurance Corporation (the agency) conducted an investigation and found the restructuring violated the bank's commercial-loan policy. After the banker had a hearing before an administrative law judge (ALJ), FDIC adopted the ALJ's finding of the banker's culpability and issued an order barring the banker from further employment in the banking sector in addition to other penalties. The banker appealed to the Sixth Circuit. That court found the agency had committed two legal errors by failing to require a showing of proximate cause and by misattributing some of the bank's financial injuries to the banker's actions. Despite these findings, the Sixth Circuit affirmed the agency's sanctions against the banker. The court concluded substantial evidence existed in the record to support the agency's decision. The banker appealed to the Supreme Court.

In Calcutt v. Fed. Deposit Ins. Corp., 143 S. Ct. 1317 (2023), the Supreme Court reversed the Sixth Circuit and chided the lower court for violating the Chenery doctrine, "a wellestablished maxim of administrative law." That doctrine mandates that a reviewing court must assess an agency action only on the grounds invoked by the agency. "It is 'a simple but fundamental rule of administrative law' that reviewing courts," the Court explained, 'must judge the propriety of [agency] action solely by the grounds invoked by the agency.' SEC v. Chenery Corp., 332 U.S. 194, 196, 67 S. Ct. 1575, 91 L. Ed. 1995 (1947). '[A]n agency's discretionary order [may] be upheld,' in other words, only 'on the same basis articulated in the order by the agency itself.' Burlington Truck Lines, Inc. v. United States, 371 U. S. 156, 169, 83 S. Ct. 239, 9 L. Ed. 2d 207 (1962)." By affirming the FDIC's sanctions against the petitioner based on a legal rationale different from the one adopted by the FDIC, the Sixth Circuit violated these commands. Functionally, this means if the reviewing court finds the agency action legally deficient, the court should almost always remand to the agency the court lacks the power to affirm the agency action on an alternative ground. The Court noted a narrow exception exists for circumstances when the agency is "'required' to take a particular action." However, the Court concluded this exception did not apply because the agency's sanctioning of the banker constituted a discretionary judgment involving a "highly fact-specific" inquiry. Thus, the Sixth Circuit should have remanded to the agency for further proceedings once it found legal error. By Peter Benson pebenson@ttu.edu.

Circuit Court Ruled CFPB's Unconstitutional Removal Restriction Failed to Injure the Aggrieved Party [2D CIR]

The Consumer Financial Protection Bureau (the agency) enforces "federal laws involving debt-collection practices" and receives funding from Congress's annual appropriations. In 2017, the agency issued a civil investigative demand (CID) an administrative subpoena to the law firm. Although the law firm complied, it withheld some documents on the basis of attorneyclient privilege. In early 2020, the agency moved the district court to enforce the CID; however, the Supreme Court then decided Seila Law LLC v. Consumer Fin. Prot. Bureau, 140 S. Ct. 2183 (2020). There, the Supreme Court held that the requirement that the agency's sole director could only be removed for cause was unconstitutional. Questioning the validity of its enforcement action in the wake of the Court's decision, the agency filed a notice of ratification regarding the enforcement of the CID against the law firm. The district court ratified the CID and granted the motion to enforce it. The law firm appealed.

In Consumer Fin. Prot. Bureau v. Law Off. of Crystal Moroney, P.C., 63 F.4th 174 (2d Cir. 2023), the Second Circuit Court

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

of Appeals affirmed the lower court's ruling. The law firm offered four arguments against enforcement, none of which persuaded the court. First, the law firm asserted the CID was void ab initio because it was issued while the agency's director was protected by an unconstitutional removal restriction. To address this argument, the court relied on Collins v. Yellen, 141 S. Ct. 1761 (2021). In that case, the Supreme Court had ruled a party in the law firm's position "could be entitled to relief if it could show that '[the] unconstitutional provision . . . inflicted compensable harm' on the [party]." Because the Supreme Court never adopted an exact test, lower courts have split on which test to use. The appellate court chose to apply but for causation and held the law firm could not "show that the [CID] would not have been [issued] but for the President's inability to remove the [director]." The court noted that, during the life of the case, two different Presidents could have exercised at-will removal of the agency's director but did not. Second, the law firm claimed the agency's funding structure (from the Federal Reserve) was unconstitutional under the Appropriations Clause because the Executive Branch provided funding to the agency without meaningful oversight by Congress. The court recognized a recent Fifth Circuit opinion had found the agency's funding structure to be unconstitutional under the Appropriations Clause, but it refused to follow the Fifth Circuit's lead. Because Congress had approved the agency's funding structure by enacting the agency's enabling statute, the appellate court concluded the scheme was constitutional. Third, the law firm contended the agency's enabling act failed to articulate an intelligible principle to guide the Executive's appropriation of funds and thus violated the nondelegation doctrine. Characterizing the intelligible principal rule as a "lenient standard," the court found ample language in the statute supporting an intelligible principle. Finally, the law firm argued the CID was unduly burdensome because it sought information related to the practice of law protected by the attorneyclient privilege. Even though Congress had "prohibited the [agency] from exercising enforcement authority over attorneys engaged in the practice of law," the court pointed out the present enforcement action targeted the law firm's debt collection practices, not its practice of law. Because the law firm failed to submit a privilege log to the district court, the appellate court rejected the claim of attorney-client privilege and held the law firm had failed to meet its burden in proving the undue burden of the CID. By Peter Benson pebenson@ttu.edu.

