NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

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BANK REGULATIONS

Banking Codes Preempt Common Law Claims [ED PA]

The supply chain company and a shipping company exchanged emails regarding the supply chain company paying the shipping company. A hacker hacked into the shipping company's email and sent the supply chain company fraudulent instructions for wiring money to the shipping company. While the wire instructions identified the shipping company as the recipient, the specified account number was different. The supply chain company wired the money to the supply chain company through the bank. The bank completed the transfer despite the recipient account number differing from the shipping company's known account number, resulting in the supply chain company sending hundreds of thousands of dollars to the hackers. The supply chain company sued the bank for negligently completing the transfer and failing to "timely freeze the identified funds."

In **Zhejiang Matrix SCM Co. v. PNC Bank, N.A.**, No. 23-0979, 2024 WL 1096534, 2024 U.S. Dist. LEXIS 44671 (E.D. Pa. March 13, 2024) (opinion not yet released for publication), the court approved the bank's motion to dismiss. The supply chain company sued asserting common law negligence. In Pennsylvania, common law claims for funds transfers, including wire transfers, are preempted by Article 4A of the Pennsylvania Commercial Code. Consequently, the court dismissed the supply chain company's claim regarding the bank's negligence in approving the wire transfer. Regarding the bank's failure to freeze the supply chain company's funds after approving the transfer, Section 606 of the Pennsylvania Banking Code states that for a party other than the recipient party or another party approved to remove money from the recipient account to make a claim concerning control over a deposit account, that party must "obtain and serve on the institution an appropriate order directed to the institution by a court restraining any action with respect to the account or property . . . or . . . deliver to the institution a bond." The supply chain company did not do so, and thus, the court dismissed the supply chain company's claim concerning the bank's failure to freeze the deposited money. The court further held that the supply chain company could not amend its complaint. Following case law from other courts, the court held that a party may only sue a bank with which it is in privity. As the supply chain company was not a customer of nor in privity with the bank, the supply chain company could not sue the bank under Article 4A. Furthermore, the supply chain company could not sue the bank under an amended negligence claim because the bank had no duty of care to the supply chain company.

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Plausible if True? Go on Through [WD TN]

The account holder discovered it could not access its commercial bank account with the bank. The account holder contacted the bank and spoke to multiple bank employees about the issue, but none of them could give the account holder access to its account. Next, the account holder contacted another bank employee, who informed the account holder of a pending wire transfer. The account holder stated that this transfer was fraudulent and requested its cancellation. However, the bank employee took no action. Additionally, it was the bank's practice to call and clear wire transfers with the account holder. Despite this practice, the bank did not call the account holder before initiating the transfer. Following the transfer, the account holder filed a complaint against the bank and later moved to amend its complaint, alleging that the bank violated Article 4A of the Tennessee UCC, the Tennessee Consumer Protection Act {TCPA), negligence, and breach of contract. The bank moved to dismiss, alleging the "proposed amendments are futile."

In **Zen-Bio, Inc. v. Regions Bank**, No. 2:23-cv-02475, 2024 WL 1053337, 2024 U.S. Dist. LEXIS 42273 (W.D. Tenn. Mar. 11, 2024) (unpublished opinion), the court granted the bank's motion in part and denied its motion in part. First, the court held that the account holder's Article 4A claim under T.C.A.

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§ 47-4A-202 and § 47-4A-203 could not be dismissed as futile because the account holder's allegations, if true, would not be futile, and the bank's argument for dismissal hinged on factual issues that must be decided during trial. Second, the court dismissed the account holder's negligence and breach of contract claims as futile because Article 4A preempted them. Third, the account holder's TCPA claim was dismissed because the account holder did not allege any of the fifty-two acts that would constitute a violation of the statute; therefore, the court found that the account holder's TCPA claim had not been pleaded with sufficient particularity. Fourth, the court dismissed the account holder's "good faith" claim under T.C.A. § 47-4A-105(a)(6) because that section references definitions and does not create a cause of action. Finally, because not all of the account holder's substantive claims were dismissed, the court granted the account holder leave to amend its complaint for punitive damages and attorney's fees.

