NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

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BANKING REGULATION

Penalties Arising from Violations of the Bank Secrecy Act Are Imposed on a PerReport Basis [US]

The Agency fined a non-willful violator (the violator) $2.72 million under the Bank Secrecy Act (BSA) as a penalty. The violator, a foreignborn, dual citizen, returned to his country of birth and started a business. While overseas, the violator did not file any reports on his income because he was unaware of the BSA's reporting requirement. The BSA requires U.S. persons to file an annual report with the federal government about certain foreign bank accounts they own. However, upon his return to the U.S., the violator hired an accountant who prepared the required annual reports. The violator reported a total of 272 accounts for the five years in question. The BSA permits a $10k penalty per violation. The Agency argued the BSA's penalty applied per account to calculate a total fine of $2.72 million. Conversely, the violator argued the BSA's penalty applied per report, which would have resulted in a substantially lower total fine.

In Bittner v. U.S., 143 S. Ct. 713 (2023), the Court found in favor of the violator, holding that the BSA's penalty applies per report and not per account. The Court first looked to two statutory provisions, 31 U.S.C. §§ 5314 & 5321, to interpret the BSA. The first statute details the reporting requirements, while the second outlines the penalties for failing to discharge those duties. Both statutes speak in terms of reports and are silent regarding accounts. Therefore, the Court concluded penalties for non-willful violations accrue on a per-report basis, not on a per-account basis. Additionally, the Court identified numerous Agency guidance documents that interpreted the failure to report as grounds for a $10k penalty. Similarly, the Court noted that regulations promulgated by the Secretary of the Agency supported its holding. The Court also looked to the legislative history of the BSA for additional support and found that if Congress intended non-willful violations of the BSA to apply on a per-account basis, then Congress would have made this intent clear in the law, especially because the BSA authorizes penalties on a per-account basis for willful violations. Finally, the Court applied the rule of lenity to strictly construe its reading of the BSA against the Agency because of the unfairness of subjecting a non-willful violator to unexpected penalties and criminal sanctions. By Malik Williams Malik.Williams@ttu.edu Edited By Peter Benson.

BANKRUPTCY

Miscalculated: Debtor's Bankruptcy Filing Does Not Stay Other State Lawsuit Judgments [1ST CIR]

The debtor was previously engaged in multiple state lawsuits regarding real estate and violated multiple orders and judgments from the Massachusetts state courts. In an attempt to place a stay on the judgments against him, the debtor filed a Chapter 7 Voluntary Petition for Relief with the bankruptcy court. The parties to the stayed lawsuits (lienholders) asked the court to deny the debtor's bankruptcy discharge, claiming that the debtor had made false oaths on both the Statement of Financial Affairs (SOFA) and Schedule A/B. The debtor had law firm, received a $17,500 settlement from a title insurer, and had assets related to real estate in Boston. The debtor did not disclose any of the previous information on either the SOFA or Schedule A/B, even though the documentation explicitly instructed the disclosure of the debtor's assets and income. The lienholders argue this was an intentional omission, as all the assets were listed on the debtor's tax returns. Both parties moved for summary judgment, and the bankruptcy court ruled in favor of the lienholders. The debtor now appeals, claiming an improper grant of summary judgment.

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In Kupperstein v. Schall (In re Kupperstein), 61 F.4th 1 (1st Cir.), the United States Court of Appeals for the First Circuit affirmed the grant of summary judgment in favor of the lienholders. The court began by recognizing that a right to a discharge should be construed liberally in the debtor's favor. However, the court also addressed an exception to defaulting in the debtor's favor. It found that 11 U.S.C. § 727(a)(4)(A) allows for an exception when a debtor has knowingly and fraudulently made a false oath related to a material fact of the case. The court found the debtor to have made such a false oath. It reasoned that because the debtor is an attorney, he would understand the significance of improperly completing bankruptcy forms. Because he failed to disclose certain income and assets on those forms, he was found to have made a false oath when signing and submitting the documents. Next, the court determined that the debtor had made the false oath knowingly and fraudulently. It reasoned that because the debtor himself had included the assets and income on his tax returns, he knowingly and fraudulently omitted them from the bankruptcy forms. Finally, the court found that the information omitted was material to the case because it would have allowed for substantial insight and investigation of related financial transactions. In sum, the court held that the lower court properly granted summary judgment in the lienholder's favor. By Maycee Redfearn maredfea@ttu.edu Edited By Riley Caraway.

