Wisconsin Bankers ASSOCIATION

Compliance Journal
October 2025

Special Focus

WI Court of Appeals Confirms UCC Safe-Harbor Notice Requirements Not Altered by WCA Deficiency Judgment Provision

The Wisconsin Court of Appeals (Court) recently concluded that a creditor's use of the Uniform Commercial Code's (UCC) statutory safe-harbor language in pre- and post-sale notices is legally sufficient, and those requirements are not altered or influenced by the Wisconsin Consumer Act (WCA). By affirming the judgment of the circuit court, the Court's decision provides clarity for Wisconsin banks seeking to rely upon the safe-harbor language provided in the UCC's notice provisions.

The case involves a lawsuit against a credit union claiming that its pre- and post-sale notices were legally insufficient because it did not incorporate language from the WCA. While this case was the first of its type to advance to the appellate level, WBA members have confronted similar challenges. WBA joined the Wisconsin Credit Union League in the filing of an amicus curiae brief to present a united industry front in the matter.

Summary of Actions

As summarized by the Court, the relevant facts begin with the Birges defaulting on a $4,222.42 loan agreement with Simplicity Credit Union (Simplicity) to finance vehicle repairs. The loan was secured by the vehicle and after the Birges defaulted, Simplicity repossessed the vehicle and issued a pre-sale notice using the safe-harbor language provided in the UCC at Wis. Stat. § 409.614(3). The vehicle was sold at a private auction for $500. Simplicity then issued a post-sale notice showing a deficiency of $4,233.48, calculated after fees.

The Birges filed a class action lawsuit, alleging that both Simplicity's pre- and post-sale notices were legally insufficient. The Birges argued that, based upon the WCA at Wis. Stat. § 425.210, the notices were required to describe the deficiency as the difference between the loan balance and the fair market value of the vehicle, rather than as the difference between the loan balance and the vehicle's sale price. The Court affirmed the circuit court's summary judgment in favor of Simplicity, dismissing the Birges' complaint and concluding that the WCA does not alter the UCC's notice requirements, and that Simplicity's notices were legally sufficient.

Issue at Hand

Whether the WCA's deficiency judgment provision, Wis. Stat. § 425.210, which requires use of fair market value in calculating a deficiency, alters the UCC's notice requirements under Wis. Stat. §§ 409.614 and 409.616.

Applicable State Law

Pursuant to Wis. Stat. § 409.614, a secured party must provide a debtor with a pre-sale notice before disposing of repossessed collateral. The notice must include, among other things, a description of any liability for deficiency. Wis. Stat. § 409.614(3) provides a safe-harbor form to meet the notification requirement. When a creditor uses the form, it is deemed to have provided sufficient information to satisfy the statutory requirements. The safe-harbor language includes a standardized explanation of how sale proceeds will be applied to the debt and whether the debtor may still owe a deficiency.

Similarly, Wis. Stat. § 409.616 governs post-sale notices and requires that a secured party must provide an explanation

of how the deficiency or surplus was calculated, including a statement of the amount of the deficiency and the figures used in the calculation.

Separately, the WCA at Wis. Stat. § 425.210 provides how to calculate a deficiency judgment. It requires that if a creditor is entitled to a deficiency judgment under Wis. Stat. § 425.209(1), the amount recoverable is the difference between the unpaid loan balance and the fair market value of the collateral.

As emphasized by the Court, Wis. Stat. § 425.210 does not impose any notice requirements. It applies only in the context of judicial actions to recover a deficiency judgment but does not alter the UCC's safe-harbor provision. The Court further noted that Wis. Stat. § 421.103(3) clarifies the relationship between the UCC and the WCA in that unless a WCA provision specifically supersedes a UCC provision, the UCC continues to govern the transaction. Thus, because Wis. Stat. § 425.210 does not expressly supersede Wis. Stat. §§ 409.614 or 409.616, the UCC's safe-harbor provisions remain fully applicable.

Court's Analysis

The Court rejected all the Birges' arguments. First, the Birges contended that Simplicity's notices were insufficient because they failed to describe the deficiency using the fair market value of the repossessed vehicle, as required under Wis. Stat. § 425.210. The Birges argued that this WCA provision should be read to modify the UCC's notice requirements, effectively requiring creditors to inform debtors that any deficiency would be calculated based on fair market value rather than the actual sale price.

Pursuant to Wis. Stat. § 421.103(3), the WCA does not displace the UCC unless a WCA provision specifically provides otherwise. The Court relied upon this section as well as the standard of irreconcilable conflict in addressing the Birges' argument. When two statutes address the same subject matter, courts attempt to harmonize them so that both can be given effect. One will be deemed to supersede the other only if the provisions cannot reasonably operate together, that is, if they irreconcilably conflict.

Applying that standard, the Court concluded that there was no irreconcilable conflict between the UCC and the WCA. The UCC provisions in Wis. Stat. §§ 409.614 and 409.616 directly regulate the content of pre- and post-sale notices and include a safe-harbor form in § 409.614(3) that, when properly completed, is deemed to provide sufficient information. The Court emphasized that this statutory language must be given full effect. Because Wis. Stat. § 425.210 contains no express notice requirement and governs only judicial deficiency judgments, importing its fair market value concept into UCC notice provisions would contradict the Legislature's clear separation of these frameworks. Accordingly, the Court held that Simplicity's use of the UCC safe-harbor form fully satisfied its statutory obligations.

The Birges further argued that the UCC and WCA should be read in *pari materia*, that is, in relation to each other as parts of a unified statutory scheme, with the WCA's fair market value standard informing the meaning of the UCC's deficiency notice requirements. The Court acknowledged that Wisconsin courts sometimes interpret related statutes together when they address the same subject matter and can be harmonized without contradiction. However, the Court concluded that this interpretive principle did not apply here.

The Court reasoned that the UCC and WCA serve distinct purposes and operate in different contexts. The UCC provisions govern secured transactions generally, including notice procedures following repossession, while the WCA addresses remedies available in judicial actions involving consumer credit transactions. Because Wis. Stat. § 425.210 specifically applies to judicial deficiency judgments and not to nonjudicial repossession

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notices, the two statutes do not cover the same subject matter in a way that would justify reading them in *pari materia*. Accordingly, the Court declined to interpret the WCA as supplementing or modifying the UCC's notice requirements. Instead, it reaffirmed that each statutory framework operates independently within its own sphere, consistent with Wis. Stat. § 421.103(3), which provides that the UCC governs unless a WCA provision expressly supersedes it.

The Birges also claimed that Simplicity's post-sale notice was legally insufficient using similar rationale. The Court reviewed Wis. Stat. § 409.616 which governs post-sale notices and sets forth the required content, which includes providing the debtor "an explanation of how the surplus or deficiency is calculated," specifying the amount and the figures used in the calculation. Simplicity's post-sale notice, which relied on the UCC's safe-harbor language, clearly identified the sale price, application of proceeds, and remaining deficiency.

Industry Impact

Banks may continue using statutory pre- and post-sale notice forms without incorporating WCA language. However, banks should still review the language within their notices to ensure legal sufficiency under the UCC. All statutorily required elements must be included, and while the safe-harbor language is optional, any deviations, including additional information, must not be misleading. Banks choosing not to rely on the safe-harbor language should carefully consider the implications.

More specifically, banks should consider reviewing their policies and procedures regarding nonjudicial repossessions. The safe-harbor form is deemed to "provide sufficient information," but Wis. Stat. § 409.614(2) clarifies that "[a] particular phrasing of the notification is not required." Use of the form is optional. Thus, if a bank opts not to use it or adds language beyond what the UCC requires, it should evaluate that decision carefully. For example, the UCC states that "a notification in the form of § 409.614(3) is sufficient, even if it includes errors in information not required by § 409.614(1), unless the error is misleading with respect to rights arising under this chapter." While additional information may be included, it must not be misleading. Banks deviating from the safe-harbor form should be prepared for potential challenges under this standard.

Conclusion

The Wisconsin Court of Appeals' decision provides important clarity for lenders, reaffirming that the UCC's safe-harbor notice provisions remain fully effective and are not modified by the WCA's deficiency judgment rules. Banks can continue to rely on the statutory pre- and post-sale notice forms when conducting nonjudicial repossessions.

The court's full opinion may be found here:
https://www.wicourts.gov/ca/opinion/DisplayDocument.pdf?content=pdf&seqNo=1012075

Regulatory Spotlight

Agencies Issue Semiannual Regulatory Agendas.

The Bureau of Consumer Financial Protection (CFPB) published its agenda as part of the Spring 2025 Unified Agenda of Federal Regulatory and Deregulatory Actions. CFPB reasonably anticipates having the regulatory matters identified in the agenda under consideration during the period from June 2025 to May 2026. The next agenda will be published in Fall 2025 and will update the agenda through Fall 2026. The information is current as of **04/21/2025**. The agenda may be viewed at: https://www.govinfo.gov/content/pkg/FR-2025-09-22/pdf/2025-18317.pdf. *Federal Register*, Vol. 90, No. 181, 09/22/2025, 45586.

The Board of Governors of the Federal Reserve System (FRB) issued its agenda under the Regulatory Flexibility Act and its Statement of Policy Regarding Expanded Rulemaking Procedures. FRB anticipates having under consideration the regulatory matters indicated in the agenda during the period July 2025 through December 2025. The next agenda will be

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Compliance Journal

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Special Focus

Compliance Date Postponed Again for Certain Portions of FDIC Part 328 Rule.

The Federal Deposit Insurance Corporation (FDIC) has announced the postponement of the mandatory compliance date of Part 328.4 and 328.5 of its final advertising rule until **March 1, 2026**. Section 328.4 sets forth requirements of an official digital sign on automated teller machines (ATMs) and like devices. Section 328.5 includes signage requirements of digital deposit-taking channels. The delay is to allow additional time for implementation of the new signage and to resolve questions meant to alleviate customer confusion.

On December 20, 2023, FDIC adopted a final rule that, among other things, amended FDIC's sign and advertisement of membership requirements for insured depository institutions (IDIs). The amendments made by the final rule took effect on April 1, 2024; however, full compliance with the amendments was delayed to January 1, 2025. On October 17, 2024, full compliance with the amendments was delayed to May 1, 2025.

As mentioned above, FDIC has further postponed the compliance date for the requirement to display the FDIC official digital sign on an IDI's digital channels, as well as on the screen of an IDI's ATMs and like devices. During this time, FDIC will continue to review the feedback received regarding implementation issues and potential consumer confusion that may result from requirements related to the display of the digital sign. After completing its review, FDIC expects to propose changes to the regulation to address implementation concerns and potential sources of confusion.

