NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

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BANKING REGULATION

Bank was Entitled to Restitution After Teller's Mistake of Fact [6TH CIR]

The insurer contracted with Insured to obtain crop insurance for a farm owned by Insured. Through its agent, the Insurer assisted the Insured in obtaining a policy from an insurance company. Later that year, Insured discovered that certain portions of his property could not be farmed due to excess moisture. Insured filed a claim under the policy. The Insurer denied the claim, however, claiming it was beyond the scope of the policy. Although no formal resolution had been reached, the Insurer and its agent issued two checks to Insured drawn from Insurer's Bank. At the time the checks were written, however, Insurer's account had insufficient funds to cover the draws. According to Insurer's agent, he wrote these checks because of a perceived moral obligation to Insured. In exchange for these two checks, a teller at Insured's bank mistakenly issued two teller's checks. Insured later sued the Bank to enforce the teller's checks. The insured testified that he had given nothing in consideration for the checks.

In Goodman v. Commercial Bank & Tr. Co.,72 F.4th 122 (6th Cir. 2023), the court concluded that the Bank teller's erroneous belief, while paying a check, that the underlying account contained sufficient funds, constituted the type of mistake eligible to be remediated by restitution. The case turned on the interpretation of Articles 3 and 4 of the Tennessee U.C.C., "which largely tracks the Uniform Commercial Code." The record indicated that the Bank's teller felt "rushed" and was working under the assumption that the funds were available, an assumption that was not in accordance with the facts. The court held that a "mistake of fact" by the teller occurred, meaning Insured was not entitled to payment on the Insurer's checks he had attempted to cash. While the teller did not explain the basis for her apparent expectation that the funds were in the account, Tennessee's statute does not require an explanation for the payor's mistake of fact. Further the statute contains no negligence exception. Additionally, the court reasoned that Bank's teller did not choose to extend credit to Insurer's agent-she merely assumed (incorrectly) that Insurer's account had sufficient funds to cover the checks. Under Tennessee law, the teller's mistake of fact is enough to make the Bank eligible for restitution. Lastly, even with the Bank's mistake qualifying for restitution under Tennessee's Commercial Code, the Insured would not have been obligated to pay restitution unless he took the Insurer's checks "in good faith and for value." The payment of an antecedent claim is a transfer "for value." Conversely, a moral obligation alone is not a sufficient consideration to sustain a promise." The insurer's agent gave the checks to Insured because he felt "morally obligated to help" him, not in exchange for a release of claims by Insured. Indeed, Insured never gave the Insurer or Insurer's agent anything in return for these payments. Thus, the court held that Insured did not take the Insurer checks for value. The checks were nothing more than a gratuitous gift. The insurer failed to satisfy the "for value" requirement, and thus, the Bank was entitled to restitution. Accordingly, the court affirmed the judgment of the district court.By Elijah Benzvi, Elbenzvi@ttu.edu.

Bank Account Agreements May Not Always Modify the UCC Article 4A Notice Periods [SD MS]

A chief executive officer (officer") of a construction corporation (corporation) opened a checking account (account l) on behalf of the corporation with a bank (bank). When account 1 was opened, an account agreement was referenced in the checking account application, but the bank did not provide the officer with a copy of the agreement. Several years after account 1 had been opened, the fraud department of the bank contacted the officer, informing the officer the account had been compromised and asked the officer if the corporation had authorized payments to three individuals. The officer responded that the individuals were not known, and the payments were not authorized. The bank advised the officer to come to the bank and close account 1. While at the bank to close account l, the officer opened a second account (account 2). The bank transferred the remaining funds from account 1 to account 2. Shortly after the officer opened account 2, the

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bank allowed unauthorized transfers from account 2 to the same individuals as before. A bank representative informed the officer of the transfers. The officer again confirmed that the transfers were not authorized and requested the return of the funds from all unauthorized transfers. The bank claimed that under the account agreement, the corporation had 14 days to report unauthorized electronic fund transfers. Because the corporation had not timely reported the transfers, the corporation waived its right to reimbursement. Displeased with the bank's position, the corporation brought multiple common law claims against the bank. Following discovery, the corporation filed a motion for partial summary judgement, alleging that the bank was obligated to refund the principal amount of the unauthorized transfers plus interest. In response, the bank filed its own motion for summary judgment, maintaining that its obligations to the corporation were permissibly modified by the account agreement. Furthermore, the other claims advanced by the corporation must be dismissed, the bank argued, because the state's adoption of Article 4A of the Uniform Commercial Code (UCC) displaced common law claims.