The "Good Cause" Requirement for Chapter 11 Petitions [3RD CIR]

After finding itself embroiled in substantial tort litigation, the company sought to restructure itself through Texas corporate law. It did so by splitting the original company into two entities. The first entity gained its property, liabilities, and obligations to the tortious litigation as well as a funding agreement. The second entity obtained the old company's valuable consumer products with none of its liabilities related to the tort claims. After the divisional merger, the debtor, the company holding the liabilities to the talc claims (talc being a mineral powder containing traces of asbestos), filed for bankruptcy under Chapter 11 of the Bankruptcy Code. The claimants in the talc cases moved to dismiss the debtor's petition because, they claimed, the debtor did not file in good faith required by §1112(b) of the Bankruptcy Code. The bankruptcy court denied the dismissal, ruling that the filing served a valid bankruptcy purpose of creating a trust for the claimants. The court reasoned that because the talc-related claims would cost the debtor more than its assets, the debtor had filed in good faith.

In LTL Mgmt., LLC v. Those Parties Listed on Appendix A to Complaint (In re LTL Mgmt., LLC), 58 F.4th 738 (3rd Cir. 2022), the Third Circuit rejected the bankruptcy court's opinion that the debtor had filed its petition in good faith because the financial distress on the debtor was not apparent or immediate. The court emphasized the need to balance early filing to rehabilitate a debtor's business with the risks associated with premature filing. It determined that the debtor's assets alone did not show the need for immediate filing. The court did not use an exhaustive list to test the nature and immediacy of a debtor's financial troubles. Instead, the court looked to the debtor's assets, liabilities, and the funding backstop it has in place to pay the liabilities against it. Here, while the debtor had all of its predecessor's liabilities against it, the debtor gained a funding agreement in the restructuring, which entitled it to the right of payment up to the value of the other emerging company. In addition, the funding agreement gave the debtor direct access to the predecessor's balance sheet. This included equity worth well over the alleged litigation costs. The court contrasted the bankruptcy court's decision to not take the funding agreement into account with its over-estimation of the talc-related litigation costs. This overestimation is shown through the lack of acknowledgment of successful defenses by the debtor's attorneys, settlement agreements, and dismissal by the court. Additionally, the bankruptcy court ignored the fact that nearly half of all litigation costs were attributed to one case the company once described as "unique" and "not representative" of the litigation. For these reasons, the court dismissed the case, ruling that the debtor had not shown that its financial distress was apparent and immediate to constitute good faith as required by §1112(b) of the Bankruptcy Code. By Sabrina Urso sabrina.urso@ttu.edu Edited By Riley Caraway.

Can a Non-voting Creditor Be Deemed to Have Accepted the Plan? [BKR WD MI]

The subchapter V small business debtor sought relief under 11 U.S.C. § 1129(a)(8), which requires a debtor to show a "class of creditors has either 'accepted' the plan or is not impaired under it." However, a creditor, in a class by itself, declined to return the ballot indicating either its rejection or acceptance of the debtor's plan. Because Congress neglected to address this situation when it enacted the Code, courts have split on how to resolve the issue. The bankruptcy court chose to treat the debtor's plan as a "cram down" plan under § 1191(b) rather than a consensual plan under § 1191(a). In an effort to show compliance under the statute, the debtor argued the court should have adopted the Tenth Circuit's "deemed acceptance" precedent to treat the debtor's plan as consensual.