FDIC acknowledges that some IDIs have implemented aspects of the final rule. However, aspects under section 328.5 to display the FDIC official digital sign on certain digital channel pages continue to generate questions regarding implementation. Compliance with other provisions in subpart A remains unchanged and generally is required by **May 1, 2025**. The announcement may be viewed at: https://www.govinfo.gov/content/pkg/FR-2025-03-11/pdf/2025-03790.pdf

Judicial Spotlight

WI Court of Appeals Concludes NBA Does Not Preempt WCA Notice of Right to Cure Default Requirements

The State of Wisconsin Court of Appeals (Court) recently concluded that the National Bank Act (NBA) does not preempt the Wisconsin Consumer Act (WCA) notice of right to cure default requirements. When the issue previously arose in Wisconsin, the Eastern and Western Districts were divided over whether the WCA provision is preempted. The Eastern District of Wisconsin in Boerner v. LVNV Funding LLC, 358 F. Supp. 3d 767, 776-77 (E.D. Wis. 2019), held that the WCA provision is not preempted, while the Western District of Wisconsin in *Lako v. Portfolio Recovery Associates*, No. 20-cv-355-wmc (W.D. Wis. Aug. 4, 2021), held that it is preempted.

As a result of the Court's recent decision, nationally-chartered banks need be aware of the applicability of the notice of right to cure default requirements under Wisconsin Statute Chapter 425 for loans subject to WCA.

WBA joined the amicus brief of the American Bankers Association (ABA), Bank Policy Institute (BPI), and the Wisconsin Chamber (Chamber) to be filed on behalf of the banking industry in the matter in *Bank of America, N.A. v. Jean-Pierre*

Riffard, 2023AP000125. The following is a summary of the facts, laws the Court took into consideration, and the Court's rationale for its conclusion.

Summary of Initial Actions

As the Court summarized, Riffard applied for and was issued two separate credit card accounts from Bank of America (Bank). Riffard defaulted on his obligation to make monthly payments on the accounts. As a result, Bank filed small claims actions in circuit court for the unpaid balance of the credit card accounts. The combined total unpaid balance from both accounts was $24,352.91.

In response to the complaint, Riffard alleged, among other things, that Bank did not provide a Notice of Right to Cure Default as required under Wis. Stat. § 425.104, which meant that the complaints were barred. Riffard filed for the circuit court to dismiss both cases. Bank filed opposing the request for dismissal. The circuit court denied Riffard's motion to dismiss having concluded that the regulations which implement NBA preempted the state law notice of right to cure default requirements of WCA under Wis. Stat. §§ 425.104- .105. The circuit court determined Riffard's failure to make payments breached the contract with Bank for the credit card accounts, that Bank had performed all conditions for its court filings, and concluded that Bank was entitled to judgments for $24,352.91 plus cost and interest from the date of judgments. Riffard appealed the matter to the Court.

Issue at Hand

At issue for the Court was whether the NBA preempts the WCA's procedural notice of right to cure default requirements to bring an action to collect a defaulted credit card account.

Applicable State and Federal Law

Under Wisconsin law, if a customer is in default of a consumer credit transaction subject to WCA, the customer has a right to cure the default. While there are occasions within WCA which do not afford the customer such right, when the right does apply, a creditor is prohibited from bringing an action in court unless it provides a Notice of Right to Cure Default to the customer, waits fifteen days to provide time for the customer to cure the default, and the customer has not cured the default. Wis. Stat. §§ 425.104-, .105. If the default is cured, the consumer credit transaction is considered to be back in good standing meaning that the consumer credit transaction is no longer considered to be in default.

Under federal law, the implementing preemption regulation of NBA regarding lending by national banks is found in 12 CFR 7.4008. Section 12 CFR 7.4008(d) provides for the preemption of state laws affecting non-real estate lending, and states that a national bank may make non-real estate loans without regard to state law limitations concerning...

> (4) The terms of credit, including the schedule for repayment of principal and interest, amortization of loans, balance, payments due, minimum payments, or term to maturity of the loan, including the circumstances under which a loan may be called and payable upon the passage of time or a specified event external to the loan.

Section 12 CFR 7.4008(e) includes a provision referred to as the "savings clause" which provides that state laws on the "right to collect debts" are not preempted so long as they are "not inconsistent with the non-real estate lending power of national banks and apply to national banks to the extent consistent with the decision of the Supreme Court in *Barnett Bank of Marion County, N.A., v. Nelson, Florida Insurance Commissioner, et al.*, 517 U.S. 25 (1996). The Court considered *Barnett* in its analysis of the issue at hand with Riffard.

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As previously mentioned, Wisconsin's Eastern and Western District Courts came to differing conclusions to 12 CFR 7.4008. The Eastern District of Wisconsin's approach to the issue in the *Boerner* case was that state and federal law were not in irreconcilable conflict and took the approach that the notice by the debt collector was "incidental" to the national bank's lending authority. Whereas the Western District of Wisconsin in the *Lako* case took the opposite approach recognizing that the cure provisions under WCA are not merely that of a notice. The procedures under the WCA notice of the right to cure default provisions give the consumer the ability to restore the credit status, which in turn does affect the terms of the credit itself. Terms of the credit are something specifically exempt under 12 CFR 7.4008(d).

Wisconsin Court of Appeals Review

The Court looked to whether the laws were in irreconcilable conflict or whether it would be physically impossible to apply both state and federal laws. To which the Court concluded that the WCA notice of right to cure default requirements and the NBA preemption and savings clause provisions did not impose directly conflicting duties on a national bank; the WCA requirements only arise when a creditor seeks to file a court action to collect a defaulted consumer credit transaction.

The Court also considered whether the WCA significantly interfered with the ability of a national bank to exercise its powers. For this part of the Court's analysis, it considered past cases in which courts concluded that debt collection and protections found under laws such as WCA are the type of laws which traditionally are within a state's authority. The Court also looked to regulations promulgated by the Office of the Comptroller of the Currency (OCC) given that the NBA regulation was promulgated by that agency. The Court looked specifically at OCC's 12 CFR 7, Bank Activities and Operations, and 12 CFR 34, Real Estate Lending and Appraisals. The Court also looked at court cases involving the review of preemption, including *Aguayo v. U.S. Bank*, 653 F.3d 912, 922 (9th Cir. 2011) whereby a court must "read a statute or regulation in its entity and when applied,... must consider both the express preemption and savings clauses together."

The Court concluded, in disagreement with *Lako*, that the WCA does not interfere with a national bank's power and authority under NBA; that the WCA notice of right to cure default requirements is not preempted, but instead the savings clause 12 CFR 7.4008(d) applies. The Court concluded that the WCA notice of right to cure requirements is not preempted by NBA.

Industry Impact

Certainly, the Court's decision has a detrimental impact on nationally-chartered banks as now the WCA notice of right to cure default requirements of Wis. Stat. §§ 425.104- .105 apply despite preemption rules. WBA is disappointed with the decision. As terms of its credit agreement, a nationally-chartered bank sets forth the conditions of default and the bank's authority involving the default. The state law alters the bank's authority in that the state law results in the loan being "reset" which is a condition that significantly interferes with the nationally-chartered bank's ability to set the terms of the consumer credit agreement and restricts the bank's ability to collect on the defaulted loan.

It is also disappointing that the Court did not further consider OCC's own analysis of preemption.

As a result of the Court's decision, nationally-chartered banks must be sure to comply with the notice of right to cure default requirements of Wis. Stats. §§ 425.104- .105 for consumer credit transactions subject to WCA. These requirements are not just that a Notice of Right to Cure Default is given to customers and that a fifteen-day time period be provided before a bank may bring an action in court. Nationally-chartered banks must also change procedures whereby the status of the loan is changed, if cured. The nationally-chartered bank is not able to proceed with its authority involving a defaulted consumer credit transaction. Instead, if the default is cured under state law, the course the nationally-chartered bank would have otherwise had to collect on a defaulted loan is changed.

The Wisconsin Court of Appeals case may be viewed at:
https://www.wicourts.gov/ca/opinion/DisplayDocument.pdf?content=pdf&seqNo=916793

U.S. Supreme Court Held CFPB's Funding is Constitutional

On **May 16, 2024**, the U.S. Supreme Court released its decision regarding whether the funding structure of the Bureau of Consumer Financial Protection (CFPB) is constitutional. The following is a summary of the Court's decision and rationale, and its impact on other court cases involving the CFPB.

How government agencies are funded is a general function of Congress as authorized by the U.S. Constitution. In general, the Constitution gives Congress control over funding subject to Article 1, section 9, clause 7 of the Constitution which provides that "[n]o Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law." For federal agencies, Congress provides funding through annual appropriations. An appropriation in this context is a law that authorizes expenditures from a specified source of public money for a designated purpose.

The funding for CFPB, however, is structured differently. Congress provided a standing source of funding outside the ordinary annual appropriations process for the CFPB. Instead of typical appropriations, CFPB is authorized to draw from the Board of Governors of the Federal Reserve System (FRB) for an amount that CFPB believes is "reasonably necessary to carry out" CFPB's duties, subject to an inflation-adjusted cap.

In *Consumer Financial Protection Bureau* v. *Community Financial Servies Association of America Ltd.*, No. 22-448, the Community Financial Services Association of America, Ltd (Association) challenged whether CFPB's funding structure violated the Appropriations Clause of the U.S. Constitution. The Association presented three arguments against CFPB's funding structure. First, the Association argued that CFPB's funding structure was not "in Consequence of Appropriations made by Law" because CFPB itself decides its funding needs rather than Congress deciding the amount of annual funding for the CFPB.

The Association's second argument was that the Appropriation Clause requires both chambers of Congress to periodically agree on an agency's funding, which ensures each chamber has authority to unilaterally block funding measures if a chamber did not act. Lastly, the Association contended that if CFPB's funding mechanism was constitutional, then Congress should allow such mechanism for all other agencies. The Association was presenting a separation of powers argument.

The U.S. Supreme Court was not persuaded by the arguments set forth by the Association and instead held that Congress' statutory authorization to allow CFPB to draw money from the earnings of FRB to carry out CFPB's duties satisfies the Appropriations Clause.

In particular, the Court concluded that under the Appropriations Clause an appropriation is a law that authorizes expenditures from a specific source of public money for designation purposes, and that CFPB's funding statute satisfies the requirements of the Appropriates Clause because it authorizes CFPB to draw public funds from a particular source (combined earnings of the Federal Reserve System) in an amount not to exceed an inflation-adjustment cap, and the funds are to be used for a specified use (pay the expenses of CFPB to carry out its duties and responsibilities given the agency by Congress). In its analysis, the Court made its decision based upon the historical appropriations of Congress, including the appropriations practice of the Colonies, the First Congress, and early state legislatures.

The U.S. Supreme Court also concluded that Congress did not violation the Appropriations Clause by allowing CFPB to determine how much funding to draw up to a cap, as appropriations which include terms of "sums not exceeding" a certain amount are common at the time the Appropriations Clause was created. The Court also concluded that the Constitution does not specifically limit the duration of appropriations and that the Appropriations Clause is phrased as a limitation which does not require more than a law that authorizes the disbursement of specific funds for an identified purpose. The Court did not agree with the Association's separation of powers argument.