BANKRUPTCY

Debt Nondischargeable [5TH CIR]

A roofing company (Debtor) borrowed money from a bank, with the owner of the Debtor guaranteeing the loan. Later, the Debtor defaulted on the loan by failing to make payments as required by the loan documentation. In addition, the owner formed a new entity without telling the bank that the entity had been created and that the owner would be doing business through the new entity. Shortly thereafter, the owner and the Debtor both filed for bankruptcy. After execution of the debt instruments with the bank, the company, under the new entity, subcontracted with a construction company. The owner diverted revenue from this project to the new entity without informing the bank. Additionally, the owner diverted some of the funds from his company into a personal account that had not been disclosed in the original bankruptcy filing. Finally, he transferred several intangible assets, apparently security for the loan, from the original company to the new entity. When the bank discovered these actions, it filed suit in bankruptcy court. The bankruptcy court held that the bank had established a claim and that the claim was nondischargeable because the owner had made false representations and committed actual fraud against the bank. The owner appealed to the district court, which affirmed, and then appealed to the Fifth Circuit Court of Appeals.

ln Lawrence v. Frost Bank (In re Lawrence), No. 21-10103, 2022 WL 118966, 2022 U.S. App. LEXIS 886 (5th Cir. Jan. 12, 2023) (unpublished opinion), the court affirmed the bankruptcy court's finding that the owner had committed actual fraud and, therefore, the debt was nondischargeable. The court began its analysis by defining "actual fraud." The circuit court explained that "actual means any fraud that involves moral turpitude or intentional wrong" and "fraud encompasses situations in which a debtor's transfer of assets... impairs a creditor's ability to collect the debt." To hinder the bank's ability to reach some money, the owner diverted the funds from the original company, the borrowing entity, into the bank account for the new entity and his personal account. When viewing the circumstances in the aggregate, the court held that these actions constituted actual fraud and that the owner had intended to defraud the bank. Because the borrower had engaged in actual fraud, the debt was nondischargeable, and the district court judgment was affirmed. By Ashley Boyce ashboyce@ttu.edu.

Bankruptcy Court Did Not Violate Due Process or Improperly Deny Jury Trial [3RD CIR]

The affiliated companies filed for Chapter 11 bankruptcy. A year later, an individual brought defamation claims against one of the companies for articles it had published. In connection with this defamation allegation, the individual filed proofs of claim with the bankruptcy court. The individual asserted that the damages due to the misrepresentations entitled him to $100 million. The company sought to disallow the

claims, and the bankruptcy court sustained this objection after discovery and a trial. The individual appealed on the grounds of inadequate notice pertaining to the presentation of evidence at the hearing, even though the bankruptcy court had held an evidentiary hearing where both sides presented evidence and ultimately chose to disallow the individual's claims. The district court ruled for the debtor. The individual appealed again, this time alleging bias, due process violations, and the denial of his right to a jury trial.

In In re Tribune Media Co., No. 21-2000, 2023 WL 2624718, 2023 U.S. App. LEXIS 7101 (3rd Cir. Mar. 24, 2023) (unpublished opinion), the circuit court found these arguments to be meritless. Because the individual had filed proofs of claim, he had no right to a jury trial. The circuit court affirmed the ruling that the bankruptcy court had been a proper forum. As to the individual's due process claims, the court determined the bankruptcy court did not deny him due process by failing to provide him with helpful materials or aids. Even though the individual asserted that the proceedings had been long, expensive, and did not allow him time for sufficient preparation, the circuit court concluded his due process rights had not been violated. Further, the circuit court did not find any indication of bias in the bankruptcy court's opinion. The court ultimately held that the bankruptcy court did not abuse its discretion, violate due process, or act biased. Accordingly, the court of appeals affirmed the district court's judgment that affirmed the decision of the bankruptcy court. By Avery Bertagna abertagn@ttu.edu.