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BANKRUPTCY

Tinkering with Chapter 13 Repayment Plan Results in Bad Faith: Entire Case is Thrown Out [BKR ED WA]

Two debtors filed for Chapter 13 Bankruptcy a few months after purchasing two new cars. The debtors purchased the two cars on credit and each had outstanding loans that would be due at the end of the 60-month bankruptcy plan. When creating their proposed repayment plan for their bankruptcy filing, the debtors included payments on the car loans that were significantly larger than what they were contractually required to pay each month. This meant that, under the debtors' proposed plan, less funds would remain to pay any unsecured creditors over the course of the Chapter 13 plan. The Chapter 13 trustee objected to this payment plan arguing that it improperly calculated monthly debts. The debtors argued that the cars had to be paid in full during the bankruptcy plan under the "910 Claims" rule; thus, the accelerated and higher payment schedule for the cars.

In In Re Page, 658 B.R. 178 (Bankr. E.D. Wash. 2024), the court not only rejected the debtors' proposed repayment plan but also found bad faith on the debtors' part, causing the entire Chapter 13 case to be dismissed. The court first examined the 910 Claim (known as the "Hanging Paragraph" to Bankruptcy Code § 1325(a)) to determine if it required that a loan with a repayment plan ending after the Chapter 13 plan must be re-amortized to be fully paid off within the plan's timeline. _The court examined the purpose of the Hanging Paragraph and determined that it was enacted to prevent the splitting of car loans into secured and unsecured portions; in other words protecting creditors from only being able to recover the actual value of the car in lieu of the amount of the car loan. The court found that the Hanging Paragraph had nothing to do with causing a loan to be re-amortized and that the debtor's plan should have included the contractual repayment amount for the car, not the higher re-amortized amount. The court reasoned that allowing the higher payment amount would harm the unsecured creditors while simultaneously granting a windfall to the car loan creditors by providing an earlier payoff. Next, the court mentioned the good faith requirement required by the debtors when creating their repayment plan. If it is found that a debtor "misrepresented facts in his plan, unfairly manipulated the Bankruptcy Code, or otherwise proposed his Chapter 13 plan in an inequitable manner," a court can deny the plan or throw out the case entirely. Here, the court reasoned that the debtors had acted in bad faith by inappropriately adjusting the repayment amounts in their plan. Instead, the court reasoned that the debtors should have entered the regular repayment amounts into the plan and proposed adjustments in a later section of their plan, consistent with other Chapter 13 plans. Thus, because the plan was not confirmed and the case had been pending for too long (to the detriment of the creditors), the court dismissed the debtors' Chapter 13 case.

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NEGOTIABLE INSTRUMENTS

Junior Lien Holders May Still Call Due a Promissory Note After a Senior Lien Holder Extinguishes Junior Liens Post Foreclosure [TX APP]

A debtor took out two mortgage loans from one lender when purchasing a house. The debtor defaulted on payments, and the holder of the first loan foreclosed on the property. This foreclosure satisfied the first loan amount, and the holder of that loan extinguished all junior liens, "including the lien underlying the [Promissory] Note" for the second loan ("Note"). Twelve years later, a creditor purchased the Note of the second loan and sent the debtor a notice of intent to accelerate payment. The letter demanded payment of $44,333.62 on the second Note, which the debtor did not pay. The creditor then brought suit to enforce the Note, and the district court granted summary judgment in the creditor's favor. The debtor raised seven arguments against payment on appeal. The seven arguments can be reduced down to three: (1) the creditor had no standing to enforce the Note because it was a non-negotiable instrument due to a prepayment notice; (2) multiple statutes of limitation applied since the foreclosure,

and all had run; and (3) damages were not proven for summary judgment because the creditor merely provided a signed affidavit listing the outstanding balance on the loan.

In Thompson v. Yellowfin Loan Servicing Corp., No. 01-21-00147-CV, 2023 WL 17492, 2023 Tex. App. LEXIS 4 (Tex. App.-Houston [1st Dist.] Jan. 3, 2023, no pet. h.) (unpublished opinion), the court enforced the district court's award of summary judgment in the creditor's favor. First, the court examined standing and enforceability, determining the issue in the creditor's favor. For the creditor to recover, it had to show it was the holder of the Note. The court reasoned that the Note's provision requiring notice of principal prepayment did not make the Note non-negotiable, and as such, the Note had been properly endorsed to the creditor. Next, the court reviewed the applicable statute of limitations, holding that the statute began to run once the creditor took action to enforce the Note, not when the foreclosure had occurred. The debtor had argued a two-year limitation for deficiency claims under foreclosure law or a four-year limitation period for a claim for debt payments. However, the court determined that the creditor was not seeking a deficiency judgment but rather seeking to recover on an unsecured debt separate from the secured debt of the foreclosure. In other words, while the lien may have been extinguished, the Note had not been extinguished; it merely represented an unsecured debt instead of a secured one. Thus, the court determined that §3.118 of the Texas Business and Commerce Code was the correct statute to apply and that the creditor had timely brought its claim under that statute. Finally, the court considered the evidence provided by the creditor to support its damages claim. The court looked to case law, finding that "an affidavit simply setting forth the balance due . . . is sufficient to sustain an award of summary judgment." Thus, the court affirmed summary judgment for the creditor.