As a result of the U.S. Supreme Court decision that CFPB's funding mechanism is constitutional, other courts around the country can now take up cases involving the CFPB which had been stayed pending the Court's decision. These other cases involve challenges to CFPB's Section 1071 small business data collection and reporting rule, its credit card late fee rule for large credit card issuers, and CFPB's revisions to its UDAAP examination manual in which the agency included discrimination as a basis for UDAAP violation. In general, the outstanding cases involve arguments that CFPB acted beyond the scope of its authority when creating the rules and new interpretation of UDAAP.

Judicial Spotlight

Also as a result of this U.S. Supreme Court decision, CFPB issued an interim final rule to extend the mandatory compliance dates of the Section 1071 small business data collection and reporting rule. The extension is based upon the 290 days which elapsed under an order by a Texas Court, which is one of the cases generally mentioned above. Under the extension, the Section 1071 compliance and first filing dates become the following:

Compliance Tier	Original Compliance Date	New Compliance Date	First Filing Date
Tier 1 institutions (highest volume lenders)	October 1, 2024	July 18, 2025	June 1, 2026
Tier 2 institutions (moderate volume lenders)	April 1, 2025	January 16, 2026	June 1, 2027
Tier 3 institutions (smallest volume lenders)	January 1, 2026	October 18, 2026	June 1, 2027

Lastly, there are also other actions on the federal level which attempt to fight against CFPB's efforts to operate beyond its authority and without regard to the administrative rulemaking process. These efforts include the Bank Resilience and Regulatory Improvement Act (H.R. 8337), Rectifying UDAAP Act (H.R. 6789), Small Lenders Exempt from New Data and Excessive Reporting Act (H.R. 1806), and Bank Loan Privacy Act (H.R. 1810).

WBA will continue to monitor the various court cases involving CFPB and will report the outcome and impact on the industry as each court renders its decision. In the interim, financial institutions should continue to consider how the Section 1071 rule may impact the application process of credit requests by small businesses as the rule continues to be in effect with revised mandatory compliance dates and first filing dates established by CFPB.

The U.S. Supreme Court decision involving CFPB may be viewed at:
https://www.supremecourt.gov/opinions/23pdf/22-448_o7jp.pdf

Regulatory Spotlight

Agencies Adjust Reg CC Funds Availability Thresholds for Inflation.

The Bureau of Consumer Financial Protection (CFPB) and Board of Governors of the Federal Reserve System (FRB) (collectively, the agencies) issued a final rule to amend Regulation CC, which implements the Expedited Funds Availability Act (EFA Act) and the Check Clearing for the 21st Century Act (Check 21 Act), to fulfill a statutory requirement in the EFA Act to adjust the dollar amounts under the EFA Act for inflation. The EFA Act and subpart B of Regulation CC contain specified dollar amounts, including: (1) the minimum amount of deposited funds that banks must make available for withdrawal by opening of business on the next day for certain check deposits (minimum amount, 229.10(c)(1)(vii)); (2) the amount a bank must make available when using the EFA Act's permissive adjustment to the funds-availability rules for withdrawals by cash or other means (cash withdrawal amount, 229.12(d)); (3) the amount of funds deposited by certain checks in a new account that are subject to next-day availability (new-account amount, 229.13(a)(1)(ii)); (4) the threshold for using an exception to the funds-availability schedules if the aggregate amount of checks on any one banking day exceeds the threshold amount (large-deposit threshold, 229.13(b)); (5) the threshold for determining whether an account has been repeatedly overdrawn (repeatedly overdrawn threshold, 229.13(d)(2)); and (6) the civil liability amounts for failing to comply with the EFA Act's requirements, 229.21(a)(2)(i) and 229.21(a)(2)(ii)(B). The final rule is effective **07/01/2025**. The final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2024-05-20/pdf/2024-10844.pdf. *Federal Register*, Vol. 89, No. 98, 05/20/2024, 43737-43739.

WI Supreme Court Upholds Priority of Secured Creditor Under Receivership Rules

The Wisconsin Supreme Court has released its decision to address the issue of whether properly perfected secured creditor interests were subject to unsecured creditor interests under receivership rules. WBA filed an amicus brief on behalf of the membership given the significance of the issue. In a unanimous decision, the Wisconsin Supreme Court reversed the Court of Appeals decision thereby upholding Wisconsin's longstanding precedent of priority for properly perfected secured creditors under receivership rules.

Background

The case involves a dispute between a secured lender and unsecured creditor residents of an insolvent independent senior-living facility formerly known as The Atrium of Racine (The Atrium). Bank of New York Mellon Trust Company, (BONY) is the trustee under the terms of a November 1, 2002 Trust Indenture between the Elderly Housing Authority of the City of Racine and BONY's predecessor trustee. The indenture describes series 2002A Fixed Rate Revenue Bonds and series 2002B Extendable Rate Adjustable Securities, each issued in the aggregate principal amount of $4,025,000. Payments of principal, premium, and interest were secured by promissory notes in the aggregate principal amount of $8,050,000 and were further secured by a mortgage and security interest also dated November 1, 2002.

The Atrium defaulted on its May 1, 2017 interest payment and stipulated with BONY on May 25, 2017 to an assignment for the benefit of creditors and the appointment of a receiver pursuant to s. 128.08(1)(b), Stats. On the date of the receiver's appointment, bondholders were owed approximately $6,070,000 in principal on the Series 2002A and 2002B bonds.

The receiver assumed management of The Atrium and, with BONY's consent, proceeded to market The Atrium for sale. Residents of The Atrium, however, claimed entitlement to the sale proceeds, asserting claims for $7,574,820 in entrance fees paid to The Atrium in connection with one of six versions of a residency agreement. On the receiver's motion for declaratory relief, the circuit court properly held that the residents' claim for entrance fees were not secured claims entitled to priority payment from the proceeds of the asset sale.

On July 31, 2019, the circuit court affirmed the receiver's sale of The Atrium assets for $5,500,000, but the residents objected to the disbursement of the sale proceeds to BONY. The parties agreed to hold the proceeds of the sale in trust pending appeal.

On July 30, 2021, the Wisconsin Court of Appeals issued an unpublished opinion holding that the residents' claims have priority over the properly perfected security interest of the bondholders. The result of the decision elevated the obligation to refund the entrance fees above the first mortgage securing bonds, the proceeds of which were used to finance the senior facility.

The Wisconsin Supreme Court agreed to review the issues presented by the dispute. The principal issue on appeal was whether a secured lender's properly perfected mortgage and security interest have priority over residents' claims for entrance fees from the proceeds of the sale of the building and assets. A secondary issue on appeal was whether the residents' appeal was timely and sufficient to confer appellate jurisdiction. In filing the amicus brief on behalf of the membership, WBA focused on the principal issue on appeal.

Importance of Case to Banking Industry

The case involves an interpretation of priority rules of creditors. The result of the Court of Appeals decisions upended current creditor priority rules, including rules under Ch. 128 creditors' rights, Ch. 706 real estate convenances, Ch. 779 liens, and the Uniform Commercial Code, by allowing undocumented, unrecorded liens to have priority over a properly perfected first mortgage and security interest. In particular, the decision upended s. 706.11, Stats., which makes clear that a mortgage given to certain type of lenders is superior to all later filed liens, other than real estate taxes and assessments.

The Court of Appeals decision also appeared to be in direct conflict with the Wisconsin Supreme Court opinion in *BNP Paribas v. Olsen's Mill, Inc.,* 2011 WI 61, 335 Wis. 2d 427, 799 N.W.2d 792. In this case, the court held that collateral could not be sold without the secured creditor's consent. Absent the protection given to secured creditors in the *Olsen's Mill* case, secured lenders would likely stop seeking the speedy enforcement available in a Chapter 128 Receivership.

The result of the Court of Appeals decision created uncertainty in Wisconsin's long established interpretations of law regarding the priorities held by perfected secured creditors.

Wisconsin Supreme Court Decision

As outlined in the Wisconsin Supreme Court (Court) decision, the residents of The Atrium relied upon provision within documents executed between The Atrium and BONY and a statement required under securities regulations regarding the risks of investing to assert that the bondholders contracted away the superiority of their mortgage lien. The Court disagreed with the residents.

The Court looked to the receivership statutes for resolution of the issue. Section 128.17, Stats. establishes an order of payment for how a receiver is to distribute proceeds of a sale among the estate's creditors. The order is to follow: (i) the actual and necessary costs of preserving the estate subsequent to the commencement of the proceedings; (ii) costs of administration including a reasonable attorney's fee for the representation of the debtor; (iii) wages, including pension, welfare and vacation benefits, due to workmen, clerks, traveling or city salespersons or servants, which have been earned within 3 months before the date of the commencement of the proceedings, not to exceed $600 to each claimant; (iv) taxes, assessments and debts due the United States, Wisconsin or any county, district or municipality; (v) other debts entitled to priority; (vi) debts due to creditors generally, in proportion to the amount of their claims, as allowed; and (vii) after payment of the foregoing, the surplus, if any, shall be returned to the debtor.

The Court determined that "other debts entitled to priority" encompasses mortgages under s. 706.11, Stats. which grants a priority to mortgages that are executed by a state or national bank. The Court also determined that "debts due to creditors generally, in proportion to the amount of their claims, as allowed" applied to unsecured claims. The parties of the case agreed the bondholders were secured creditors and the residents were unsecured creditors and under the order set forth under receivership rules, the claims of the secured creditors would be prioritized over those of unsecured creditors. However, the residents argued the bondholders subordinated their secured interest to the residents' interest in their entrance fees.

The Court looked to case law and the Restatement of Property in its review of how a party is to subordinate a security interest. The residents pointed to definitions of "permitted liens" and "permitted encumbrances" in documents executed between The Atrium and BONY. The residents construed the phrases to include entrance fees and the Court agreed.

The executed mortgage included language which stated, "permitted encumbrances" include "[l]iens permitted under Section 5.12(b) of the [Project Contract]." According to the Project Contract, "Permitted Liens shall consist of … [e]ntrance fees or similar funds deposited by or on behalf of such residents[.]" The residents argued that if the financing documents grant either permitted liens or permitted encumbrances priority over the bondholders' mortgage lien, the entrance fees must be refunded before the mortgage is paid.

The Court looked to the language of the contract and mortgage which the relevant terms included the following:

> "Pursuant to the Mortgage, the Corporation has granted to the Trustee a first mortgage lien on the campus currently owned by the corporation…subject in each case to Permitted Liens as defined in the Project Contract."
>
> "This Mortgage constitutes a direct and valid lien on and security interest in the Mortgaged Property subject only to Permitted Encumbrances."

In review of the form language, the Court concluded nothing within the documents subordinated the bondholders' mortgage. While the mortgage is subject to permitted encumbrances, the entrance fees never became liens on the real property of The Atrium, thus the residents' claims are unsecured claims and recovery of the fees would not trump the bondholders' perfected security interest of the mortgage; the order set forth in s. 128.17 need be applied to the payment the sale proceeds.

