NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

A newsletter covering bank legal and compliance information.

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ARBITRATION

Arbitration Provision in Prepaid Debt Card Unenforceable [9TH CIR]

Upon release from jail, a cardholder received a prepaid debit card. In accordance with state law, during the booking process the jail confiscated the cardholder's cash and returned it to the cardholder in the form of the debit card. Once released from jail, the cardholder received no other option to receive the money confiscated during booking in the form of a debit card. The front of the card had a sticker stating, "This card has already been activated." The text on the back of the card provided that "by accepting and or using this card, you agree to the Account Agreement." The Account Agreement (Agreement) provided for a weekly maintenance fee for the card, a fee for ATM withdrawals, and mandatory arbitration. The cardholder sued the Issuer, arguing he had not entered into a valid contract. Specifically, the cardholder claimed that when he received the card he had not agreed to the terms of the agreement, and also that the agreement lacked consideration. The Issuer argued that the cardholder's retention and use of the card demonstrated the cardholder's intent to accept the terms of the agreement, including the arbitration clause.

In Reichert v. Rapid lnvs., Inc., 56 F.4th 1220 (9th Cir. 2022), the court denied the issuer's motion to compel arbitration. First, the court evaluated the issuer's argument that the card retention demonstrated the cardholder's intent to accept the terms of the agreement, therefore, making the arbitration clause valid. The court rejected the issuer's argument because the cardholder's retention of the card before use could not constitute assent to the agreement. The court reasoned that inaction in response to an offer is not acceptance, and failure to reject an offer is not equivalent to assent. Furthermore, the court stated that the cardholder could not be found to be under a duty to act in which silence or inaction may constitute acceptance. The court explained that none of the applicable actions that constitute acceptance by silence by an offeree to an offer by an offeror were applicable, such as the offeror encouraging acceptance, the parties had a prior course of dealings that would make assent by silence reasonable or expected, or the offeree retaining a benefit by failing to act. The court reasoned none were applicable because the cardholder did not encourage the issuer to consider his silence to be acceptance. Moreover, the cardholder and the issuer had no prior course of dealings that would have imposed a duty on the cardholder to act because they had no pre-contract communications. Additionally, the cardholder did not retain a benefit by leaving the jail with the card and agreement. Therefore, because there were no circumstances that would have placed a duty on the cardholder to act, and because the cardholder's retention of the card did not manifest assent, no contract had been formed.

Next, the court considered whether the cardholder's use of the card constituted assent to the terms of the agreement, including the arbitration provision. The court stated that conduct may constitute acceptance when the "reasonable meaning" of a person's actions is to assent to the offer. The reasonable meaning of a party's actions depends on the circumstances surrounding the transaction. The court reasoned that the circumstances surrounding this transaction between the cardholder and the issuer could not constitute a manifestation of assent by the cardholder because the money the cardholder withdrew happened to be his own money; the card came pre-activated; there existed no other way to obtain immediate use of the cardholder's funds; and because the issuer structured its fees to begin after three days regardless of usage. Therefore, because the cardholder did not assent to the agreement through retention and use of the card, no contract had been formed, and the arbitration provision was unenforceable.

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BANKRUPTCY

Bankruptcy Court Allows Surcharge of Secured Creditors in Connection with Credit Bid [BKR SD TX]

The debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code and filed an application for the employment and retention of auctioneers for the sale of its property. The court approved the retention order, in which the auctioneer agreed to market the assets as a "turnkey offering" for a period of sixty days. The agreement also provided that in the event the turnkey offering did not market successfully, the assets would be subjected to a public auction sale. The agreement provided that the auctioneer would be compensated with a commission of 7% or 5% based on the sale price on the turnkey. The court approved the sale procedures, authorizing: (1) the debtor to sell via turnkey subject to a turnkey minimum within a sixty-day period; and (2) if no bids met the minimum within the period, the debtor would issue a Notice of Auction and seek approval of the procedures by the court. The debtor later filed a notice of proposed allocation to sell an asset to a third-party for less than the turnkey minimum, but many creditors objected to the sale. In response, the debtor filed an Auction Notice and Supplemental Notice of Auction Procedures. Again, many creditors filed objections, arguing that the court did not yet approve the auction sale. Secured creditors objected that their collateral should not be surcharged if they made a credit bid.