In JESCO Constr. Corp. v. Wells Fargo Bank, N.A., 579 F. Supp. 3d 827 (S.D. Miss., 2022), the court held that because the state of Mississippi had adopted and codified Article 4A-204 of the UCC verbatim, the plain language of the statute, informed further by the official comments, determined that the oneyear notice period for reporting fraudulent transactions and obtaining a refund of the principal amount of the transfers could not be modified by agreement. In addition, there was no genuine dispute of material fact that the transfers were unauthorized or that the customer had reported them within one year. The court granted partial summary judgment to the customer, entitling it to a judgment for the principal amount of the transfers, which had not yet been refunded. However, the 14-day timeperiod set forth by the agreement did bar the recovery of some interest because 4A-204(b) of the Mississippi UCC (and the official version) allowed the time for notice of an unauthorized transfer with respect to the right to receive interest on the unauthorized transfer to be varied by agreement. The bank's motion for summary judgement was granted in part, however, to dismiss the customer's claim for punitive damages because both the UCC and Miss. Code Ann. § 11-1-65(1)(a) reserve punitive damages for "extreme cases." The customer's additional UCC claim and state-law claims presented material fact questions for a jury to resolve and Wells Fargo had not pointed the court to a specific Article 4A provision prohibiting the remedies sought. Accordingly, those claims were not dismissed. By Melissa Hightower, mehighto@ttu.edu.

BANKRUPTCY

Pre-petition Substitution of Creditors not Avoidable in Bankruptcy [7TH CIR]

Before a company (the debtor) declared bankruptcy, the company entered into a payoff agreement under which a new lender paid the company's debt to one of its existing creditors and the new lender obtained the old lender's security interest in the company's accounts. The debtor's CEO has been fabricating invoices from fake companies to make it seem like the fake companies owed money to the debtor and sold those invoices to creditors to create the appearance that the company was a flourishing business when in fact it was quite the opposite. When the company declared bankruptcy, the trustee sued the old creditor to avoid the payoff, claiming that the payoff agreement was avoidable as both a preferential and a fraudulent transfer. The bankruptcy court dismissed the suit because the payoff agreement did not qualify as a transfer of an interest of the debtor in property and it therefore was not avoidable. The district court affirmed. The trustee then appealed.

In Mann v. LSQ Funding Grp., LLC, 71 F.4th 640 (7th Cir. 2023), the circuit court held that the trustee failed to show that the transfer involved "an interest of the debtor in property," which is required to avoid both preferential and fraudulent transfers. The court began its analysis by looking at the preferential transfer argument. The circuit court noted that Bankruptcy Code §547 only allows transferees to avoid transfers of "an interest of the debtor in property." The court then defined what "an interest of the debtor in property" means, stating that it is property that would have been part of the estate had it not been transferred before commencement of the bankruptcy case. Both parties agreed that the funds would not have been part of the debtor's estate and that the funds never actually passed through the debtor's account. Additionally, the change in creditors was instantaneous and the transaction had no adverse effect on other creditors. The court concluded that the transfer at issue did not involve "an interest of the debtor in property" so it could not be avoided as a preferential transfer. The court then discussed the argument that the transaction constituted a fraudulent transfer. The court stated that § 548 of the Bankruptcy Code contains that same phrase as § 547. The court reasoned that because of the plain language of the text, controlling Supreme Court precedent, and the view of other circuits, the phrase "an interest of the debtor in property" means the same thing in both Bankruptcy Code sections 547 and 548. The court concluded by reasoning that because the transaction had no impact on the property of the debtor, it was not the type of fraud that constituted a fraudulent transfer. Accordingly, the court affirmed the district court's judgment that the transaction could not be avoided. By Ashley Boyce, ashboyce@ttu.edu.

Debtor was Authorized to use Secured Creditor's Cash Collateral [BKR SD NY]

Creditors filed an involuntary petition seeking an order of relief against the Debtor and the court entered the order for relief against the debtor. However, the Debtor remained in possession of its property and continued to operate and manage its business, to the extent required, as a debtor-in-possession. The Debtor's sole asset was a hotel and its surrounding complex, and its sole business was to lease the asset. The Debtor had obtained a loan, which was secured by a mortgage on the hotel. The Debtor, operating as a lessor, entered into a lease agreement with a Lessee for the hotel. The rent payable under the Lease was structured to enable Lessor to service the promissory note, which was secured by the mortgage against the hotel. Later, by assignment, the trustee for the lenders (the Lender'") acquired all tights, title, and interest in the note and mortgage. All cash coming into the Debtor's possession after the petition date, including the post-petition payments, rents, and other revenue received, and any funds paid to the Debtor from any source, was the Lender's cash collateral. Debtor argued that it required immediate access to the cash to ensure that it could continue to operate its business during the Chapter 11 case, preserve the value of its estate for the benefit of all parties in interest, and, most importantly, maximize value for all constituents in the case. Other than the cash collateral, the Debtor claimed that it did not have access to funds sufficient to pursue the Chapter 11 case. The Debtor, therefore, sought approval to use the cash collateral.