The Court also reviewed the use of the finding in *M&I First National Bank* v. *Episcopal Homes Management Inc.*, 195 Wis. 2d 485, 536 N.W.2d 175 (Ct. App. 1995), by the Court of Appeals in its decision to deem the residents' claim superior to the bondholders' lien.

Judicial Spotlight

The Episcopal Homes case involved a senior-living facility that defaulted on bond repayments. In that case, a group of roughly 1,700 bondholders bought more than $11 million in bonds to fund the construction of a facility. Under a series of financing documents, the bondholders held a security interest in an account containing approximately $1,000,000 in entrance fees. The residency agreements subordinated entrance fee repayments to the bondholders' lien. After default on bond repayment, the bondholders claimed a secured interest in a segregated entrance fee account funds. Based upon language of the rental agreements, the Court of Appeals concluded the entrance fees were effectively security deposits under Wis. Admin. Code sec. ATCP 134.02(11). Based upon language within agreements, administrative code, and public policy, the Court of Appeals held the residents' entrance fees were protected from the bondholders' interests.

The residents in The Atrium claim their entrance fees were like those interests of the residents in the Episcopal Homes. However, the Court determined the facts between Episcopal Homes and The Atrium were different and that the equitable powers used by the Court of Appeals in the Episcopal Homes against a segregated account containing funds traceable to residents' entrance fees could not be used in The Atrium case as sections 706.11 and 128.17, Stats. so clearly grant the bondholders' mortgage lien unequivocal superiority. The Court concluded it has no legal authority to extend the Court of Appeals decision in Episcopal Homes beyond a segregated account of entrance fees not in receivership to reach the distinct proceeds from the sale of real property subject to a perfected mortgage lien. The Court could not disregard the plan language under Chapter 128.

The Court's unanimous decision in this case upholding Wisconsin's longstanding precedent of priority for properly perfected secured creditors under receivership rules is important. Under s. 128.17, Stats. the bondholders, given their security interest of the perfected mortgage, were entitled to payment from the proceeds of the sale of The Atrium assets before payment to unsecured creditors, the residents.

The Court's decision may be viewed on the WBA Compliance Page located at: https://www.wisbank.com/resources/compliance/



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Add your voice in support of our industry on the state level at WBA Capitol Day and on the federal level by attending the WBA/ICBA Capital Summit. As a WBA member, you can attend WBA Capitol Day in addition to the WBA/ICBA Capital Summit.*

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- April 26 — WBA Capitol Day, Madison — *wisbank.com/CapDay*
- May 14–17 — WBA/ICBA Capital Summit, Washington, D.C. — *icba.org/capitalsummit*

Contact WBA's **Rose Oswald Poels** at *ropoels@wisbank.com*, **Daryll Lund** at *dlund@wisbank.com*, or **Lorenzo Cruz** at *lcruz@wisbank.com* if you have questions or want more information about WBA Capitol Day or the Washington Summit.

*Note: the WBA/ABA Washington Summit was held March 20–22 in Washington, D.C

Wisconsin Bankers ASSOCIATION

WI Supreme Court Affirms Longstanding Principle Regarding Foreign Country's Law

The Wisconsin Supreme Court (Supreme Court) recently affirmed a long established principle that a foreign country's law is something that need be presented and proven before a circuit court as a question of fact when it recently declined to consider the foreign law de novo in the case *Hennessy* v *Wells Fargo Bank*, 2019AP1206.

Generally speaking, when a circuit court hears a case, factors important to the case are questions of fact that the circuit court need determine is or is not fact. Wisconsin courts have long followed a common law principle that a foreign country's law is something that is to be presented and proven in a circuit court as a question of fact. In this case, the Supreme Court was asked to put that standard aside, and to instead consider the foreign law de novo. "De novo" as a Latin term means "from the new" and a de novo review by a court will result in the court making its own determination of facts and issues without any reference to any legal conclusion by a previous court. Utilizing a de novo standard in a case involving a foreign country's law would have been a new standard in Wisconsin. A brief outline of the facts and procedural events in the case follow.

The Hennessys obtained a loan for $7.5 million to build a condominium in Mexico. The parties executed a construction loan agreement, a promissory note, and an addendum to the note. The documents were written in English and governed by Wisconsin law. Property underlying the loan transaction as collateral was held in trust; thus, there was also a trust agreement as part of the documentation. The trust agreement was written in Spanish and governed by Mexican law. The agreements (*i.e.*, loan agreements and trust agreement) were "closely interlinked and reference each other."

After the Hennessys defaulted on the loan, the bank initiated a foreclosure action in Mexico in May 2012. The bank sought payment for amounts owed under the agreements, and if those amounts were not recovered, possession of the property which was the collateral. After actions in a lower court and appeals court in Mexico, the bank was awarded judgment in which the Hennessys were to repay the $7.5 million principal balance of the loan and interest. The Hennessys were also instructed by the court that if the funds were not repaid, they were ordered to deliver the property which was collateral for the loan. In 2017, the Hennessys transferred the property to the bank.

In late 2016, the Hennessys filed a complaint in the Milwaukee County circuit court (circuit court) seeking declaratory injunction that the bank was time-barred from bringing a breach of contract claim under Wisconsin law against them for the failure to pay their loan obligation. In May 2017, the bank, in response, filed a counterclaim to domesticate the Mexican judgment and in August 2017, the circuit court granted summary judgment in favor of the Hennessys. However, the circuit court's order stated that the bank was allowed to enforce the Mexican judgment.

With regard to the bank's request to domesticate the Mexican judgment, the circuit court then split the proceedings into two phases: (1) to hear arguments regarding the effect and meaning of the Mexican judgement under Mexican law; and (2) to determine whether to recognize the Mexican judgment under principles of comity. Comity, generally, is a principle that a court of one jurisdiction respects the laws and judicial decision of another jurisdiction. In this case, whether a Wisconsin court should respect the laws and judicial decision from Mexico.

In the first phase, the circuit court received briefings from both parties, reviewed extensive amounts of exhibits on Mexican law, and held hearings which included experts testifying on the substance and meaning of Mexican law.

The Hennessy's position was that the judgment could not be enforced against them personally, arguing that Mexican law only provided in rem relief (*i.e.*, relief against property) in this circumstance. The bank argued that Mexican law did permit it to seek monetary compensation of any deficiency between the value of the collateral and the amount still owed to the bank. The circuit court issued a decision in favor of the bank.

Regarding the second phase to domesticate the Mexican judgment, the circuit court concluded, under principles of comity, the bank was entitled to recognition of the Mexican judgment. The Hennessys appealed and the court of appeals affirmed the circuit court's decision.

As mentioned previously, the Supreme Court was petitioned to consider a different standard of review for questions of a foreign country's law. The Hennessys sought reversal of the circuit court and court of appeals decisions based on their interpretation of Mexican law and on comity.

Judicial Spotlight

The Supreme Court, in review of the circuit court record, did not find the court's interpretation clearly erroneous, nor did it find that the circuit court erroneously executed its discretion by choosing to recognize the Mexican judgment in Wisconsin. As a result, the Supreme Court affirmed Wisconsin's longstanding common law approach that foreign laws are facts which must be presented and proven in circuit court as a question of fact, and found the Mexican judgment was properly domesticated.

The case is helpful as it confirmed Wisconsin's current common law standard remains when needing to prove a foreign country's law.

The Wisconsin Supreme Court opinion may be viewed at: https://www.wicourts.gov/sc/opinion/DisplayDocument.pdf?content=pdf&seqNo=473528 ■

Regulatory Spotlight

Agencies Adjust CMPs for Inflation.

- The Bureau of Consumer Financial Protection (CFPB) issued a final rule to adjust for inflation the maximum amount of each civil monetary penalty (CMP) within its jurisdiction. The adjustments are required by the Federal Civil Penalties Inflation Adjustment Act, as amended by the Debt Collection Improvement Act and further amended by the Federal Civil Penalties Inflation Adjustment Act Improvements Act. The inflation adjustments mandated by the Inflation Adjustment Act serve to maintain the deterrent effect of CMPs and to promote compliance with the law. See the final rule for the adjusted CMP amounts. The final rule is effective **01/15/2022**. The final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2022-01-14/pdf/2022-00672.pdf. *Federal Register*, Vol. 87, No. 10, 01/14/2022, 2314-2316.

- The Board of Governors of the Federal Reserve System (FRB) issued a final rule to amend its rules of practice and procedure to adjust the amount of each civil money penalty (CMP) provided by law within its jurisdiction to account for inflation as required by the Federal Civil Penalties Inflation Adjustment Act Improvements Act. See the final rule for the adjusted CMP amounts. The final rule is effective **01/14/2022**. The final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2022-01-14/pdf/2022-00592.pdf. *Federal Register*, Vol. 87, No. 10, 01/14/2022, 2312-2314.

- The Federal Deposit Insurance Corporation (FDIC) issued a notice to adjust its maximum civil money penalties (CMPs) for inflation. See the notice for the adjusted CMP amounts. The adjusted maximum amounts of CMPs are applicable to penalties assessed after **01/15/2022**, for conduct occurring on or after **11/05/2015**. The notice may be viewed at: https://www.govinfo.gov/content/pkg/FR-2022-01-11/pdf/2022-00286.pdf. *Federal Register*, Vol. 87, No. 7, 01/11/2022, 1411-1413.

- The Office of the Comptroller of the Currency (OCC) issued a notice to announce changes to its maximum civil money penalties (CMPs) as adjusted for inflation. The inflation adjustments are required by the Federal Civil Penalties Inflation Adjustment Act, as amended by the Federal Civil Penalties Inflation Adjustment Act Improvements Act. See the notice for the adjusted CMP amounts. The adjusted maximum amount of CMPs are applicable to penalties assessed on or after **01/12/2022**, for conduct occurring on or after **11/02/2015**. The notice may be viewed at: https://www.govinfo.gov/content/pkg/FR-2022-01-12/pdf/2022-00109.pdf. *Federal Register*, Vol. 87, No. 8, 01/12/2022, 1657-1659.

- The Financial Crimes Enforcement Network (FinCEN) issued a final rule to reflect inflation adjustments to its civil monetary penalties (CMPs) as mandated by the Federal Civil Penalties Inflation Adjustment Act, as amended. The final rule adjusts certain maximum CMPs within the jurisdiction of FinCEN to the amounts required by the Act. See the final rule for the adjusted CMP amounts. The final rule is effective **01/24/2022**. The final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2022-01-24/pdf/2022-01284.pdf. *Federal Register*, Vol. 87, No. 15, 01/24/2022, 3433-3435.