In In re Crane, 641 B.R. 850 (Bankr. S.D. Tex. 2022), the bankruptcy court approved an auction subject to approval of auction procedures. In the court's approval of the proposed sale, it had provided that in the event of an auction sale, the court must approve the procedures of the auction sale, including the time and location of the sale, the rules of the sale, and the rules of the auction process. This requirement implemented by the court gave creditors notice and an opportunity to object to the proposed procedures. The debtor and auctioneer contended that the Approval Order between them had contemplated an approval of an auction sale. However, the court rejected this argument because the procedure order explicitly required a second court authorization before commencement of the auction. The court overruled the creditors' objection to the 3% commission unless the court determined in hindsight that the amount was unreasonable, or if it did not benefit the creditor. Bankruptcy Code § 506(c) and cases in the Fifth Circuit interpreting that section provide that a secured creditor may only be charged with administrative expenses if: (l) the expenditure was necessary; (2) the amounts expended were reasonable; and (3) the creditor benefited from the expenses. Ultimately, the court did not decide the amount of a possible surcharge but determined that the surcharge was not prohibited based on § 506(c) and precedents in which surcharges of even 10% had been permitted. The court reasoned that "professionals would be discouraged from providing services to debtors if their fees could be circumvented by credit bidding."

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BANK REGULATION

Vacatur of Bank Employees' Criminal Conviction May Vacate FDIC Ban from Banking [9TH CIR]

In a criminal case, the United States brought charges against two bank executives for conspiring to deprive the bank in which they worked of various property interests. The jury convicted the executives of one count of conspiracy to commit bank fraud and twelve counts of making false bank entries. The executives appealed their criminal convictions and demonstrated the invalidity of the conspiracy and false-entry counts. The appellate court vacated all convictions in favor of the executives because the government had presented invalid legal theories at trial. However, before the appellate court vacated the convictions, the Federal Deposit Insurance Corporation Board (FDIC), relying on the trial court's verdict, had issued an order prohibiting the executives from employment with any insured depository institution. The FDIC also imposed civil penalties for violations of the Federal Deposit Insurance Act. One of the executives appealed the FDIC's order.

In Yates v. FDIC, No. 19-71853, 2022 WL 16916364, 2022 U.S. App. LEXIS 31393 (9th Cir. Nov. 14, 2022) (unpublished opinion), the appellate court vacated and remanded the default order issued by the FDIC in light of the court's intervening decision in the criminal appeal. Because the agency had partially relied on the criminal convictions in issuing its order, vacatur of the criminal convictions required a remand of the civil action back to the FDIC.

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GENERAL LENDING

Paying Off Subordinate Creditor Without Written Consent of Priority Creditor Constitutes Default [TX APP]

The debtor company sued the creditor (the "Senior Creditor") after the Senior Creditor declared two events of default on its loan to the debtor. As a result of the default, the Senior Creditor began charging a default interest rate. The debtor had purchased a hotel by taking out two loans, one of which was with the Senior Creditor. Although the hotel was in Texas, the loan agreement between the debtor and Senior Creditor provided it would be governed by New York law. The various agreements also gave the Senior Creditor priority in the security interests and a right to be paid before the other secured creditor (the Junior Creditor). When the Junior Creditor declared its loan in default because the outstanding amount of the debtor's trade payables exceeded the limit provided for in the loan documentation, the Junior Creditor advanced funds to bring the balance below the limit. The Junior Creditor demanded that the debtor repay the amount advanced and when that amount was not repaid, the Junior Creditor accelerated its loan. When the junior loan was paid off by another entity, the Senior Creditor declared a default because it had not consented to the payment of the Junior Creditor.

In 1701 Commerce Acquisition, LLC. v. Macquarie US Trading, LLC., No. 02-21-00333-CV, 2022 WL 3904976, 2022 Tex. App. LEXIS 6697 (Tex. App.-Fort Worth. Aug. 31, 2022) (unpublished opinion), the court ruled in favor of the Senior Creditor and found the Senior Creditor properly declared a default. The court did not agree with the debtor's argument that the loan documents did not prohibit prepayment of the Junior Creditor's loan. The debtor argued that the entity that had repaid the Junior Creditor on its behalf was not an entity forbidden to make a prepayment to the Junior Creditor under the documentation. However, the court noted that while that may have been true, the documentation also created grounds for default when any such a prepayment was made without the consent of the Senior Creditor. In addition, the debtor also contended that the prepayment was neither a settlement of the loan nor a payoff of the subordinate loan. Disagreeing with the debtor yet again, the court noted that the document used to discharge the loan characterized the payment as a payoff, not a settlement. Accordingly, the court affirmed the lower court's ruling with respect to the liability of the debtor for the default interest, but on the issue of the attorney fees that had been awarded in favor of the Senior Creditor, the court reversed. Following New York law as provided for in the loan agreement, the court held that the language in the document lacked enough specificity to allow for an award of attorneys' fees.

