NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

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BANKING

Loan Agreement with Usurious Rate Void in New York [NY App. Div.]

The lender and the borrower entered into a loan agreement, under which the loan amount was under $2.5 million, and the interest rate was 34%. The agreement included a choiceof-law provision requiring that disputes be governed by the laws of the state of Virginia. The lender brought a suit against the borrower for breach of the loan agreement. The borrower claimed that the agreement was void because the interest rate violated New York law, and the choice-of-law provision violated New York's public policy. The lender argued that the choice-of-law provision must be honored and alternatively argued that the agreement should be modified to provide for the maximum interest rate allowable under New York law.

In Samson Lending LLC v. Greenfield Mgmt. LLC, 196 N.Y.S.3d 850 (N.Y. App. Div. 2023), the court dismissed the lender's complaint and held that the loan agreement was void. The court began its analysis with an examination of the historical precedent established by the history of New York's usury statutes spanning three centuries. Given New York's long-standing adherence to stringent usury statutes, loans deemed usurious historically resulted in void agreements, absolving the borrower of repayment obligations. The court underscored that New York's usury statute constitutes a deeply rooted tradition designed to protect both people and corporations from the "evils of usury." Next, the court looked at the standard interest rate limit set by the New York General Obligations Law ("GOL") § 5- 501 (1)-(3). New York law dictates that the interest rate for loans given for less than $2.5 million may not exceed 25%. Therefore, an interest rate of 34% for a loan less than $2.5 million violated New York's criminal usury rate limit. Penal Law § 190.40 The court then analyzed the agreement's choice-of-law provision. While New York contract law allows parties to include choice-of-law provisions in their agreements, there are constraints on that ability. Courts retain the authority to decline enforcement when the chosen law violates "fundamental principles of justice, prevailing moral standards, or deep-seated traditions of the common weal." The court concluded that New York's usury laws, explicitly articulated in GOL §5-501 (1)-(3), establish a fundamental principle of justice prohibiting usurious interest rates. Consequently, the court refused to enforce the choice-of-law provision; because Virginia law permits interest rates above the 25% maximum stipulated by New York statute. Finally, the court ruled that the agreement, being usurious on its face, must be void under New York law. No equitable remedies were deemed available because the lender charged criminally usurious interest.

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BANKING REGULATION

Federal Banking Agency Has Disciplinary Authority Over Any of Its Member's Banker's Misconduct, even if The Misconduct Occurred at a Non-Member Bank [10TH CIR]

Two bankers who worked for a state bank that was not a member of the Federal Reserve System (FED) committed misconduct. The bankers left the non-member bank and started working for a state bank that was a member of the FED. At both banks, the bankers were directors, officers, or controlling stockholders, thus making them InstitutionAffiliated Parties (IAP). While working at the member bank, the Federal Reserve System Board of Governors (the Board) became aware of their prior misconduct, removed them from being officers and directors of the new banks, and restricted them from serving in these positions in the future. The bankers appealed, arguing that the Board was not the proper federal agency to regulate their conduct and thus did not have the authority to do so. They also argued that the appointment of the Administrative Law Judge (ALJ) who oversaw their case violated the Constitution's Appointments Clause, U.S. Const. Art. II, § 2, cl. 2, and thus the reprimand was invalid.

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In Smith v. Bd. of Governors of the Fed. Reserve Sys., 73 F.4th 815 (10th Cir. 2023), the court held that the Board had the authority to remove the bankers and that the bankers forfeited their Appointments Clause claim because they had failed to raise it before the Board. First, the applicable statute grants the Board authority over any IAPs of a member state bank for any misconduct. Here, the Board was the regulatory authority over the member state bank, and the bankers were IAPs for that bank, meaning the Board had authority over them. 12 U.S.C. § 1818(e)(1). It was irrelevant that the conduct occurred at a non-member bank. Further, while the FDIC may also have had authority over the bankers for their misconduct at the non-member bank this did not exclude the Board from having authority. Second, the bankers had forfeited their Appointments Clause claim because they did not raise it before the Board, as required by statute, to avoid forfeiture. Additionally, the bankers had no defense to not having raised it because raising this issue before the Board would not have been futile, and they failed to show that they could not have raised this issue before the Board.