- The Office of Foreign Assets Control (OFAC) issued a final rule to adjust certain civil monetary penalties (CMPs) for inflation pursuant to the Federal Civil Penalties Inflation Adjustment Act, as amended by the Federal Civil Penalties Inflation Adjustment Act Improvements Act. See the final rule for the adjusted CMP amounts. The final rule is effective **02/09/2022**. The final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2022-02-09/pdf/2022-02736.pdf. *Federal Register*, Vol. 87, No. 27, 02/09/2022, 7369-7373.

requirements in §1026.9(c)(1)(ii) and (c)(2)(v)(A) is **October 1, 2022**. The final rule provides helpful examples for creditors to determine a replacement index for LIBOR in compliance with Regulation Z requirements.

The final rule also updated the interest rate adjustment sample forms used for certain closed-end ARMs under §1026.20(d) and (c). The updated forms replace LIBOR references with references to a SOFR-based index. Given that most USD LIBOR tenors will not sunset until **June 30, 2023**, creditors have the option to rely on either a form similar to current sample forms (referred to as Legacy Form) or may use updated sample forms (referred to as Revised Form) beginning **April 1, 2022**, through the sunset date **September 30, 2023**. Beginning **October 1, 2023**, creditors may only rely on a form which is substantially similar to the updated sample forms provided in the final rule to be deemed in compliance. The sample forms, found in Appendix H, have been marked to designate the dates for which each may be used.

Resources

The final rule may be viewed at: www.govinfo.gov/content/pkg/FR-2021-12-08/pdf/2021-25825.pdf

A series of frequently asked questions (FAQs) regarding the final rule may be viewed at: https://files.consumerfinance.gov/f/documents/cfpb_libor-transition_faqs.pdf

An Executive Summary of the final rule may be viewed at:
https://files.consumerfinance.gov/f/documents/cfpb_libor-transition_executive_summary_2021-12.pdf

CFPB Director Chorpa's statements regarding the final rule, including a statement that no new financial contracts may reference LIBOR as the relevant index after the end of 2021, and that starting in June 2023, LIBOR can no longer be used for existing financial contracts may be viewed at: www.consumerfinance.gov/about-us/newsroom/statement-of-director-rohit-chopra-on-libor-transition-rule/ ■

WI Supreme Court Finds Garage is Part of Residence Used by Consumer as Dwelling under WCA

In a four-three opinion filed in early January, the Wisconsin Supreme Court concluded that a "dwelling used by the customer as a residence" under the Wisconsin Consumer Act (WCA) includes a garage attached to the residential building in which the customer lives for purposes of rules that need be followed when creditors proceed with nonjudicial repossession.

On behalf of the membership, WBA participated as an *amicus curie* in the case of *Duncan* v *Asset Recovery Specialists, Inc.* as the case involved the interpretation of statutory language used within the repossession rules of the WCA. This case was first reported on in the November 2020 edition of the *WBA Compliance Journal.*

The facts of the case were undisputed by the parties and include that Duncan purchased a vehicle from a dealership; she financed the purchase with a loan. Duncan failed to make payments that came due and eventually was in default. The vehicle served as collateral for the loan and the bank followed the procedure allowed under Wisconsin law for a "nonjudicial" repossession under Wis. Stat. §425.206(1)(d). The bank met all statutory requirements to proceed with nonjudicial repossession and ultimately retained Asset Recovery Specialists to repossess Duncan's vehicle. At the time, Duncan rented an apartment unit in a multi-story apartment building. The ground floor of the building consisted entirely of a private parking garage for tenants, and Duncan sometimes kept her vehicle in it.

The central dispute between the parties is whether Asset Recovery Specialists violated Wis. Stat. §425.206(2)(b) when they entered the garage shared by residents in Duncan's apartment building to repossess her vehicle. The court reviewed language within §425.206(2) which provides in full: In taking possession of collateral or leased goods, no merchant may do any of the following: (a) Commit a breach of the peace. (b) Enter *a dwelling used by the customer as a residence* except at the voluntary request of a customer. The court focused its review on the statutory language in italics.

Although "dwelling" is undefined in the WCA, the court looked to the word's ordinary, dictionary definition, and to the use of the word in other sections of the WCA and its Administrative Code. In taking that approach, the court concluded a "dwelling" means, at minimum, a building in which at least one person lives. In proceeding in this manner, the court concluded that "dwelling used by the customer as a residence" in Wis. Stat. §425.206(2)(b) includes a garage attached to the residential building in which the customer lives. In making its conclusion, Asset Recovery Specialists was found to have violated §425.206(2)(b) when they repossessed Duncan's car from the parking garage of her apartment building without her consent.

While the banking industry sided with the dissent opinion, the court's opinion provides clarity of the term "dwelling." And, while banks in Wisconsin are not heavily engaged in nonjudicial repossession of vehicles, the effect of the court's decision broadens the plain language of Wis. Stats. §425.206(2)(b). As a result, banks need be aware of the court's new interpretation to ensure there is no violation of the WCA when repossessing vehicles in a similar setting.

The Wisconsin Supreme Court opinion may be viewed at:
https://www.wicourts.gov/sc/opinion/DisplayDocument.pdf?content=pdf&seqNo=470708 ■

Regulatory Spotlight

Agencies Issue Determination of Review of Several Definitions Within Credit Risk Retention Regulations.

The Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), Department of Housing and Urban Development (HUD), Federal Housing Finance Agency (FHFA), and Securities and Exchange Commission (SEC) (collectively, the agencies) issued a determination of the results of the review of the definition of qualified residential mortgage, the community-focused residential mortgage exemption, and the exemption for qualifying three-to-four unit residential mortgage loans, in each case as currently set forth in the agencies' Credit Risk Retention Regulations. After completing the review, the agencies have determined not to propose any change at this time to the definition of qualified residential mortgage, the community-focused residential mortgage exemption, or the exemption for qualifying three-to-four unit residential mortgage loans. The notice may be viewed at: https://www.govinfo.gov/content/pkg/FR-2021-12-20/pdf/2021-27561.pdf. *Federal Register*, Vol. 86, No. 241, 12/20/2021, 71810-71813.

Agencies Issue Final Rule to Amend Small Bank and Intermediate Small Bank CRA Asset-Size Thresholds.

The Board of Governors of the Federal Reserve System (FRB) and Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) issued a final rule to amend Community Reinvestment Act (CRA) regulations to adjust the asset-size thresholds used to define "small bank" and "intermediate small bank." As required by CRA regulations, the adjustment to the threshold amount is based on the annual percentage change in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI–W). "Small bank" means a bank that, as of December 31 of either of the prior two calendar years, had assets of less than $1.384 billion. "Intermediate small bank" means a small bank with assets of at least $346 million as of December 31 of both of the prior two calendar years and less than $1.384 billion as of December 31 of either of the prior two calendar years. The final rule is effective **01/01/2022**. The final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2021-12-20/pdf/2021-27439.pdf. *Federal Register*, Vol. 86, No. 241, 12/20/2021, 71813-71815.

Agencies Adjust CMPs for Inflation.

- The National Credit Union Administration (NCUA) issued a final rule to amend its regulations to adjust the maximum amount of each civil monetary penalty (CMP) within its jurisdiction to account for inflation. The action, including the amount of the adjustments, is required under the Federal Civil Penalties Inflation Adjustment Act, as amended by the Debt Collection Improvement Act and the Federal Civil Penalties Inflation Adjustment Act Improvements Act. The final rule is effective **01/05/2022**. The final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2022-01-05/pdf/2021-28555.pdf. *Federal Register*, Vol. 87, No. 3, 01/05/2022, 377-380.

into law. The Governor's veto was a disappointment, but WBA is hopeful both sides can reach a consensus later this year to finally repeal this archaic tax.

A copy of the 2022-2023 Wisconsin State Budget may be viewed at: https://docs.legis.wisconsin.gov/2021/related/acts/58.pdf

A copy of the Governor's full veto message on the state budget may be viewed at: https://content.govdelivery.com/attachments/WIGOV/2021/07/08/file_attachments/1873805/Gov.%20Evers%202021-23%20Veto%20Message.pdf

The Governor's personal property tax veto message may be viewed at: https://content.govdelivery.com/attachments/WIGOV/2021/07/08/file_attachments/1874361/191.pdf ■

Recent WI Supreme Court Cases Affirm DNR Authority to Place Permit Restrictions on Farms and High-Capacity Wells

The Wisconsin Supreme Court (Court) recently decided two cases to allow the Wisconsin Department of Natural Resources (DNR) to place permit restrictions on large livestock farms and high-capacity wells as a way to protect Wisconsin's water. The issue in both cases is whether DNR had the authority under Wisconsin law to issue permits with conditions.

In both cases, the Court looked to language used in Sec. 227.10(2m) Wis. Stats. and determined that (1) agencies' actions under administrative law need be supported by explicit, not specific, statutory or regulatory authority; and (2) that explicit authority can be broad in scope. As a result of the two decisions, DNR was given broader authority than many believed was permissible since enactment of 2011 Wisconsin Act 21 (Act 21) because the agency actions authorized by the Court are not specifically stated in the statute sections in question. The following is a summary of the two cases.

Kinnard Farms

In the first case, Kinnard operates a large, concentrated animal feeding operation (CAFO). Kinnard wanted to expand its dairy operations by building a second site and adding 3,000 dairy cows. The expansion required Kinnard to apply to DNR for reissuance of its Wisconsin Pollutant Discharge Elimination System (WPDES) permit to include both the original site and the proposed expansion. DNR approved the application and reissued Kinnard's WPDES permit.

Persons (petitioners) living near the CAFO sought review of the reissued WPDES permit because of their proximity to the farm, had private drinking wells, and were concerned the proposed expansion would exacerbate current groundwater contamination issues. The petitioners alleged that the reissued WPDES permit was inadequate because, among other things, it did not set a "maximum number of animal units" or "require monitoring to evaluate impacts to groundwater."

DNR granted the petitioners a contested case hearing and the matters were referred to an administrative law judge (ALJ). Kinnard filed for summary judgment alleging DNR lacked statutory authority to impose the conditions, citing Act 21. The ALJ denied the motion and conducted a four-day evidentiary hearing during which community members who lived or worked near the CAFO testified about contamination of well water and the impact the contamination had on their businesses, homes, and daily lives. Based upon evidence presented by residents and experts, the ALJ determined that DNR had "clear regulatory authority" to impose the two conditions disputed upon Kinnard's reissued WPDES permit.

Ultimately the matter was argued to the Court. The issue in the case involved sec. 227.10(2m), Wis. Stats., which dictates that "[n]o agency may implement or enforce any standard, requirement, or threshold…unless that standard, requirement, or threshold is *explicitly required or explicitly permitted by statute or by a rule* that has been promulgated in accordance with this subchapter." (emphasis

added). The parties disputed the meaning of "explicitly required or explicitly permitted" in the context of DNR imposing conditions upon Kinnard's reissued WPDES permit.

Kinnard asserted that explicit means specific, and that in the absence of statutory or administrative authority, DNR must first promulgate a rule in order to impose the conditions upon its reissued WPDES permit. The DNR and petitioners countered that such a reading of "explicitly required or explicitly permitted" was too narrow, and that Kinnard had overlooked the explicit, but broad, authority given to DNR in Secs. 283.31(3) – (5) Wis. Stats. to prescribe such conditions.