EFTA

Feuding Over Joint Bank Account! How One Account Holder learned the Importance of Civil Procedure [SD FLA]

A mother and daughter (the account holder) shared a joint bank account at the defendant bank (the bank). One day the account holder attempted to transfer all the money that was in the joint account, an amount of $405,952.60, to her other account at a different bank. She also attempted to prevent her mother from drawing any funds from the joint account. Her mother intervened, and requested the bank stop the account holders requested wire transfer of all the money in their joint account. The account holder's mother then requested to withdraw $161,000.00 from the joint account. Due to the conflicting interests of the account holder and her mother the bank chose to close the joint account and mail a cashier's check to the address on file, which was the mother's address. Although the account holder and her mother did reach a settlement, in which she received a portion of the money from the joint account, she then brought this action against the bank to recover the remaining balance. The account holder brought three claims alleging (1) violation of the Electronic Funds Transfer Act ("EFTA"), 15 U.S.C. § 1693, (2) breach of contract, and, in the alternative, (3) negligence. The bank moved to dismiss all three claims under Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim.

In Stepakojf v. lberiaBank Corp., F.Supp.3d, 2022 WL 16555034, U.S. Dist. LEXIS 197827 (S.D. Fla. Oct. 31, 2022) (opinion not yet released for publication), the court ruled in favor of the bank and dismissed all three of the account holder's claims. In her first claim, the account holder asserts that the bank violated the EFTA by failing "to make an electronic fund transfer in a timely manner in accordance with the terms and conditions of an account and when properly instructed to do so[.]" The court remarked how the EFTA imposes many regulations and protections on electronic transfers, however, the court noted that the regulations specifically exclude certain types of transfers from EFTA coverage, in this case, "any transfer of funds through Fedwire or through a similar wire transfer system that is used primarily for transfers between financial institutions or between businesses." The bank claimed that requested transfer at issue in the first claim were of a "through a similar wire system that is used primarily for transfers between financial institutions," so it is excluded from EFTA coverage. The account holder failed to raise any issue as to the material fact of the bank's claim. Thus, the court found that the first claim failed to state a claim for relief because 12 C.F.R. § 205.3(b)(l) exempts the requested wire transfer at issue from EFTA coverage. In addressing the second claim, the court emphasized how poorly pleaded the account holder's responses to the bank's pleadings were, especially in failing to address numerous specific provisions. Specifically, one of the provisions in the contract the account holder claims was breached gave the bank discretionary authority when conflict between joint account holders arose. Because she failed to properly address this discretionary language in her pleadings the court found that the account holder failed to state a claim that the bank's actions were in violation of the joint account's Terms and Conditions and dismissed her second claim. Regarding the third and last claim, the bank raised the defense of the independent tort doctrine. Once again, the account holder in their pleadings failed to contest that the independent tort doctrine prohibits her from concurrently asserting a negligence claim in the alternative to breach of contract. As a matter of law, the court concluded the independent tort doctrine prohibited the account holder from repackaging its breach of contract claim as an independent action in tort and dismissed her third claim. By Riley Caraway rcaraway@ttu.edu.

LENDING

Acceleration not Rescinded by Later Monthly Mortgage Statements [5TH CIR]

A borrower obtained a home equity loan secured by a mortgage on his home and, in doing so, executed a note and a security instrument. After fifteen months, the borrower stopped making payments on the note. The lender sent a notice of default and intent to accelerate to give the borrower an opportunity to make the required payments. However, the borrower failed to take any action. Later, the lender sent the borrower a monthly mortgage statement showing an amount owed that was less than the accelerated loan amount. The monthly statement also included the accelerated amount and notice that the foreclosure process was beginning. The lender then sent a notice of acceleration of loan maturity, stating that the entire balance of the note had been accelerated, and on the same day, sent the borrower a monthly mortgage statement. The lender filed an action for judicial foreclosure and a motion for summary judgment. The borrower responded by arguing that the lender had failed to satisfy the conditions precedent to acceleration and foreclosure. The borrower argued that subsequent monthly mortgage statements had rescinded the notice of acceleration and also argued that the lender was estopped from claiming that the acceleration had not been rescinded. The district court granted the lender's motion for summary judgment, and the borrower appealed.

In Bank of N.Y. Mellon Trust Co. N.A. v. Meachum, No. 21-10766, 2022 WL 1171059, 2022 U.S. App. LEXIS 10757 (5th Cir. April 20, 2022) (unpublished opinion), the Fifth Circuit Court of Appeals held that the lender did not intend to abandon the acceleration of the loan, and the subsequent monthly statements did not rescind the notice of acceleration. The court then discussed the requirements in Texas for notice of intent to accelerate, stating that the notice of intent and notice that the debt had been accelerated must be given to the borrower before foreclosure proceedings begin. The court also explained that Texas courts typically refer to traditional principles of waiver when evaluating whether the acceleration of a debt has been abandoned. The court observed that the monthly statements sent after the formal notice of acceleration had included a notice of foreclosure proceedings, a total payment amount required to bring the account current, and the accelerated amount. Accordingly, the court concluded that those statements did not show an intent to abandon acceleration and explained that it had previously ruled that "a monthly statement requesting payment for less than the full amount of the loan did not, by itself, evidence a clear intent to abandon acceleration." The court also rejected the borrower's judicial estoppel argument because he had not raised it in his responsive pleading or answer. For these reasons, the Fifth Circuit Court of Appeals affirmed the district court's judgment. By Ashley Boyce ashboyce@ttu.edu.