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SECURITY INTERESTS

Attempted Threat to Creditor-Priority Rules [ND TEX]

The lender obtained a perfected security interest in the debtor's accounts receivable in exchange for a loan provided by the original lender to the debtor. The lender filed UCC-1 financing statements to perfect its interest in the accounts receivable on October 22, 2013. The debtor then entered into an indemnity agreement for surety bonds with the indemnitor, which granted it a security interest in the lender's accounts receivable and allegedly placed certain accounts receivable in a trust for the indemnitor. The indemnitor filed a UCC-1 financing statement perfecting its interest in the accounts receivable on March 10, 2021. The debtor defaulted on its loan with the lender, and the lender took the accounts receivable funds from the debtor's bank account pursuant to the loan agreement. The indemnitor sent a demand letter to the lender demanding the return of the funds because they had been held in a trust for the indemnitor's benefit. The indemnitor alleged that it was entitled to the funds because the trust shielded the funds (which were trust property) from the lender's security interest in the debtor's accounts receivable. However, the lender argued that no trust had been created and therefore, it had the superior interest in the funds under the rules of priority. Both the lender and the indemnitor filed motions for summary judgment.

In Markel Ins. Co. v. Origin Bancorp, Inc., 663 F. Supp. 3d 670 (N.D. Tex. 2023), the district court granted the lender's motion and denied the indemnitor's, holding that no trust had been created and the lender's security interest was superior to the indemnitor. First, the court held that the lender had a perfected security interest. To establish a perfected security interest in collateral, a party must show that its interest attached to the collateral and that it has properly perfected its interest against other parties. Here, the lender's interest attached after it gave a loan to the debtor (providing value), the debtor had rights in the accounts receivable, and the security agreement had been signed by the debtor listing the accounts receivable. The interest was then perfected when the lender filed the financing statement and filed continuation statements, every five years. Second, the court held that the lender's security interest took priority over the indemnitors because it was first in time. Next, the court held that the indemnity agreement language lacked actual intent to create an express trust and was merely an attempt to work around creditor-priority rules. The court explained that in determining whether a trust is created it must look to the document as a whole rather than just look for "magic" trust language. However, a lack of terms essential to a trust can indicate a lack of intent. Additionally, the court must consider whether the words impose an obligation on the trustee and also must consider the certainty of the trust property and beneficiary. The court found that here the parties used generic trust language and indicated no intent to create a trust; specifically, the terms "beneficiary" or "grantor" do not appear anywhere, "trustee" only appeared once; and there was no provision prohibiting commingling of the funds in the trust with other funds. Finally, the court held that because the lender's security interest was superior, it was entitled to the funds over the indemnitor's security interest in the funds.

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Breach of the Peace? That is for the Jury to Decide [ED PA]

A debtor purchased a car and defaulted on her payments shortly thereafter. At that point, the creditor contacted a vendor about repossessing the vehicle. The first vendor was unable to repossess the car, so the creditor reassigned the Order of Repossession to a different collector. That collector was able to repossess the vehicle nearly a year after default. However, while the collector was at the debtor's home, she came outside, calmly asked the collector to stop, and made it clear she disagreed with the repossession. Nonetheless, the car. was ultimately towed away that day. The debtor then sued the creditor, claiming that it had violated the Fair Debt Collection Practices Act ("FDCPA") by repossessing the car after she objected. The creditor moved for summary judgment, arguing that it did not violate the FDCPA. To resolve the dispute, the court had to determine (1) whether a breach of peace had occurred during the repossession; and (2) whether the collector had control over the vehicle when the debtor had objected to the repossession.