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Puerto Rican Bank Denied Injunction Against New York Fed [SD NY]

A bank opened a master account with the Federal Reserve Bank of New York (the NY Fed). Several years later, the FBI investigated the bank's transactions and money laundering compliance. Shortly after, the U.S. District Court issued a seizure warrant that instructed the NY Fed to transfer a substantial portion of the funds in the bank's master account to U.S. Marshals. One year later, the bank and the NY Fed made an agreement under which the bank would pay fines and revise its anti-money laundering policies, with supplemental terms agreed to between the bank and the NY Fed. These supplemental terms required enhanced riskmitigation measures by the bank, with the NY Fed having the right to close the bank's account. A few years later, the NY Fed requested that the bank submit assessments regarding the effectiveness of the bank's compliance program. The bank submitted these reports, but the NY Fed's anti-money laundering specialists determined that the bank posed an undue risk and that this risk could not be mitigated with additional action. Soon after, the NY Fed notified the bank that it would be closing its master account. In response, the bank filed a preliminary injunction against the NY Fed to suspend closure of its account. The bank also filed a motion seeking relief from the Board of Governors of the Federal Reserve (the "Board").

In Banco Sam Juan Internacional, Inc v. FRB of N.Y, No. 23-cv-6414, 2023 WL 7111182, 2023 U.S. Dist. LEXIS 193296 (S.D.N.Y. Oct. 24, 2023) (opinion not yet released for publication), the District Court for the Southern District of New York denied the bank's request for a preliminary injunction because the bank had failed to meet the requirements for such judicial action. The court outlined three requirements for a preliminary injunction to be granted, as stated in N. Am. Soccer League, LLC v. US. Soccer Fed'n Inc., 883 F.3d 32, 37 (2d Cir. 2018). The requirements included "(1) irreparable harm; (2) either a serious likelihood of success on the merits or both serious questions on the merits and a balance of hardships decidedly favoring the moving party; and (3) that a preliminary injunction is in the public interest." Id. The court found that the bank failed to show a serious question on the merits. The bank asserted that it would lose customers without its master account; but in the court's opinion, this assertion was purely speculative, especially because the bank had fewer than fourteen account holders, which were mostly related. The bank also contended that it had a statutory right to its master account and that the NY Fed's administrative actions violated the Due Process Clause. However, the court cited 12 U.S.C. § 342, in response, which provides that federal reserve banks are not required to maintain master accounts. The court also dismissed, as moot, the bank's motion seeking relief from the Board because the bank could not demonstrate that the claimed injury "will be redressed by a favorable disposition" regarding the bank. The Board asserted that the bank did not have standing because the Board lacked the functional capacity of reopening the bank's account. The court agreed with the Board's assertion, further explaining that the board operates in a supervisory capacity over the NY Fed but lacks the statutory authority to open or close master accounts.

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BANKRUPTCY

Time to Object to Discharge of Debt Not Subject to Equitable Tolling [3RD CIR]

The debtor defaulted on weekly payments owed to the creditor as a part of a settlement. The creditor then obtained a judgment in New York state court against the debtor. The debtor filed for Chapter 7 bankruptcy, listing, among other debts, the judgment amount in full. Following the creditors' meeting, the bankruptcy trustee reported that there were no assets for bankruptcy distribution and that creditors should not file a proof of claim unless assets became available. No creditors in the case filed motions to oppose the dischargeability of any debt, the bankruptcy court granted the debtor's discharge, and the bankruptcy case was closed. After more than five years, the creditor moved to reopen the bankruptcy case, alleging that before filing his petition the debtor had fraudulently transferred assets, which should have been part of the bankruptcy estate, to a company currently operated by the debtor. The creditor challenged the dischargeability of its debts against the debtor under 11 U.S.C. §