In In re Wythe Berry Fee Owner LLC, No. 22-11340 (MG),2023 WL2483427, 2023 Bankr. LEXIS 645 (Bankr. S.D.N.Y. Mar. 13, 2023) (unpublished opinion),' the Debtor was authorized to use the Lenders' cash collateral. First, the court found that the Debtor has complied with the relevant local and bankruptcy rules for its cash collateral motion by 1) including a concise summary of the requested relief, the secured claim, the proposed adequate protection payments; 2) by prominently highlighting and explaining the material provisions required by Local Rule 4001-2; and 3) by including the budget to which the Debtor will be subject. Second, the court found that the Debtor should have been permitted to use cash collateral because the Lender had consented to its use under the terms and conditions set forth in the cash collateral order and the proposed budget. Third, the court found that the cash payments, replacement liens, and priority administrative expense claims provided adequate protection to the creditor. Finally, the court approved a removal stipulation, removing a state court action to the bankruptcy court. As a condition of not objecting to the cash collateral motion, a creditor and the Debtor had agreed to remove this state court action to the bankruptcy court. Because there were no objections to this arrangement and the removal allowed the court to administer one of the most significant disputes of the Debtor, the court approved the removal stipulation. By Elijah Benzvi, Elbenzvi@ttu.edu.

LENDING

"Express Purpose" Means Specific Purpose, Not Sole Purpose Under the Military Lending Act [4TH CIR]

A United States military member (the "borrower") sought a loan from United Auto Credit Corporation (the "lender") for the purchase of a car. The Military Lending Act (the "Act") regulates lenders when they extend consumer credit to military members. However, the Act has a specific exception for loans made for the express purpose of financing a car purchase. This exception removes auto loans from the Act's restrictions on consumer credit loans to military members. In this case, the borrower used the loan from the lender to purchase a car, but in addition to the car, he used the loan to buy extra insurance in the form of guaranteed asset protection. "Guaranteed Asset Protection," the court explained, "is like extra insurance, covering any amount still due on the car loan after auto insurance is paid out if the car is totaled or stolen." The borrower sued the lender, claiming the loan violated the Act because the loan agreement mandated arbitration and failed to disclose certain information. The borrower argued that because the loan was used to purchase something other than the car, here, the extra insurance, the loan did not fall within the auto loan exception of the Act and the loan should be treated as a regular consumer credit loan. The district court dismissed the case, ruling that the loan fell within the Act's auto loan exception, and the borrower appealed.

In Davidson v. United Auto Credit Corp., 65 F.4th 124 (4th Cir. 2023), the appellate court affirmed the district court's ruling that the loan given to the borrower fell within the Act's auto loan exception even though the borrower had purchased extra insurance with the car. Looking at the language of the Act, the court reasoned that if a loan is given "for the express purpose" of financing a car purchase, then the Act does not apply to the loan. "For the express purpose" as used in the Act, means for the specific purpose, the court reasoned. Thus, the court ruled that a loan with the specific purpose of financing a car purchase still satisfies the Act's exception, even if it has other purposes. The court found that the borrower's interpretation of "for the express purpose" to mean "sole purpose" was incorrect given the context behind the Act. The court explained that when interpreting statues, its job is to interpret the words consistent with their ordinary meaning when Congress enacted the statute. Here, the court first looked

to dictionaries to find the ordinary meaning of the phrase "for the express purpose." The court could not get a conclusive answer because the dictionaries the court relied on had differing definitions and were inconsistent. With no solution in the phrase's plain meaning, the court turned to the context behind the Act. Ultimately, the court found the context of the Act revealed that the phrase "for the express purpose" is a conditional statement within the Act. When "for the express purpose" is used as a conditional statement, it means for the specific purpose, not for the sole purpose-the specific purpose is financing the purchase of a car. As a result, the court found under 10 U.S.C. § 987(i)(6), a loan is excluded from the Act if it was: (1) procured in the course of purchasing a car; (2) offered for the express purpose of financing the purchase of that car; and (3) secured by the car. The circuit court noted that the few federal courts to address the issue agreed with its conclusion. Nevertheless, one of the circuit court judges filed a dissent. By Riley Caraway, rcaraway@ttu.edu.