In Gonzalez v. VJ Wood, Recovery, LLC, No 5:23-cv-01599-JMG, 2024WL 1321074, 2024 U.S. Dist. LEXIS 54629 (E.D. Pa. Mar. 27, 2024) (opinion not yet released for publication), the Court denied the creditor's motion for summary judgment, clarified the law, and determined there was an issue of fact that needed to be determined by a jury. First, the court explained that the debtor's claims "hinge on a jury deciding that a breach of the peace occurred." If the evidence showed that the collector had control over the vehicle before the debtor made her protest, the collector (and creditor) would not be found to have violated the FDCPA. On the other hand, if the collector only took control of the vehicle after the debtor had made her protest, a breach of the peace would have occurred; and there would have been a violation of FDCPA. However, the court found that the timing of the protest was contested by the parties, making it unable to grant summary judgment. The court thus denied the motion, holding that a jury would need to determine when the protest was made in relation to the repossession.

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Pledged Assets Are Not Collateral Until Transferred [BKR SD NY]

The holding company and the subsidiary (collectively the debtors) were digital and fiat currency services providers. The exchange was a cryptocurrency exchange. The exchange and the debtors entered into an agreement to allow the exchange's users to lend their digital assets to the debtors. Initially, the exchange did not require the holding company to pledge collateral to obtain the loans. Following turmoil in the cryptocurrency market, the debtors and the exchange entered into two agreements in which the debtors pledged collateral for the loans. In the second collateral agreement, the debtors agreed to transfer approximately 31 million shares of Grayscale Bitcoin Trust (GBTC) to the exchange as collateral to receive loans from the exchange's users. The holding company was to transfer the shares to the subsidiary, and the subsidiary was then to transfer the shares to the exchange. Two months later, the debtors filed for Chapter 11 bankruptcy without having transferred the shares. The exchange sued the debtors to obtain the shares that the debtors pledged as collateral but had not yet transferred to the exchange. Alternatively, the exchange sought to create a constructive trust for the GBTC shares. The debtors moved to dismiss the exchange' s claims.

In Genesis Global Holdco, LLC v. Genesis Global Capital, LLC, 658 B.R. 31 (Bankr. S.D.N.Y. 2024), the court granted the debtors' motions to dismiss. The agreement between the debtors and the exchange defined collateral as property "transferred by or on behalf of [the subsidiary] to or for the benefit of [the exchange] or [the exchange's customers]." Because the subsidiary had never transferred the GBTC shares to the exchange, the shares never became collateral. While the debtors did pledge to transfer the GBTC shares and may be liable for breaching their contract by failing to transfer the GBTC shares, the contract consistently relied on the definition of collateral such that, despite the debtors pledging to transfer the shares, the shares were not collateral because the debtors had never transferred the shares. The exchange also argued that because the holding company transferred the GBTC shares to the subsidiary solely to secure loans from the exchange's users, the subsidiary lacked any equitable interest in the shares. However, the contract stated that the holding company was to transfer "all right, title, and interest in" the shares to the subsidiary, suggesting that the subsidiary owned the shares following the holding company's transfer of the shares to the subsidiary. The exchange also argued that the holding company's transfer of the shares to the subsidiary was "on behalf of" the exchange, meaning that the shares became collateral following the transfer. However, a transfer "on behalf of" means a third party acting as a proxy for a given entity. As neither the holding company nor the subsidiary acted as proxies for the exchange, the transfer was not on behalf of the exchange. The exchange alternatively sought to impose a constructive trust on the shares to prevent unjust enrichment for the debtors. The exchange argued that because the holding company only transferred the shares to the subsidiary so that the subsidiary could transfer them to the exchange, the subsidiary would be unjustly enriched if it kept ownership of the shares. However, constructive trusts are not permitted when "the rights of the parties are governed by a contract." The exchange argued that a constructive trust claim exists because the debtors challenged the validity of its contract with the debtors. However, the

debtors stated that it is "undisputed that the parties' rights and obligations with respect to [the shares] are governed by a valid contract," rendering the exchange' s argument incorrect. The exchange further argued that it had a constructive trust claim because its breach of contract claim was worthless due to the debtor's insolvency. However, while the exchange's claim was imperfect, it "is far from worthless. If it prevail[ed] on a breach of contract claim, [the exchange] would be entitled to recover as a general unsecured creditor and share ratably with other general unsecured creditors." The exchange last argued that it, the subsidiary, and the exchange' s users who loaned their assets to the subsidiary were in a fiduciary relationship with each other. However, the contracts between the exchange's users and the subsidiary, the language of which was incorporated into the contract between the exchange and the debtors, stated that the parties were "not acting as a fiduciary for or an advisor to it in any respect of any Loan."