523, claiming that the fraudulent act of the debtor rendered the debt owed to the creditor non dischargeable. Furthermore, the creditor argued that even if its debt was dischargeable, discharge obtained through fraud must be revoked under 11 U.S.C. § 727(d)(l). The bankruptcy court, relying on In Re New Century TRS Holdings, Inc., No. 07-10416 (BLS), 2021 Bankr. LEXIS 2826, 2021 WL 4767942 (Bankr. D. Del. Oct. 12, 2021), denied the creditor's motion to reopen, reasoning that (1) the challenges as to the dischargeability were not only untimely, but "time-barred" and (2) the creditor had a sufficient alternative to seek relief in state court against the debtor and the newly discovered company (which the creditor had already sought). The creditor argued on appeal that the bankruptcy court had discretion to reopen the case despite time limits because the bankruptcy rules governing timing for its claims allowed for equitable tolling.

In In Re Delloso, 72 F.4th 532 (3d Cir. 2023), the Court of Appeals for the Third Circuit held the bankruptcy court properly denied the creditor's motion to reopen. The court stated that the Bankruptcy Code provisions on which the creditor's claim relied (§§ 350, 523, and 727) were subject to the time limitations of Fed. R. Bankr. P. 4007(c). Even considering that under Fed. R. Bankr. P. 9006(6)(3) bankruptcy courts generally have the power to enlarge these time limitations, the court found that such enlargements were limited to the conditions set out in the plain text of Rule 4007(c). The court held that the text of Rule 4007(c) clearly precluded exceptions to the time limit for challenges to the dischargeability of a debt regardless of equitable tolling.

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CHECKS

Stale Check Rule Destroys Favorable Settlement [GA APP]

Following a motor vehicle accident, the injured party sued the responsible party for injuries arising from the incident. The injured party's attorney wrote a demand letter outlining the injuries sustained and the amount he sought to recover from the responsible party's insurance. In the demand letter, the injured party's attorney outlined the terms of acceptance, which included the time in which to accept the offer, who to pay, the time when the payment must be received, and that the offer must be accepted as is and any changes would render it void. The responsible party's insurance company sent an acceptance letter with the payment by check attached. The check included a notation that it was void after 180 days. The injured party then sued the responsible party for damages resulting from the injuries sustained. The responsible party responded to the complaint by alleging that the matter had been settled, but the injured party alleged that the responsible party's purported acceptance was not identical to the offer and therefore was invalid. The trial court found that the parties had settled, which was important, because the plaintiff's medical bills had allegedly been over $1 million, and the original settlement offer had been for $25,000.

In Pierce v. Banks, 890 S.E.2d 402 (Ga. App. 2023), the Georgia Court of Appeals reversed the trial court's judgment. The court started its analysis by looking at OCGA § 9-11-67.1 (a Georgia statute relating to settlements). The court determined that the settlement offer made by the injured party's attorney was an offer in terms of contract law. Because the offeror is the master of the offer, it can set the terms of acceptance, making this a unilateral contract. Therefore, acceptance must be identical and not vary in any way. The failure to comply with an offer will render the acceptance void, meaning the acceptance is no longer an acceptance but is now a counteroffer. Here, the responsible party's insurance company failed to comply with the terms of the offer; therefore, its alleged "acceptance" letter was, in fact, a counteroffer. The key was that the payment check had indicated on its face that it was void after 180 days, which was contrary to the settlement offer. The court reasoned that OCGA § 11-4-404 (Georgia's adoption of section 4.404 of the UCC) does not provide that a check is void after 180 days; it simply provides that after 180 days, a bank is under no obligation to pay a check but that it may do so in good faith. Thus, the district court had erred in concluding that the insurance company had accepted the offer and that there had been a properly formed settlement agreement. Accordingly, the Court of Appeals of Georgia reversed the court's judgment in favor of the injured party.