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Balance Theories in Calculating NSF Fees [7TH CIR]

The debtor contracted with a credit union (the creditor) based in Illinois that engaged in business solely over the internet. The debtor contended that the creditor breached its contract by charging her a nonsufficient fund fee when her account had sufficient funds for her transaction. The debtor filed a breach of contract action, alleging that the nonsufficient fund fees violated the contract. The debtor contended that the "ledgerbalance method" remained the correct method to calculate an NSF fee under the contract. Conversely, the credit union asserted that the "available-balance method" is the calculation provided for in the contract. The debtor relied on the account balance theory, alleging that the agreement unambiguously prohibits the creditor from charging nonsufficient fund fees when the account has sufficient funds under the ledger account balance method. Additionally, the debtor argued that the agreement prohibits multiple fees when a merchant repeatedly attempts to charge the account.

In Page v. Alliant Credit Union, 52 F.4th 230 (7th Cir. 2022), the court affirmed the decision of the lower court to dismiss the debtor's action for failure to state a claim. The court found the agreement unambiguous and found that it did not require the creditor to follow the ledger-balance method. In construing the contract's language, the court disagreed with the debtor's contention that "insufficient account balance" meant the ledger balance shown to her rather than the account balance absent any recent transactions. Specifically, taking the contract as a whole, its language throughout the document provided that if there were insufficient funds in the account, the account could be subject to being charged an NSF fee. Indeed, looking within the four corners of the contract, the court concluded the average person would not read the language differently in subsections throughout the contract. Additionally, the debtor asked the court to rely on similarities between the contract at issue in this case and a Georgia case involving a similar issue in which the court reversed a motion to dismiss based on the finding that the language was ambiguous. The court rejected this argument, stating that the words connecting "available" to overdraft funds were much closer in this contract than in the contract at issue

in the Georgia case. Finally, the court rejected the debtor's contention that the agreement provided that the creditor could only charge a $25 fee once per transaction because the agreement provided: "Nonsufficient Fund Item (each)." The debtor alleged that the meaning of the word· "item" relates to only a single transaction, which would not include any transactions charged more than once by a merchant. The court looked to the provision in the contract, which stated that the creditor was not required to notify the debtor of insufficient funds or other items. The court then determined that the term 'insufficient funds' as used in the contract meant items and fees could be charged multiple times. For these reasons, the court affirmed the decision of the lower court to dismiss the debtor's claim.

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PROCEDURE

Action Against Attorneys for Taking Advantage of Affluent and Afflicted Client Remanded to State Court [SD TX]

The movants, a bank and an individual, were the Guardian Ad Litem for a wealthy woman who suffered from a major neurocognitive disorder. The respondents had represented the wealthy woman in a large real estate transaction. The movants had complained that the respondents took advantage of the woman's cognitive impairment by persuading her to sign an agreement changing a fee agreement for assisting her in selling a ranch from an hourly rate to a contingency fee. After the parties entered into the new agreement, the property sold for nearly $40 million, and the respondents received about $10 million as provided in their (new) 24% contingency fee. The movants had originally filed the action in state court. Thereafter, the respondents removed the case to federal court. Accordingly, the movants filed their motion to remand the case to the state court. The district court had before it the issue of whether to grant the movant's motion to remand the case to the state court. In support of its removal of the action, the respondent contended, in part, that the movants' complaint federal claims against another bank, with respect to the Electronic Fund Transfer Act.

In Breland v. Law Office of Debra Jennings, No. 4:22-CV-3284, 2023 WL 1965997, 2023 U.S. Dist. LEXIS 23625 (D. Tex. Feb. 13, 2023) (mem. op.), the court remanded the case to state court for lack of federal jurisdiction. The respondents argued federal question jurisdiction was apparent based on the artful pleading doctrine. Specifically, the respondents argued that that the movants purposefully left out the claim against the bank to prevent pleading federal claims and therefore prevent the case from being removed to federal court. However, the artful pleading doctrine only permits federal question jurisdiction over a state-law claim in two situations. First, federal question jurisdiction is permitted when Congress has expressly provided for that jurisdiction, and the second instance is when a federal statute wholly displaces the state-law cause of action through complete preemption. The respondents did not show either circumstance. The court stated that ultimately, when neither exception applies, the complainant is the master of his complaint and may allege only state law causes of action, even when federal remedies might also exist. The court also noted that a state-law cause of action does not raise a federal issue simply because the parties may ultimately litigate a federal issue. Because the respondents were unable to establish federal jurisdiction, the court granted the movants' motion to remand the case to state court.