TRUTH IN LENDING ACT (TILA)

Turn Up The AC!!! Borrower Had Standing to Bring TILA Claim [11TH CIR]

A customer (the "borrower") needed air conditioning repairs, so he reached out to Fast AC, LLC (the "agent") to perform the repairs. The agent's employee provided the borrower with an estimate for the repairs, which was more than he could afford. The agent's employee informed the borrower that he could finance the repairs with FTL Capital Partners, LLC (the lender). The borrower was hesitant about accepting the finance option but eventually agreed. However, the agent's employee was the one who filled in the loan information on the borrower's computer and accepted the loan agreement, not the borrower himself. This prevented the borrower from seeing the loan paperwork, which contained disclosures about the loan, specifically the total price of the loan. The information that the borrower did not see because of the agent's actions were the types of disclosures required under the Truth in Lending Act (TILA). Shortly after the repair work began, the borrower changed his mind and canceled the service, but the lender did not release him from the loan. Instead, the lender reported negative payment activity on the borrower's credit report. The borrower then sued both the agent and the lender, asserting numerous claims. Regarding the lender, the borrower sued under an agency theory of liability, claiming injuries in the form of wasted time, economic harm, and emotional distress resulting from the lender violating the TILA. The district court concluded that the borrower lacked standing to bring his TILA claim, reasoning that the injuries were not traceable to the lender, and granted summary judgment for the lender, which the borrower then appealed.

In Walters v. Fast AC, LLC, 60 F.4th 642 (11th Cir. 2023), the court reversed and remanded the lower court's ruling, concluding that the borrower did have standing to bring his TILA claims against the lender. The court first looked to the three elements a plaintiff must show to have standing: (l) that he suffered an injury in fact that is concrete, particularized, and actual or imminent; (2) that the injury is traceable to the defendant's legal violation; and (3) that the injury would likely be redressed by judicial relief. Element one was satisfied because the borrower testified that "he was forced to spend time disputing his debt; (2) his credit took a hit, preventing him from making other purchases or refinancing his home; (3) he spent money faxing documents to his attorney; and (4) he felt anxious, exploited, embarrassed, and worthless." The lender made several arguments regarding why the borrower did not satisfy the first element, including that it had been the agent, not the lender, who caused the borrower's injuries. The

court held that this "traceability" element was not relevant to the first element, and that the injury-in-fact analysis is complete when a plaintiff establishes that he suffered an actual, concrete harm, as the borrower did here. Questions about who or what caused the injury are more appropriately addressed under the second element. Finding that element three was also established, the court devoted most of its analysis to the second element. The borrower alleged two theories as to how the second element was satisfied. While the court dismissed his first theory, the court did find the borrower's second theory satisfied the second element. This theory was that the agent's actions were not "independent" of the lender because it took those actions as an agent of the lender. Because the lower court failed to address this theory, the court concluded that the borrower had standing to assert his agency based TILA claim against the lender. By Riley Caraway rcaraway@ttu.edu.

MINNESOTA BANKERS ASSOCIATION SUES FDIC

The Minnesota Bankers Association (MBA) and Lake Central Bank initiated a lawsuit against the Federal Deposit Insurance Corporation (FDIC), centering around the FDIC's position on the Unfair or Deceptive Acts or Practices Act (UDAP) regarding NSF fees on re-presented checks.

. The suit argues that the FDIC exceeded its bounds by altering existing bank disclosure regulations and implementing a substantive UDAP rule, triggering significant confusion and frustration for FDIC-supervised institutions. The MBA and Lake Central Bank emphasize that they did not undertake this legal action lightly, but felt it necessary given the FDIC's questionable procedural actions.

This lawsuit underlines the importance of banking regulators adhering to the principles of law and procedure when exercising their regulatory powers. The plaintiffs insist that the FDIC failed to follow the mandatory rulemaking process defined in the Administrative Procedure Act, a federal law designed to ensure fair and transparent operation of government agencies. Filed in the Minnesota District Federal District Court, this lawsuit stands as a potent reminder of the need for regulatory bodies to respect the laws governing their operations, providing a secure and predictable regulatory framework for the institutions they oversee.

A copy of the Complaint can be found at the following link: Minnesota Banks Association et al v. Federal Deposit Insurance Corporation et al

Also, you can find the Minnesota Bankers Association's press release at the following link: Press Release

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.