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FAIR DEBT COLLECTION PRACTICES ACT (FDCPA)

Filing Complaint Key to FDCPA Statute of Limitations [9TH CIR]

The debtor took out student loans to pay for college but defaulted on the loans. The collectors then purchased the loans and hired an entity to collect on the defaulted loans. A few years later, the debtor filed for bankruptcy relief under Chapter 13. The collectors filed claims for the remaining student loan balances in the debtor's bankruptcy case. The debtor made payments for three years on all the filed claims, after which any remaining funds were to be distributed to "non-dischargeable student loan creditors." The bankruptcy court issued discharge orders for all dischargeable debts under 11 U.S.C. § 1328(a). After the bankruptcy discharge, the collectors sent the debtor letters seeking the remaining balances on the debtor's student loans. Their attempts to collect were unsuccessful, so the collectors initiated a lawsuit in Washington state court. The collectors failed to show

that the debtor's student loans had been assigned to them, so the court dismissed the debt collection suit. The debtor then filed suit, alleging violations of the Fair Debt Collection Practices Act (FDCPA) because the collectors had knowingly brought a meritless lawsuit. The district court dismissed the debtor's suit because (l) discharged debtors do not have a right of action outside a bankruptcy court for a violation of their discharge, and (2) the FDCPA has a one-year statute of limitations, and more than one year had elapsed since the litigation was initiated. The debtor appealed to the Ninth Circuit.

In Brown v. Transworld Systems, Inc., 73 F.4th 1030 (9th Cir. 2023), the Ninth Circuit affirmed in part and reversed in part the district court's dismissal of the debtor's complaint. The court first noted that some litigation acts are FDCPA violations that carry their own one-year statute of limitations, and the court clarified that filing a lawsuit can constitute an independent FDCPA violation that starts the statute of limitations running when it is preceded by service. The court ruled, however, that discharged debtors do not have a FDCPA right of action base on violation of a bankruptcy discharge order because the district court would have to determine whether the debt had been discharged, an issue entrusted solely to bankruptcy courts, relying on Walls v. Wells Fargo Bank, 276 F.3d 502 (9th Cir. 2002). Turning to the statute of limitations issues, the court cited the test from Naas v. Stolman, 130 F.3d 892 (9th Cir. 1997), to determine whether a litigation act is an independent FDCPA violation, thus triggering its own statute of limitations. The test considers (1) when was the debt collector's last opportunity to comply with the statute, and (2) whether the date of the violation is ascertainable. The court concluded that here there was one FDCPA violation that would trigger a new statute of limitations: the filing of a new affidavit that attempted to prove that the collectors owned the debts after the suit had already been filed. Due to the new basis on which the collectors attempted to complainabandoning their original affidavit-this created a "last opportunity to comply" with the FDCPA, which they failed to do. Additionally, the court looked to the filing date to see that it was indeed easily ascertainable. The court concluded that the debtor's suit was timely because he had one year from the filing of the state court action to bring the FDCPA violations claim. The court held that when service occurs before filing, that action of filing a complaint can constitute an independent violation of the FDCPA from which the statute of limitations can be calculated. Accordingly, the court reversed the dismissal of the complaint.

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WIRE TRANSFERS

Bank Not Liable for $6 Million Dollar Wire Mistake [OH DC]

Hackers stole a $6 million wire transfer from a company that had intended to pay one of its vendors. The company accused the bank of negligent and reckless failure to prevent the fraud. The hackers had opened a fraudulent account with the bank using the identity of a deceased man. Next, the hackers began communicating with the company pretending to be an employee of its vendor. The hackers gave the company their fraudulent account number, and the company sent them the wire transfer through its bank. However, the wire transfer was addressed to the vendor's name, which did not match the name associated with the fraudulent account. The company accused the bank of violating the Patriot and Bank Secrecy Acts by failing to verify the hackers' identity when opening the accounts and failing to submit required reports to the U.S. Department of Treasury. The company filed suit against the bank for failure to comply with the Uniform Commercial Code, public nuisance, and civil conspiracy. The bank filed a motion to dismiss all counts.