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REAL ESTATE LENDING

Borrowers' Claims to Undo Non-Judicial Foreclosure Fail [9TH CIR]

The borrowers lost their home to a nonjudicial foreclosure conducted by the lender bank. The borrowers sued the lender on several different grounds. They first claimed the lender had no interest in the property because the loan assignment had been invalid. Second, the borrowers argued for promissory estoppel. Third, they asserted a dual-tracking violation of California's Civil Code. Fourth, they claimed a violation of the Fair Debt Collection Practices Act (FDCPA). Lastly, they brought a claim under the Truth in Lending Act (TILA) and argued the Act's statute of limitations should be equitably tolled. The district court dismissed all the borrowers' claims. The borrowers appealed.

In Tagoia v. Wells Fargo Bank, N.A., No. 19-15216, 2022, WL 4233636, 2022 U.S. App. LEXIS 26042 (9th Cir. Sept. 14, 2022) (unpublished opinion), the appellate court sustained the district court's dismissal of all five of the borrowers' claims. The court first held the borrowers failed to allege facts establishing a void assignment. If an assignment violates the pooling and servicing agreement, the assignment is not void, but becomes voidable, which requires one of the parties to the agreement to void it. However, the court noted the borrowers were not parties to the assignment agreement. On a related point, the court ruled the assignment did not need to be recorded under California law because it involved a deed of trust. Second, the court held the borrowers failed to allege facts establishing the

elements of promissory estoppel. Moreover, the bankruptcy documents contained a stipulated order that declared the lender could foreclose in the event of non-payment. Third, the court upheld the dismissal of the borrowers' dual tracking violation claim under California law because the alleged events predated the relevant statute's enactment. Fourth, the court found the borrowers' claim under the FDCPA to be without merit because the Act does not cover "actions taken to facilitate a non-judicial foreclosure." The court also found that the borrowers failed to allege facts establishing the bank was a "debt collector." Finally, the court held the one-year statute of limitations barred the borrowers' TILA claim. The court ruled tolling of the statute of limitations was unavailable even if the lender had failed to disclose required information. Ultimately, the court affirmed the district court.

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REGULATIONS

CFPB Suggested Language Does Not Constitute Mandatory Model Clause [D.C. APP]

The Electronic Fund Transfer Act (EFTA) requires financial institutions to disclose the specific "terms and conditions" of electric fund transfers "at the time the consumer contracts for an electronic fund transfer service." The Bureau of Consumer Financial Protection (CFPB) promulgated the "Prepaid Rule" which requires account providers to disclose certain information before a consumer acquires an account and begins transactions. Prepaid Rule, 81 Fed. Reg. at 83,934-43; see also 12 C.F.R. § 1005.2(b)(3)(i)(A)-(D). One of the disclosures, the "short form disclosure," includes only a subset of all fees that could arise from a prepaid account. 12 C.F.R. § 1005.18(b)(2), (4). PayPal sued CFPB, challenging the Prepaid Rule under the Administrative Procedure Act (APA) and the U.S. Constitution. PayPal claimed that the Prepaid Rule exceeded the CFPB's statutory authority because the agency's formatting and content requirements mandated the adoption of a model clause, which is contrary to the EFTA, which allows only "optional" clauses.

In PayPal, Inc. v. Consumer Fin. Prot. Bureau, 58 F.4th 1273 (D.C. Cir. 2023), the court proceeded on the assumption (shared by PayPal and the CFPB) that the EFTA prohibits mandatory model clauses and considered whether the Prepaid Rule is such a clause. The court concluded that the EFTAs reference to a "model clause" means "specific and copiable language" rather than content and formatting. Because the Prepaid Rule did not require PayPal to use specific language, it did not mandate a "model clause." The court further held that the Prepaid Rule, in connection with CFPB's legally required disclosures, may constrain the range of disclosure language, but does not make the optional model clauses mandatory ones. The D.C. Circuit declined to address the APA and constitutional challenges and reversed and remanded the case to the district court.