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Unsafe Practices May Void a Present Right to Possession [D MN]

The debtor entered into a transaction financed by the bank to purchase a vehicle. Later, the debtor defaulted on her payments, and the bank hired a repossession company, which then contracted another repossession company to repossess the car. While the debtor was waiting for her food in a restaurant parking lot, an employee of the repossession company lifted her vehicle with its tow truck. The debtor protested to the employee, and eventually, the employee lowered the car; however, the tow truck blocked the debtor's exit for around thirty minutes. The debtor then sued the bank and both repossession companies, claiming breach of the peace, conversion, trespass to chattel, and violation of the Fair Debt Collection Practices Act (FDCPA). The bank and both repossession companies moved to dismiss the debtor's claims.

In Hansen v. Santander Bank, N.A., 689 F. Supp. 3d 679 (D. Minn. 2023), the court granted in part and denied in part the bank and repossession companies' motion to dismiss. First, the court held that numerous district courts in Minnesota had already established that repossession companies are debt collectors under the FDCPA, and collection efforts that breached the peace voided a debt collector's present right of possession. Second, the court denied the motion to dismiss the debtor's FDCPA claim because it found that a fact finder could reasonably find that the repossession company's act of lifting the debtor's vehicle could constitute a breach of the peace. Third, the court dismissed the debtor's conversion claim because Minnesota law required the deprivation of property to be for a "sufficiently indefinite length of time," and the court found that the thirty-minutes the debtor was blocked from exiting the parking lot was not an indefinite length of time. Fourth, the court dismissed the trespass to chattels claim with prejudice because the debtor had removed her claim against the bank and the middle-man repossession company. Finally, the court rejected the claim for punitive damages against the bank and the middle-man repossession company because there were no allegations that either of those entities directed the repossession company's actions. However, the court denied the motion to dismiss for punitive damages against the repossession company because the debtor adequately alleged that the act of lifting her car while she was inside of it suggested a "deliberate disregard for the [debtor's] safety."

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When is a Lien Continuous? [BKR SD OH]

A debtor entered into a contract with a company for the purchase of a vehicle. The company issued a certificate of title subject to its security interest to the debtor. Through a series of assignments and mergers, the company assigned the security interest to the lender. The debtor defaulted on the contract, and the lender repossessed the vehicle and applied for a repossession certificate of title in its own name (the "repossession title"). The lender returned physical possession of the vehicle to the debtor but still held the repossession title. The debtor then filed a Chapter 7 bankruptcy petition. After the petition was filed, the lender issued a new certificate of title with its security interest listed (the "replacement title"). The Chapter 7 trustee (the "trustee") filed a complaint and moved for summary judgment, alleging the lender's lien listed on the replacement title was avoidable as an unauthorized post-petition transfer or preference and asked that the lender's claims be disallowed until it released the lien.

In Friesinger v. MyUSA Credit Union, Inc. (In re Badger), No. 21-3127, 2023. Bankr. LEXIS 1175 (Bankr. S.D. Ohio Apr. 26, 2023) (unpublished opinion), the bankruptcy court held that the lender continuously maintained its security interest and, therefore, no transfer occurred that would make the security interest avoidable by the trustee. First, the lender held the security interest as noted on the original certificate that was issued following the purchase of the vehicle. Second, the court found that the lender retained rights in the vehicle even while it had repossession title because, under Ohio law, when a lender holds a repossession title, the debtor maintains a right of redemption and equitable title until the time the secured collateral is sold. Therefore, the lender did not get full rights to the collateral upon issuance of a repossession title but rather a mechanism to exercise its legal remedies on the vehicle. As such, the lender's security interest on the vehicle remained (if the lender had sold the vehicle, the security interest would have been paid with the proceeds). Lastly, the lender held the lien as listed on the

replacement title issued to the debtor's post petition. The court distinguished the facts of this case from 11 case where a debtor is sold a vehicle prepetition, and the lender fails to place a security interest at all on the vehicle until post-petition. Here, the security interest already existed prepetition. The lender, therefore, had an enforceable and perfected security interest throughout the entire process in the security interest listed on the original title, in the maintained security interest rights while it held the repossession title, and when it issued a replacement title with its security interest listed. The court found the issuance of the replacement title post-petition when the lender had continuously maintained its security interest was merely a ministerial act and not a transfer of property of the estate (i.e., a new security interest had not been created). Because there was no transfer, the security interest was not avoidable as an unauthorized post-petition transfer under 11 U.S.C. § 549 or as a preference.

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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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