The Court first looked to dictionary definitions of the term "explicit" and revised Sec. 227.10(2m) in context and determined explicit authority can be broad in scope. The court next examined the text of Secs. 283.31(3) – (5), and related regulations, to determine whether DNR had explicit authority to impose an animal unit maximum and off-site groundwater monitoring conditions upon Kinnard's reissued WPDES permit. The Court held that while the statute sections do not specifically state an animal unit limit or off-site ground water monitoring, DNR did have explicit authority to prescribe both conditions when it reissues the WPDES permit.

The Court determined that (1) agencies' actions under administrative law need be supported by explicit, not specific, statutory or regulatory authority; and (2) that explicit authority can be broad in scope.

High-Capacity Wells

In a second case, the Court also reviewed whether Sec. 227.10(2m) Wis. Stats. allowed for DNR to consider the potential environmental effects of proposed high-capacity wells when such consideration is not required under Sec. 281.34(4) Wis. Stats.

For some types of wells, DNR is required to follow a specific process in its environmental review of a well application. For other types of wells, a specific process is not required; however, DNR often still considers the potential environmental impact of a proposed well when considering a well application. Eight well applications in dispute in the case were the type that no specific environmental review was required. DNR did have information that the wells would negatively impact the environment. DNR approved the applications, knowing the impact of the wells, having concluded it did not have the authority to consider the proposed wells' environmental impact.

Clean Wisconsin and the Pleasant Lake Management District (collectively, Clean Wisconsin) appealed DNR's action arguing DNR's decision was contrary to the Court's decision in the *Lake Beulah Management District v. DNR* (2011 WI 54, 335 Wis. 2d 47, 799 N.W.2d 73) case. In *Lake Beulah*, the Court held that DNR had the authority and discretion to consider the environmental effects of all proposed high-capacity wells under the public trust doctrine when it determined that a proposed well would harm other waters in Wisconsin.

DNR argued the *Lake Beulah* court case was no longer good law because Act 21 had since become law and the law limits an agency's action to only those "explicitly required or explicitly permitted by statute or by a rule." The eight well applications were for the type of wells for which there was no formal environmental review under Sec. 281.34 Wis. Stats. DNR had also relied on a past Attorney General opinion which stated the agency could not rely on the public-trust authority and could not rely upon the *Lake Beulah* case as that would not withstand the requirements under Wis. Stats. Sec. 227.10(2m) (OAG-01-16).

With respect to the high-capacity well applications, the Court ruled in favor of Clean Wisconsin having determined DNR has explicit authority, based upon its broad public trust authority under Secs. 281.11 and 281.22 Wis. Stats., to determine the environmental impact of high-capacity wells despite the fact that Sec. 281.34 does not specifically state such requirement. The Court's finding reaffirmed the Court's *Lake Beulah* decision despite enactment of Act 21.

Take Away from Cases

The interesting and concerning parts of the decisions are that after the passage of Act 21, many took the revised language of Sec. 227.10(2m) Wis. Stats. to mean that for an agency to act, the action had to be specifically stated or provided for within statutory language or administrative rule. If the action was not within such language, the agency would first have to promulgate a rule or otherwise change statutory language for the agency to take the actions desired.

However, given how the Court has interpreted "explicit" in the two cases, that may not be the case. It is possible that because of the two Court decisions, an agency may act regardless of the action not being stated within statutory language or administrative rule. Instead, it is possible an agency may rely on its broader authority for action.

Judicial Spotlight

Financial institutions should keep the decisions of the two Court cases in mind when considering whether an agency has the authority to act in a particular manner. Financial institutions should be cautious that just because an action is not specifically found within statute or rule, the action may still be authorized under a broader, explicit authority. Despite the passage of Act 21, agency action could be broad.

As is often the case, one should read the dissenting opinions of both cases. The dissenting opinions outline the concerns of many regarding how broad an agency may act despite Act 21, despite the fact the agency's actions were not specifically stated within statute or administrative rule in connection with reissuing an WPDES permit or when approving the type of well applications involved in the high-capacity well case, and despite the Court's previous decision under *Tetra Tech EC Inc. v. Wisconsin Dep't of Revenue*, 2018 WI 75, 373 Wis.2d 2387, 890 N.W.2d. 598. The decisions appear to give back to agencies potentially broad authority.

Conclusion

In both cases, the Court looked to language used in Wis. Stats. Sec. 227.10(2m) and determined that (1) agencies' actions under administrative law need be supported by explicit, not specific, statutory or regulatory authority; and (2) that explicit authority can be broad in scope. As a result of the two decisions, DNR was given broader authority than many believed was permissible since enactment of Act 21 and *Tetra Tech*. Financial institutions need be aware of the Court decisions and be cautious that just because an action is not specifically found within statute or rule, the action may still be authorized under an agency's broader, explicit authority.

Clean Wisconsin et. Al v. Wis. Dep't of Natural Resources, 2021 WI 71 (Kinnard Farm) decision may be viewed at: https://www.wicourts.gov/sc/opinion/DisplayDocument.pdf?content=pdf&seqNo=386188

Clean Wisconsin and Pleasant Lake Mgmt. Dist. v. Wis. Dep't of Natural Resources, 2021 WI 72 (High-Capacity Wells) decision may be viewed at: https://www.wicourts.gov/sc/opinion/DisplayDocument.pdf?content=pdf&seqNo=385454 ■

Regulatory Spotlight

CFPB Issues Final Rule to Amend Regulation X to Provide Protections for Borrowers Affected by COVID-19 Emergency.

The Bureau of Consumer Financial Protection (CFPB) issued a final rule to amend Regulation X, with implements the Real Estate Settlement Procedures Act (RESPA), to assist mortgage borrowers affected by the COVID-19 emergency. The final rule establishes temporary procedural safeguards to help ensure that borrowers have a meaningful opportunity to be reviewed for loss mitigation before the servicer can make the first notice or filing required for foreclosure on certain mortgages. In addition, the final rule would temporarily permit mortgage servicers to offer certain loan modifications made available to borrowers experiencing a COVID-19-related hardship based on the evaluation of an incomplete application. CFPB has also finalized certain temporary amendments to the early intervention and reasonable diligence obligations that Regulation X imposes on mortgage servicers. The final rule is effective **08/31/2021**. The final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2021-06-30/pdf/2021-13964.pdf. *Federal Register,* Vol. 86, No. 123, 06/30/2021, 34848-34903.

CFPB Issues Interpretive Rule Regarding Examinations for Risks to Active-Duty Servicemembers and Covered Dependents.

CFPB issued an interpretive rule regarding its examination for risk to active-duty servicemembers and their covered dependents. In the interpretive rule, CFPB outlines its statutory authority to conduct examinations, at the institutions that it supervises, regarding the risks to active-duty servicemembers and their covered dependents that are presented by conduct that violates the Military Lending Act. The interpretive rule explains the basis for CFPB's authority. The interpretive rule is effective **06/23/2021**. The interpretive rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2021-06-23/pdf/2021-13074.pdf. *Federal Register,* Vol. 86, No. 118, 06/23/2021, 32723-32728.

Wisconsin Court of Appeals Determines Parking Garage at Apartment Building Part of Residence under WCA Repossession Rules

The Court of Appeals of Wisconsin recently decided a matter concerning the Wisconsin Consumer Act as it relates to the repossession of a consumer's motor vehicle located in a parking garage at an apartment building. At issue was whether the parking garage should be considered a dwelling and whether the dwelling was used by the consumer as a residence. This article outlines the court's decision and rationale which secured creditors should take into consideration if repossessing motor vehicle collateral from an apartment building parking garage.

Background

Danelle Duncan purchased a vehicle from a dealership. Duncan financed the purchase with a loan. The vehicle served as collateral for the loan. The loan contract was ultimately assigned to Wells Fargo Bank. Duncan failed to make payments that came due and eventually was in default. The loan was subject to the Wisconsin Consumer Act (WCA).

Generally speaking, the WCA allows a creditor two paths for recovering motor vehicle collateral when the consumer is in default. Under the first option, pursuant to Wis. Stat. sec. 425.205, Wells Fargo Bank could go to court to obtain a replevin judgment. Alternatively, the bank could follow the procedures for a "nonjudicial" repossession under Wis. Stat. sec. 425.206(1)(d). The bank chose to proceed under the "nonjudicial" method of repossession and after properly performing all requirements to proceed with nonjudicial repossession, Wells Fargo Bank retained the services of Asset Recovery Specialists to perform the repossession of the motor vehicle collateral.

Duncan rented an apartment unit at a multi-story apartment building. The ground floor of the building consisted entirely of a private parking garage for tenants. Duncan sometimes kept her vehicle in the parking garage. When a representative for Asset Recovery Specialists arrived to repossess Duncan's motor vehicle, the garage door had been left open and Duncan's vehicle was parked inside the garage. Asset Recovery attached the vehicle to its tow truck and drove away with the vehicle. No one on behalf of Asset Recovery Specialists interacted with Duncan at time of the repossession.

Besides an unconscionable conduct claim in the lawsuit, Duncan alleged Asset Recovery Specialists violated the WCA when it repossessed her motor vehicle.

Illegal Repossession Claim

The main dispute between Duncan and Asset Recovery Specialists is whether Asset Recovery violated Wis. Stat. sec. 425.206(2)(b) when they entered the garage shared by residents in Duncan's apartment building to repossess her motor vehicle.

Section 425.206(2)(b), Wis. Stat. provides: In taking possession of collateral or leased goods, no merchant may do any of the following: (a) commit a breach of the peace; (b) enter a dwelling used by the consumer as a residence except at the voluntary request of a customer.

The court had to determine whether entering the parking garage to repossess the motor vehicle was considered entering a dwelling used by the consumer as a residence. In its review of the matter, the Court of Appeals considered the meaning of the term "dwelling" as the term is used in section 425.206(2)(b).

"Dwelling" is not a defined term under WCA. However, the Wisconsin Department of Financial Institutions (DFI) has defined the term within its administrative code for the WCA. Section DFI-WCA 1.392 provides: "For the purposes of s. 422.419(1)(a), Stats., the term "dwelling" shall include, any garage, shed, barn or other building on the premises whether attached or unattached." The administrative code section has been in force since the WCA went into effect in 1973. While DFI's administrative code section references a section different from the motor vehicle repossession rules of sec. 425.206(2)(b), the court applied the administrative code language in this situation.

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The court also had to consider whether the dwelling was used by the consumer as a residence. Language within 426.206(2)(b) does not prohibit merchants from entering any dwelling; rather, it prohibits merchants from entering a dwelling used by the customer as a residence. The two parties did not agree as to what was considered a "dwelling used by the customer as a residence." Asset Recovery Specialists claimed the garage should not be considered to be used by Duncan as a residence as she lacked the authority to exclude others from the parking garage and did not use it as living quarters, such as a place that contained furniture, has a bathroom, a place to sleep, cook, and eat. Duncan claimed the rule to be straightforward, simply that—a merchant may not enter the customer's dwelling in the course of a repossession.