Foreclosure Upheld Due to Debtor's Improper Pleadings and Lack of Evidence [9TH CIR]

A debtor (the debtor) and his now deceased wife obtained a loan from a lending company. The loan was evidenced by a note and secured by a deed of trust on the debtors' home. A bank received an assignment of the note, and then retained a mortgage service company to service the loan. The debtors fell behind on payments, and the mortgage service company's agent (the "agent") commenced a foreclosure action. The agent placed a notice on the door of the debtor's home informing him of his debt to the bank. Later the debtor received a Notice of Default, a Notice of Foreclosure, and a Notice of Trustee's sale. The debtor attempted to postpone the sale of the house, but the agent refused to postpone the sale. The debtor filed an action, and the district court granted a preliminary injunction. Later, however, the district court then granted summary judgment against the debtor.

In Tierney v. Carrington Mortg. Servs., No. 22-35221, 2023 WL 2783241, 2023 U.S. App. LEXIS 809l (9th Cir. Apr. 5, 2023) (unpublished opinion), on appeal, the circuit court addressed each of the four issues raised by the debtor. The debtor attempted to show that the bank could not seek non-judicial foreclosure. The court determined that, because the debtor was not at risk of double paying the debt, he lacked standing on this issue. Next, the court evaluated the debtor's Fair Debt Collection Practices Act (FDCPA) claim, which requires that the lending company be a debt collector. In the debtor's original complaint, he failed to sue the agent, and only sued the mortgage company and the bank. Therefore, the court found it was unclear whether the debtor properly had pied a FDCPA claim. The court held that, despite the pleading issue, the claim still would have failed because neither the agent, the mortgage company or the bank qualified as debt collectors under the FDCPA. The circuit court relied on Obduskey v. McCarthy & Holthus LLP, 139 S. Ct 1029, 1033, 203 L. Ed. 2d 390 (2019), in which the Supreme Court had held that an entity "principally involved in 'the enforcement of security interests' is not a debt collector except for [one section of the FDCPA]." The court then looked at the Washington State Consumer Protection Act (CPA) claim and determined that it failed because the debtor claimed that he had lost equity in his home due to having been prevented from taking action to avoid foreclosure. The debtor, however, had failed to prove damages. Finally, the court looked at the negligence claim against the agent and determined the district court improperly analyzed the issue. However, despite this, the court denied the claim because the debtor had failed to prove damages and had presented no evidence of the claim. Overall, the court affirmed the decisions of the district court. By Avery Bertagna, abertagn@ttu.edu.

TRUTH IN LENDING ACT

Borrower Fails to Bring Timely Claims and State a Claim for Relief [2D CIR]

Following alleged misconduct connected to a mortgage loan, the borrower sued the lender claiming that the lender violated the Truth in Lending Act ("federal TILA"), the Connecticut Truth in Lending Act ("Connecticut TILA'"), and the Connecticut Unfair Trade Practices Act (CUTPA). The borrower also brought state law negligence, negligent infliction of emotional distress, and breach of the implied covenant of good faith and fair dealing claims. The lender filed a motion to dismiss the complaint in the district court, which was granted. The district court reasoned that the borrower's federal TILA, Connecticut TILA, and CUTPA claims were untimely, and the remaining causes of action failed to state a claim for relief. The borrower then appealed.

In Edwards v. McMillen Capital, LLC, No. 21-1024-cv, 2022 WL I6984534, 2022 U.S. App. LEXIS 31755 (2d Cir. Nov. 17, 2022) (unpublished opinion), the appellate court affirmed the district court's finding that the borrower's federal TILA, Connecticut TILA, and CUTPA claims were time barred and the remaining causes of action failed to state a claim for relief. The court began by discussing the federal and Connecticut TILA claims. For both the federal and state law, the claims generally must be brought within one year of. the violation, although some claims have an extended statute of limitations of three years. This claim, however, was brought nearly six years

after the mortgage had been executed. The borrower claimed the "discovery rule" applied here, which only applies to open-end transactions. Contrary to the borrower's belief, the transaction at issue was a closed-end transaction because it did not contemplate future disbursements or repeated transactions. Therefore, the discovery rule did not apply. The court then discussed the CUTPA claim, which also has a statute of limitations of three years, making it also time barred here. The court discussed the possibility of the "continuing course of conduct doctrine" being applied but concluded that it does not apply here because there were no allegations that suggested the borrower and the lender were in a special fiduciary relationship. Finally, the court discussed the remaining state law claims, and once again agreed with the district court. The borrower's negligence claims failed to identify a duty owed to the borrower by the lender. The claim for breach of the implied covenant of good faith and fair dealing failed because the borrower failed to explain how the lender improperly denied him the benefits of the contract he signed when the complained-of terms were clear and explicit. The court concluded that the district court was correct in dismissing each of these claims and affirmed the judgment. By Ashley Boyce, ashboyce@ttu.edu.

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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