In Kent Grp. Partners, LLC v. Citizens Bank, N.A., No. 1:22-CV-01334, 2023, WL 5352051, 2023 U.S. Dist. LEXIS 145881 (N.D. Ohio August 21, 2023) (opinion not yet released for publication), the court granted the motion to dismiss on all three counts, with prejudice. First, the company argued that the bank knew or should have known of the hacker's fraud; however, the Ohio Rev. Code Ann.§ 1304.62 [Ohio's adoption of UCC 4A- 207(b)] allowed the bank to rely on the provided account number and complete the transfer if it was unaware of the discrepancy. The court found that the company had failed to show that the bank knew of this discrepancy or that the account was fraudulent. Second, the court dismissed the public nuisance claim because the company was not a governmental entity and the plaintiff had failed to allege a special injury that differed from any injury suffered by the general public. Furthermore, even if the company had shown a special injury, the Patriot and Bank Secrecy Acts do not create a private right of action, or a duty of care owed from the bank. Finally, the civil conspiracy charge could not stand without an underlying cause of action; therefore, the action had to be dismissed because all other counts were dismissed.

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Receiving Bank Loses Summary Judgment Motion on Mistaken Wire [D MN]

The sender attempted to send $2,000,000 to the receiver. Unknown to the sender, a hacker compromised the email containing the account and routing number information from the receiver and altered both numbers. The sender initiated the transfer of funds to the receiver using the account and routing numbers substituted by the hacker. Upon receiving the transfer request, the receiving bank flagged the transaction as potentially fraudulent. Both the sender and the sender's bank learned of the receiving bank's fraud concerns, and the sender promptly confirmed the account number was misdescribed. The sender requested the funds be recalled. At some point before the receiving bank agreed to return the funds, the hacker accessed the funds and obtained a check for a large sum of money. The receiver's bank executed an agreement to have the funds returned to the sender; however, the bank failed to return almost $800,000 of the funds to the sender's bank. The sender then filed an action against the receiving bank claiming conversion, civil theft, promissory estoppel, breach of contract, and unjust enrichment. The sender also sought declaratory and injunctive relief under Article 4A of the UCC. The receiving bank then filed a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6).

In Sunset Cmty. Health Ctr., Inc. v. Capital One Fin. Corp., 652 F.Supp.3d 1020 (D. Minn. 2023), the district court granted the bank's motion in part and denied the bank's motion in part. The court started by analyzing the applicable law, identifying the fund transfer as a payment order under Article 4A of the UCC. Next, the court began by addressing the declaratory and injunctive relief claims. While looking at 28 U.S.C. § 220l(a), the court concluded that the first step is to determine whether an actual "case or controversy" exists. Here, the allegations that the bank unlawfully retained a large sum of money from the sender did qualify as a definite and concrete justiciable controversy "touching the legal relations of parties having adverse legal interests." The court then considered whether the sender had the power to unilaterally cancel the payment order. Under U.C.C. § 4A-2 l l (b) a "sender of a payment order may unilaterally cancel the order only before the receiving back accepts it." In determining whether the bank accepted the order, the court looked at U.C.C. § 4A- 209(b), which states that a payment order acceptance occurs at the earliest of: "(I) when the beneficiary's bank pays or notifies the beneficiary of the payment order; (2) when the bank receives payment of the entire amount; or (3) the opening of the next business day following the date of the payment order if the sender's order is fully covered by a withdrawable credit balance." The court determined that the phone call that the receiving bank made to the sender's bank, to confirm if the sender's bank wanted to release the funds, suggested that the receiving bank had not yet released the funds to the receiver. Thus, the sender plausibly alleged the bank did not "accept" the payment, which meant the bank could have unilaterally cancelled the payment order. Next, the court addressed the issue of misdescription of the receiver. The court indicated that the bank could only be held liable for its acceptance of the payment if it had actual knowledge of the mismatch, as stated in U.C.C. § 4A- 207(b)(2). The court imputed actual knowledge to the receiving bank because the bank itself had contacted the sender about the mismatch. Therefore, the court denied the motion to dismiss as to the declaratory and injunctive relief. Lastly, the court addressed the remaining claims of promissory estoppel, breach of contract, conversion, civil theft, and unjust enrichment. The court concluded Article 4A preempted all these common law claims because they all protect against injuries that are already adequately protected by the UCC; therefore, the court dismissed those claims. Thus, the court denied the bank's motion to dismiss the declaratory and injunctive relief and granted the receiving bank's motion to dismiss the rest of the claims.

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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.

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