Despite the Appeals Court having to stretch meanings to avoid rendering statutory provisions meaningless, and in an attempt to reconcile separate statutory provisions, the Appeals Court agreed with Duncan's interpretation of the statute and concluded that the garage in her apartment building was part of the "dwelling used by the customer as a residence." The Appeals Court concluded Duncan was entitled to summary judgment in her favor on the illegal repossession claim. The Appeals Court made no decision about the appropriate disposition of Duncan's unconscionable conduct claim and the case was remanded to circuit court for further proceedings.

As a result of the Appeals Court action, a bank need be aware that if it seeks to repossess motor vehicle collateral pursuant to Wis. Stat. sec. 426.206(1)(d), and that collateral is located in a parking garage of a consumer's apartment building, the parking garage will be considered a dwelling used by the customer as a residence. And, in accordance with sec. 426.206(2)(b), when taking possession of motor vehicle collateral, the bank cannot enter the parking garage except at the voluntary request of the consumer. The Appeals Court opinion may be viewed at: https://www.wicourts.gov/ca/opinion/DisplayDocument.pdf?content=pdf&seqNo=273623 ■

Regulatory Spotlight

Agencies Issue Final Temporary Appraisal Deferral Rule.

The Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) (collectively, the agencies) adopted as final an interim final rule published by the agencies on **04/17/2020**, which made temporary amendments to the agencies' regulations that require appraisals for certain real estate-related transactions. The final rule adopts the deferral of the requirement to obtain an appraisal or evaluation for up to 120 days following the closing of certain residential and commercial real estate transactions, excluding transactions for acquisition, development, and construction of real estate. Regulated institutions should make best efforts to obtain a credible estimate of the value of real property collateral before closing the loan and otherwise underwrite loans consistent with the principles in the agencies' *Standards for Safety and Soundness and Real Estate Lending Standards*. The final rule adopts the interim final rule with one revision in response to comments received. The final rule is effective **10/16/2020**, through **12/31/2020**. The final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2020-10-16/pdf/2020-21563.pdf. *Federal Register*, Vol. 85, No. 201, 10/16/2020, 65666-65672.

Agencies Revise Regulatory Capital and LCR Rules Due to Pandemic Related Activities.

The Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) (collectively, the agencies) issued a final rule to adopt revisions to the regulatory capital rule and the liquidity coverage ratio (LCR) rule made under three interim final rules published in the *Federal Register* on **03/23/2020**, **04/13/2020**, and **05/06/2020**. The agencies adopted the interim final rules as final with no changes. Under the final rule, banking organizations may continue to neutralize the regulatory capital effects of participating in the Money Market Mutual Fund Liquidity Facility (MMLF) and the Paycheck Protection Program Liquidity Facility (PPPLF), and are to continue to neutralize the LCR effects of participating in the MMLF and the PPPLF. In addition, Paycheck Protection Program (PPP) loans will receive a zero percent risk weight under the agencies' regulatory capital rules. The final rule is effective **12/28/2020**. The final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2020-10-28/pdf/2020-21894.pdf. *Federal Register*, Vol. 85, No. 209, 10/28/2020, 68243-68249.

Agencies Issue Statement on Reference Rates for Loans.

The Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) (collectively, the agencies) issued a statement to reiterate the agencies are not endorsing a specific replacement rate for LIBOR for loans. A bank may use any reference rate for its loans that the bank determines to be appropriate for

transfers, and Koss did not have one. Koss was unable to explain why wire transfers sent to other Koss bank accounts would have raised suspicions on the part of any Park Bank employee.

It is helpful to note that according to the Concurring Opinion neither "the amount and number of transactions carried out on an account containing fiduciary funds, nor the mere names of payees on checks drawn on that account, should be sufficient to create bad faith liability based on Bank's action in paying such checks." And in this case, over a period of ten years of the officer's embezzlement, a period during which Park Bank issued more than 60,000 cashier's checks, and 49 bank employees issued the 359 cashier's checks requested by the Koss officer, was not sufficient to establish "bad faith" and liability based on Park Bank's action in paying such checks over such a period of time.

In the end, Park Bank won this case at the trial court level, on appeal at the Court of Appeals level and at the Supreme Court level, regardless of which definition of "bad faith" was applied by the courts. The facts simply did not justify a finding under any of these definitions that Park Bank acted in bad faith and the courts therefore determined Park Bank was not liable to Koss for the embezzlement.

WBA wishes to thank Atty. John Knight, Boardman & Clark, llp for providing this article. ■

Supreme Court Issues Ruling on Koss Corp v. Park Bank Case Addressing Definition of Bad Faith Under Uniform Fiduciary Act

On January 29, 2019, the Wisconsin Supreme Court (Court) issued its opinion in the Koss Corporation v. Park Bank case (Koss Corp.). The case involved the definition of "bad faith" under Wisconsin's Uniform Fiduciary Act (UFA). Previously, there was little case law in Wisconsin interpreting "bad faith" under the UFA. WBA filed with the Wisconsin Supreme Court an amicus brief in support of Park Bank's position.

An employee embezzled approximately $34 million from Koss Corporation over a period of ten years. The employee used multiple methods to embezzle funds. Methods included obtaining cashier's checks for personal expenditures, instructing other, non-signatory employees to request checks, taking and cashing checks made payable to cash, and initiating wire transfers to out-of-state banks. After the employee pled guilty, Koss Corporation sought relief against Park Bank under the UFA, claiming Park Bank acted in bad faith in those transactions. The Milwaukee Circuit Court dismissed all claims against Park Bank. The Wisconsin Court of Appeals affirmed the lower court, and the Wisconsin Supreme Court affirmed that decision.

Two conclusions are clear from the Court's decision. First, Park Bank's conduct did not amount to bad faith. Second, negligence does not prove bad faith. However, a disagreement between the lead opinion and the concurring opinions disrupted the opportunity to clearly define "bad faith." This article will discuss what is clear from the Court's opinion, what is unclear, and how the opinion affects Wisconsin banks.

Koss Corp. involves the question of whether a bank can be held liable for the actions of a third party fiduciary. Specifically, whether a bank can be held liable for acting in "bad faith" in its transactions with an employee embezzling millions from a corporate deposit account. The UFA provides protections from such liabilities and was adopted by Wisconsin in 1925. Wis. Stats. Section 112.01(9) of the UFA provides standards whereby a bank can obtain protection from claims involving the acts of a customer's fiduciaries. In this case, that section forms the basis of Koss Corporation's claim that Park Bank acted in bad faith. The Court broke 112.01(9) down into three standards by which a bank could be liable:

1. When a bank had actual knowledge of the unlawful conduct of a fiduciary;

[1] The UFA provides protections for banks. This case was unique in that the UFA was presented as the basis for a complaint rather than as a defense. The Court's opinion is still significant in understanding that defense.

2. When a bank had knowledge of sufficient facts to show that it acted in bad faith by honoring a fiduciary's withdrawals from the principal's account; or,

3. When a drawee bank accepts its own check in payment of or as security for a personal debt of the fiduciary at the drawee bank, contrary to the interest of the principal.

Koss Corporation alleged, based upon 112.01(9), that Park Bank's transactions were done in bad faith. Because neither 112.01(9) nor the rest of the UFA defines bad faith, its definition became the issue before the Court.

While the Court ruled that Park Bank did not act in bad faith, the lead and concurring opinions reached this conclusion by different means. The lead opinion and the concurring opinion define bad faith differently. The significance of this will be discussed below. First, it is important to examine both opinions.

The lead opinion began its analysis with the UFA's definition of good faith to construe a definition of bad faith. By that definition, a thing is done in good faith when it is done honestly, whether it be done negligently or not. Thus, the lead opinion concluded that bad faith must involve something more than negligent bank conduct, in which the bank acted dishonestly. The concurring opinion agreed with this portion of the lead's analysis.

In creating its test for bad faith the Court's lead opinion set forth the following standard:

1. Bad faith is reviewed on a transaction by transaction basis.

2. Bad faith is determined at the time of breach of fiduciary duty.

3. Bad faith is an intentional tort. Negligence is insufficient to show bad faith.

4. Bad faith requires subjective intent.

The first component of the test means that even if an aggregate view of every transaction made by the fiduciary creates a pattern that reveals a breach of duty, that is still insufficient to establish bad faith. So, the facts known to each individual bank employee are not aggregated to form collective knowledge of the bank. Furthermore, whether a bank acted in bad faith is determined at the time of the breach of fiduciary duty, not by looking back at transactions that occurred many months earlier. Instead, the Court gave the example that a bank is liable to the principal if its action in a single transaction amounts to bad faith.

The lead opinion also concluded that bad faith is an intentional tort. Thus, a finding of bad faith requires subjective, rather than objective, intent. Meaning, a bank's actions in relation to the breach must be intentional. Recall that a thing done in good faith is done honestly. So bad faith would mean an intentional, dishonest act, such as a bank that deliberately evades knowledge because of a belief or fear that an inquiry would disclose a vice or defect in the transaction. A clear example would be a bank that obtains actual knowledge of fiduciary misconduct, ignores investigating that misconduct in order to avoid discovering the defect, and continues with the transaction.

This is where the concurring opinion disagreed with the lead opinion. The concurring opinion rejected the lead's conclusion that bad faith requires willful and deliberate bank action. Instead, the concurring opinion set forth that bad faith requires evidence that a bank remained passive in the face of compelling and obvious facts suggesting fiduciary misconduct.

The distinction between the lead and concurring opinions turns on the matter of actual knowledge. The lead would require it. The concurrence would not, and instead would create a standard whereby something less than actual knowledge is required to find bad faith. Specifically, that standard would be a bank that remains passive in the face of compelling and obvious facts of misconduct.

The following is an example which explains these standards. Consider a fiduciary who writes a check on their employer's account to a department store. It later turns out that this check was drawn to pay for the fiduciary's personal expenses, resulting in a breach of duty. The lead opinion would ask: did bank have actual knowledge, and intentionally ignore that actual knowledge to avoid finding a defect in the transaction? If so, that is bad faith. The concurring opinion would ask: did the facts of the transaction suggest anything that should have been obvious enough to the bank to suggest it should investigate further into the transaction, and if so, did the bank fail to do so? If so, that is bad faith.

The lead and concurring opinions did reach the conclusion that Park Bank's activities did not amount to bad faith, and negligence does not amount to bad faith. That means that a higher standard than negligence must be proven to establish bad faith. However, because of the different standards proposed by both the lead and concurring opinions a question of law still exists as to: what is that standard? That is ultimately a complex question of jurisprudence and legal precedent beyond the scope of this article. Instead of exploring that issue, the remainder will focus on how banks should consider the results of Koss Corp. despite the lack of clarity in a test for bad faith.