In In re Creason, No. 22-00988-swd, 2023 WL 2190623, 2023 Bankr. LEXIS 478 (Bankr. W.D. Mich. Feb. 23, 2023) (opinion not yet released for publication), the court rejected the deemed acceptance concept for four reasons. First, the court explained it had a duty to ensure the debtor met all statutory requirements before confirming the plan, regardless of whether the creditor raised the issue. Second, the court described the Tenth Circuit precedent as "an out-of-circuit case representing the minority position." Third, the court found the deemed acceptance theory irreconcilable with the Federal Rule of Bank Procedure concerning acceptance and rejection of a reorganization plan. Fourth, although the court questioned the wisdom of allowing a creditor to force the consequences of a cram down confirmation on a debtor, it left resolution of this policy issue in the hands of Congress. Finally, the court addressed the separate issue of whether the creditor was in fact a secured creditor. Applying the fair and equitable standard of § 1191(c)(1), the court found the creditor to be unsecured because the creditor's financing statement misidentified the debtor as an organization. By Khusbu Shah khusshah(w,ttu.edu Edited By Peter Benson.

CONTRACTS

Users Must Manifest Assent When Agreeing to Clickwrap or Scrollwrap Digital Forms [2D CIR]

A credit union was accused of wrongly collecting overdraft fees on accounts that were not actually overdrawn. This wrongful fee collection impacted a member of the credit union who filed a class-action complaint against the creditor. However, the credit union argued that the member had agreed to arbitration by signing the Account Agreement when the member opened an account with the credit union. Upon investigation, the original Account Agreement the member signed actually had no arbitration agreement, but the credit union argued that the member received inquiry notice of the arbitration agreement nonetheless. The credit union claimed all members agree to the Account Agreement when they sign up for an online banking account, which the member had done. The version found online contained the arbitration and class action waiver provisions but apparently was an update from what the member had signed. However, the creditor had never sent notice to its members regarding the revised agreement. It had the opportunity to send updates via mail, website banners, email, electronic statements, and more, but failed to directly inform its members of the newly added arbitration clause.

In Zachman v. Hudson Valley Fed. Credit Union, 49 F.4th 95 (2d Cir. 2022), the court remanded the case to the lower courts to determine if the Account Agreements were "clearly identified" on the creditor's website. Contract law allows for binding contracts to be formed through online "clickwraps" or "scrollwraps" so long as there is actual or constructive notice of the conditions posted. The court will determine actual or constructive notice by reviewing the design and content of the webpage to ensure the terms to be agreed to have been made clear. Here, the creditor did not provide the court with any evidence of the terms and conditions webpage, so the court could not evaluate whether the members had actual or constructive notice of the revised Account Agreement. Because the court of appeals could not review the evidence, it remanded to the lower courts with instructions to gather evidence from the creditor's website. Then, so long as the design and layout of the website give the member notice that using the website would manifest assent to the revised Account Agreement, the arbitration agreement would have been effective. However, if the website did not give the member notice, the arbitration clause will not stand, and the classaction would go forward in the courts. By Maycee Redfearn maredfea@ttu.edu Edited By Avery Bertagna.

SECURED TRANSACTIONS

Creditor is Found Commercially Reasonable in Sale of Borrower's Collateral [TX APP]

A borrower entered into a loan agreement with a creditor for over a million dollars. The borrower's assets secured the loan. The borrower leased the property (the premises) from a lessor. The borrower failed to pay rent to the lessor. Therefore, the lessor locked the borrower out of the premises, with the collateral locked inside. Thereafter, the borrower defaulted on its loan from the creditor, and the creditor sought to foreclose on the collateral. However, the lessor denied the creditor possession of the collateral. The creditor sued the lessor for possession of the collateral while also selling it and crediting it to the borrower's loan. Later, the creditor and lessor settled, which the creditor credited to the borrower's balance. The creditor then sued the borrower for the deficiency. The borrower argued that the creditor's sale of the collateral was not commercially reasonable, as required under the Uniform Commercial Code (UCC), because (1) the creditor made minimal effort to sell the collateral; (2) the collateral had a worth of more than the amount it sold for; (3) the creditor's failure to submit expert testimony; and (4) the creditor's claim that the lessor interfered with its attempts to dispose of the collateral could not act as an excuse for the creditor's failure to act in a commercially reasonable manner.