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SECURITY INTERESTS

Ferrari Drives Bank to a Loss Because Ordinary Course Buyer Beats Secured Party [TX APP]]

A bank (bank) entered into an agreement with a car dealership (debtor) to provide floor-plan financing to purchase used cars to resell. The used cars secured the financing agreement between the bank and the debtor. The agreement also provided that the debtor would repay the bank as each car sold. The debtor purchased a Ferrari for resale. A buyer purchased the Ferrari, took possession of the vehicle, and received the title; however, the buyer did not apply for the title in his name immediately and left the title at the debtor's dealership with a friend. A few days after purchasing the car, the buyer brought the Ferrari back to the debtor's car lot while he went out of town. The debtor presented the Ferrari and its title to the bank for a $100,000 advance under the financing agreement. After the debtor defaulted on the floor-plan financing agreement, the bank sued the debtor to recover on the note. In addition, the bank added multiple individuals to the suit, including the buyer of the Ferrari, alleging that the buyer had conspired with the debtor to deprive the bank of its security interests in the vehicles. The buyer filed a countersuit against the bank for conversion and tortious interference with an existing contract. The buyer asserted the affirmative defense that he was a bona fide purchaser of the Ferrari. Later, the buyer moved for summary judgment, seeking damages and attorney's fees. The bank challenged the motion for summary judgment and the buyer's defense, arguing that its rights were superior to those of the buyer because it had a perfected security interest, having obtained a security interest in the vehicle, and having filed a proper financing statement.

In One World Bank v. Miller, No. 05-21-00705CV, 2023 WL 333712, 2023 Tex. App. LEXIS 363 (Tex. App.-Dallas Jan. 20, 2023, no pet.) (opinion not yet released for publication), the court found that the Business and Commerce Code §§ 9.320(a) and 1.201(b)(9) governed the dispute, stating that when the buyer received the certificate of title and took possession of the Ferrari, he was a good faith purchaser and a

buyer within the ordinary course of business. The court further acknowledged the bank had properly perfected its security interest in the automobile inventory. The court explained, however, that a buyer in the ordinary course of business "takes free of a security interest created by the buyer's seller, even if the security interest is perfected." The bank did not provide evidence that the buyer knew of the financing agreement or that the Ferrari would be used to obtain an advance on the line of credit. Accordingly, the buyer convinced the court that he was entitled to a judgment of law on his conversion claim because he demonstrated that he had a superior title. Finally, the court determined that section 70.008 of the Texas Property Code allowed for recovery of attorney fees in "a suit concerning possession of a motor vehicle" and "a debt due on it." Therefore, the court awarded the buyer his attorney's fees, in an amount greater than $76,000.

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No "Deemed Acceptance" of Plan; Faulty Financing Statement [BKR WD MI]

The 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, the creditor, in a class by itself, did not return the ballot indicating either its rejection or acceptance of the debtor's plan. Because Congress neglected to address this situation of no ballot being returned from a class of claims when it enacted the Bankruptcy Code, courts have split on how to resolve the issue. Some courts hold that the class should be deemed to have rejected the plan; a few courts hold that the class should not be deemed to have rejected the plan. Here, the bankruptcy court held that the plan should be deemed to have been rejected by the class, and therefore designated the debtor's plan as being a "cram down" plan under § 1191(b) rather than a consensual plan under § 1191(a). This determination had important implications for the subchapter V debtor if the plan is consensual, the debtor pays creditors in accordance with his or her proposed plan. By contrast, if the plan is nonconsensual, the debtor is obligated to pay creditors three to five years of its discretionary income. In an effort to have his plan treated as a consensual plan, the debtor argued the court should have adopted the Tenth Circuit's "deemed acceptance" precedent to treat the debtor's plan as being a consensual plan.

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, In re Ruti-Sweetwater, 836 F.2d 1263 (10th Cir. 1988), as "an out-ofcircuit case representing the minority position." Third, the court found the deemed acceptance theory irreconcilable with Federal Rule of Bankruptcy Procedure 3018(c), concerning acceptance and rejection of reorganization plans. Fourth, although the court questioned the wisdom of allowing a non-voting 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 non-voting creditor was in fact a secured creditor. After examining the financing statement in the record, the court held that the creditor was unsecured because the creditor's financing statement misidentified the individual debtor as an organization with the name "PAUL KEVIN CREASON dba DR PAUL CREASON FAMILY DENTISTRY." Indeed, debtor's counsel indicated to the court that the financing statement could not be located in the state's database and the court noted that the Michigan Secretary of State's search logic would not have uncovered the financing statement.

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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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