In Airpro Mobile Air, LLC v. Prosperity Bank, 631 S.W.3d 346 (Tex. App. Dallas 2020), the court rejected the borrower's argument holding that the creditor's sale of the collateral existed as commercially reasonable under the UCC. The court first noted that the UCC provides that a secured creditor may repossess collateral after default, dispose of it, and then sue for any deficiency that remains after proceeds from the collateral are applied to the debt. However, to recover a deficiency, a secured creditor must prove that it acted commercially reasonably regarding every aspect of the collateral's disposition. In turn, the court evaluated each of the four arguments made by the borrower that the creditor failed to act commercially reasonably. First, the court assessed the borrower's argument that the creditor made minimal effort to sell the collateral. In rejecting this argument, the court found that the creditor's decision to sell the collateral had commercial reasonability because the buyer possessed a large customer base and could potentially obtain a higher sale price. Furthermore, the creditor advertised the collateral for sale and contacted potential buyers. Second, the court rejected the borrower's argument that the collateral could be worth more than the amount it sold for because the creditor obtained an appraisal of the collateral before the sale, and the sale price remained within the range of values provided by the appraisal. Furthermore, the court stated that the sale price existed higher than the amount owed by the borrower for the loan. Third, the court rejected the borrower's argument that the creditor's failure to submit expert testimony regarding the commercial reasonableness of the sale constituted no evidence of commercial reasonableness. The court rejected this argument because of a lack of expert testimony requirement, as commercial reasonableness remained a question of fact for the jury to determine. Additionally, the court noted that the creditor presenting evidence regarding its efforts to sell the collateral and the sale price it obtained for it appeared sufficient. Finally, the court addressed the borrower's argument that the creditor's excuse that the lessor interfered with its attempts to dispose of the collaterals did not equate to commercial reasonableness. The court found that the creditor presented evidence that the lessor interfered with the sale by refusing to allow access to the collateral. The court also noted that the creditor sued the lessor to obtain access to the collateral. Therefore, the court held that the creditor's explanation for the delay in selling the collateral appeared reasonable and did not affect the commercial reasonableness of the sale. By Trevor Shelton trevor.shelton@ttu.edu Edited By Avery Bertagna.

Creditor to Repossessed Fraudulently Obtained Collateral Takes Free and Clear as a Good Faith Purchaser [1ST CIR]

An agent of an investment company was overseeing the purchase of an aircraft. While in negotiations, the agent formed its own company and transferred the aircraft to that new company. The agent used the aircraft as collateral for a loan with the bank, which perfected its security interest in the aircraft. When the investment company discovered the aircraft had been registered to the agent's new company, the investment company requested the Federal Aviation Administration (FAA) place a lien on the aircraft. Later, the agent created another company (the debtor), transferring the aircraft to it. The debtor issued a promissory note payable to another bank (the creditor) to refinance the loan. The creditor accepted the aircraft as security for the note and shortly thereafter registered its security interest. With the loan settled, one year later, the debtor defaulted on its obligations towards the creditor. As a result, the creditor brought an action against the debtor based on nonpayment of the promissory note and attempted to repossess the aircraft. The investment company moved to intervene, claiming ownership of the aircraft by virtue of an alleged senior security interest.

In Unibank for Sav. v. 999 Private Jet, LLC, 31 F.4d 1, 2022 U.S. App. LEXIS 9631 (1st Cir. 2022), the court held that the creditor qualified as a good faith purchaser for value, and therefore it had a perfected security interest in the aircraft, while the investment company did not. In reaching this decision, the court first evaluated whether the creditor had record or actual notice of the investment company's claim to the aircraft. Under 49 U.S.C. §§ 44107-44108, "[an] aircraft must be federally recorded in order to obtain 'whatever priority to which they are entitled' under state law." The court determined that the investment company provided no record notice. The investment company asserted that it contacted the FAA by letter requesting a lien on the aircraft, a letter the investment company never put into evidence with the district court. Therefore, the investment company did not satisfy its burden of showing that its letter met the recording requirements to perfect a security interest. Further, the court determined that the investment company provided no actual notice of its interest in the aircraft. The investment company asserted that a phone call between it and the creditor regarding a suit with the debtor provided actual notice of the investment company's interest in the aircraft. However, the investment company's call occurred eight days after the creditor gave the debtor value and three days after the creditor perfected its security interest. Without either record or actual notice, the investment company did not have a perfected

security interest. The court then evaluated the validity of the creditor's security interest. The investment company alleged that the debtor fraudulently obtained title to the aircraft and thus had no rights to convey it to the creditor. The court relied on the Uniform Commercial Code, which provides that an interest procured by fraud can be retained as voidable title and "thus could transfer good title to ... good faith purchaser[s] for value." A good faith or bona fide purchaser is someone who purchases assets unaware of adverse claims and obtains a security interest in that property. The creditor obtained its interest in the aircraft as collateral from the debtor and lacked awareness of the debtor's fraudulent scheme. Accordingly, the creditor qualified as a good faith purchaser for value and the court determined the credit possessed a perfected security interest in the aircraft, while the investment company did not. By Malik Williams malik.williams@ttu.edu Edited By Avery Bertagna.

Court Dismisses UCC Counterclaim but Allows Civil Theft Claim to Proceed in Cattle-for-Feed Agreement Dispute [D CO]

The buyer and the seller entered into agreements for the sale of cattle. The buyer wanted the cattle to be of a certain weight before the sale, so the seller agreed to "background feed" the cattle in exchange for the buyer's promise to pay for the weight gain. Later, the buyer refused to pay for the weight gain of the cattle. Then, the seller put the cattle up for auction, which an auctioneer sold. The auctioneer of the cattle issued a check payable to both the buyer and the seller. The auctioneer included the buyer as a payee of the joint check once discovering the buyer's Uniform Commercial Code (UCC) filings stating that it was the owner of certain cattle sold at the auction. The seller attempted to have the auctioneer remove the buyer from the joint check claiming that the cattle sold at auction were not the same cattle the buyer had identified in the UCC filing. However, the auctioneer declined to reissue the check. The buyer sued the seller, and the seller brought four counterclaims against the buyer. The seller alleged the buyer wrongfully obtained and exercised unauthorized control over the proceeds of the auction arising out of the cattle's weight gain. In response, the buyer filed a l2(b)(6) motion to dismiss the civil theft and UCC counterclaims.

In Titan Feeding, LLC v. Corey Cattle Co., LLC, No. 19-CV-02541-PAB-SKC, 2022 WL 4182457, D. Colo. LEXIS 165173 (D. Colo. Sept. 13, 2022) (opinion not yet released for publication), the court denied the buyer's motion to dismiss the seller's civil theft counterclaim. However, the court granted its motion to dismiss the UCC counterclaim. First, the court considered the civil theft claim. The buyer argued that the civil theft claim should be dismissed because the seller did not allege that the buyer had wrongfully obtained the cattle. The court rejected the buyer's argument because the seller's civil theft claim rested not on the buyer's wrongful control over the cattle, but on the buyer's wrongful control over the auction proceeds. Under this theory, the seller's claims alleged sufficient factual material to survive the motion to dismiss. Next, the court considered the seller's counterclaim alleging that the buyer had failed to comply with its obligations under the UCC by not proceeding in a commercially reasonable manner in enforcing its security interest. On this counterclaim, the court granted the buyer's motion to dismiss. The court granted the motion because the seller had failed to allege that the buyer was a secured party under the UCC. There was no allegation that the parties had ever executed a security agreement and no mention of the other descriptors in the UCC. Furthermore, the court noted that a security interest is not effective unless it has attached, which requires the seller to have authenticated or signed the agreement, and there was no evidence that the buyer's filings reflected a signature or authentication from the seller. By Trevor Shelton trevor.shelton@ttu.edu Edited By Peter Benson.

Tracy Kennedy
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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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