The Koss Corp. case is still a win for the banking industry. The fact that Park Bank prevailed, and the Court's conclusion that negligence does not amount to bad faith should not be overshadowed by the legal complexities created by its opinion. Banks should review their deposit documentation, policies, and procedures, and seek to eliminate any practices that could be found to result in bad faith pursuant to the Court's opinion. This could mean a review for any practices that might result in "willful" bad faith or "passive" bad faith to avail itself of potential protections under either of the Court's standards. For a review of bank's policies, WBA recommends working with its legal counsel.

Special Focus

WBA will continue to monitor the results of Koss Corp. and report whether a bad faith standard becomes clear. It may require application in a lower court first, where a decision of what test to apply would need to be made.

The Koss Corp. decision can be found here: https://www.wicourts.gov/sc/opinion/DisplayDocument.pdf?content=pdf&seqNo=233852 ■

Regulatory Spotlight

Agencies Propose Thresholds Increase for the Major Assets Prohibition of the Depository Institution Management Interlocks Act Rules.

The Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) issued a proposed rule that would increase the major assets prohibition thresholds for management interlocks in the agencies' rules implementing the Depository Institution Management Interlocks Act (DIMIA). The DIMIA major assets prohibition prohibits a management official of a depository organization with total assets exceeding $2.5 billion (or any affiliate of such an organization) from serving at the same time as a management official of an unaffiliated depository organization with total assets exceeding $1.5 billion (or any affiliate of such an organization). DIMIA provides that the agencies may adjust, by regulation, the major assets prohibition thresholds in order to allow for inflation or market changes. The agencies propose to raise the major assets prohibition thresholds to $10 billion to account for changes in the United States banking market since the current thresholds were established in 1996. The agencies also propose three alternative approaches for increasing the thresholds based on market changes or inflation. Comments are due **04/01/2019**. The notice may be viewed at: https://www.govinfo.gov/content/pkg/FR-2019-01-31/pdf/2018-28038.pdf. *Federal Register*, Vol. 84, No. 21, 01/31/2019, 604-612.

Agencies Propose Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships With, Hedge Funds and Private Equity Funds.

The Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Commodity Futures Trading Commission (CFTC), and the Securities and Exchange Commission (SEC) issued a proposal to amend the regulations implementing the Bank Holding Company Act's (BHC Act) prohibitions and restrictions on proprietary trading and certain interests in, and relationships with, hedge funds and private equity funds in a manner consistent with the statutory amendments made pursuant to certain sections of the Economic Growth, Regulatory Relief, and Consumer Protection Act. The statutory amendments exclude from these restrictions certain firms that have total consolidated assets equal to $10 billion or less and total trading assets and liabilities equal to five percent or less of total consolidated assets and amend the restrictions applicable to the naming of a hedge fund or private equity fund to permit an investment adviser that is a banking entity to share a name with the fund under certain circumstances. Comments are due **03/11/2019**. The notice may be viewed at: https://www.govinfo.gov/content/pkg/FR-2019-02-08/pdf/2019-00797.pdf. *Federal Register*, Vol. 84, No. 27, 02/08/2019, 2778-2791.

Agencies Propose Capital Simplification for Qualifying Community Banking Organizations.

The Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) issued a proposal that would provide for a simple measure of capital adequacy for certain community banking organizations, consistent with section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act. Under the proposal, most depository institutions and depository institution holding companies that have less than $10 billion in total consolidated assets, that meet risk-based qualifying criteria, and that have a community bank leverage ratio (as defined in the proposal) of greater than 9 percent would be eligible to opt into a community bank leverage ratio framework. Such banking organizations that elect to use the community bank leverage ratio and that maintain a community bank leverage ratio of greater than 9 percent would not be subject to other risk-based and leverage capital requirements and would be considered to have met the well capitalized ratio requirements for purposes of section

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Compliance Journal

Special Focus

Do Banks Have To Monitor Corporate Deposit Accounts To Make Sure Officers Named On Those Accounts Are Acting Lawfully?

The short answer to this question is "no," but the long answer gets more complicated. The Wisconsin Supreme Court recently delved into the long answer when it was presented with that question in Koss Corporation v. Park Bank, (2019 WI 7, dated 1/29/2019), and fortunately, it came up with the same answer to the long question, and that is "no." The Court determined that Park Bank, Milwaukee, was not liable for a massive embezzlement from Koss Corporation ("Koss") accounts at Park Bank over a period of many years thanks to the Uniform Fiduciary Act adopted by Wisconsin in 1925 ("UFA"). Under the UFA, a "fiduciary" includes an officer of a corporation as well as partners and agents of corporations, limited liability companies, partnerships, or other associations. The UFA, which is a uniform law adopted by many states, clarifies that banks are not responsible for monitoring fiduciary accounts and placed the burden of employing honest employees managing those accounts on the entities that open the deposit accounts. The UFA was enacted to "facilitate banking and financial transactions" by providing relief from consequences of the then law which was to place the duty of monitoring fiduciary accounts for wrongdoing on the bank's shoulders. Thus, under the UFA, simple negligence by a bank with respect to a corporation's deposit accounts will not lead to bank liability. However, there are certain and very limited circumstances when a bank may be found liable under the UFA for the unlawful acts of a corporate officer with respect to the corporation's deposit accounts, and that is what the Koss Corporation v. Park Bank case was all about.

In this case, a Koss senior executive officer embezzled $34 million from Koss over a nine-year period without her employer noticing. Koss attempted to shift the losses caused by its own high-level executive's criminal conduct to Park Bank by arguing that the Court should find that a bank's alleged negligence in dealing with the officer constitutes liability under the UFA. Fortunately, the Court said "no" and determined that negligence alone will not lead to bank liability. This is one of the helpful holdings of the Court in this case that will definitely benefit banks maintaining UFA accounts, and virtually every bank maintains UFA accounts for their corporate customers.

In greater detail, the UFA provides for three separate standards according to which a bank could be held liable for a fiduciary's embezzlement from an account or other breach of the fiduciary's duty to the corporation. Those three standards are (1) where the bank has actual knowledge of the unlawful conduct of the fiduciary, (2) where the bank has knowledge of sufficient facts to show that it acted in "bad faith" by honoring the fiduciary's withdrawals from the account, or (3) where the bank accepts its own check in payment of a personal debt of the fiduciary to the bank. In this case, no evidence was offered by Koss that Park Bank violated standards (1) and (3), and therefore Koss alleged Park Bank's transactions with the officer who engaged in the criminal acts through the account were done in "bad faith." So this case focused on whether Park Bank violated the "bad faith" standard under the UFA to determine whether Park Bank has liability to Koss, and for this purpose the Court had to define "bad faith." "Bad faith" had not previously been defined by Wisconsin courts under the UFA since 1925 when it was enacted.

The Court's effort to define "bad faith" led to certain differences of opinion among the seven Justices on the Wisconsin Supreme Court, which differences will make it difficult for attorneys going forward to make meaningful determinations for their clients. There were three different written opinions from the Court in this case. One was called the "Lead Opinion" and was rendered by two of the seven Justices, the second was called the "Concurring Opinion" and was rendered by three of the Justices, and the third was the "Dissenting Opinion" and was rendered by two of the Justices. Importantly, the "Lead Opinion" and the "Concurring Opinion" rendered by five Justices determined that the claim by Koss against Park Bank should be dismissed. That is an official holding of the Court in this case. It means that Park Bank won the case and it is good news for the banking industry. The Dissenting Opinion

determined that the case should not be dismissed and should be sent back to the trial court for a new trial by a jury, but fortunately that opinion was made by only two of the Justices and is not the decision of the Court in this case. Lawyers for banks will be assigned the task of interpreting the "Lead Opinion" and the "Concurring Opinion" to determine the legal definition of "bad faith" going forward. I will not attempt here to sort out the differences between these two opinions and indicate which might be applicable in a future case, but I will focus on the Concurring Opinion since it will be the most difficult of the two opinions for banks to comply with. Therefore, in my view, if a bank complies with the definition of "bad faith" as described in the Concurring Opinion it is likely to be able to withstand any case brought against it down the road claiming the bank acted in "bad faith."

According to the Concurring Opinion, the standard of "bad faith" is defined as follows:

> "[B]ad faith denotes a reckless disregard or purposeful obliviousness of the known facts suggesting impropriety by the fiduciary. It is not established by negligent or careless conduct or by vague suspicion. Likewise, actual knowledge of and complicity in the fiduciary's misdeeds is not required. However, where facts suggesting fiduciary misconduct are compelling and obvious, it is bad faith to remain passive and not inquire further because such inaction amounts to a deliberate desire to evade knowledge."

The lead opinion imposed a more exacting definition of "bad faith" which would make it more difficult for customers to substantiate claims for "bad faith" against banks under the UFA. I believe the bottom line is that if a bank at least meets the standard imposed by the concurring opinion it should avoid any liability to corporate customers alleging breach of "bad faith" under the UFA. Bank counsel will, of course, in the event of litigation, argue the applicability of the more exacting standard as determined by the lead opinion is applicable to bank customers making UFA claims.

Again, regardless of the standard used, neither the Lead Opinion nor the Concurring Opinion found "bad faith" on the part of Park Bank in this case. The three Justices on the Concurring Opinion concluded that even under their less onerous standard of "bad faith" than the one adopted by the "Lead Opinion" that summary judgment in favor of Park Bank was appropriate and therefore Park Bank won the case. According to the Concurring Opinion, Koss did not put forth sufficient evidence that Park Bank remained passive in the face of compelling and obvious facts suggesting fiduciary misconduct. The Court noted that even Koss itself did not notice the fraud for several years. According to the Concurring Opinion, the facts of this case did not present the "compelling and obvious" suggestion of fiduciary misconduct so as to place liability on Park Bank.

Banks may wish to include a greater focus in their training of bank personnel on claims made under the UFA and the responsibilities of the bank under the UFA in the event bank personnel become aware of facts suggesting impropriety by a fiduciary on an account. In that event, the bank may wish to inquire further given that inaction on its part could denote a deliberate desire to evade knowledge and may constitute "bad faith."

In this case, one of the methods the officer used to embezzle funds from Koss was to order cashier's checks from Park Bank for personal expenditures. She used hundreds of cashier's checks drawn on the Koss's accounts at Park Bank to pay for her purchases from luxury retailers, as well as to pay her personal credit card bills. Generally, she would instruct an assistant from Koss to call Park Bank and request a cashier's check on the officer's behalf. It was Park Bank's practice to allow non-signatories to the account to call and request cashier's checks on the officer's behalf. The officer would then send another assistant to pick up the envelopes at Park Bank with the cashier's check included in them. The officer also used "petty cash" requests to embezzle funds. She would instruct an assistant at Koss to go to Park Bank and endorse a manually written check made out to "petty cash." The officer would call and tell Park Bank the employee was coming. The officer's third method of embezzling funds was to request wire transfers from Park Bank to an out-of-state bank where Koss also maintained accounts. The officer would then make wire transfers from those accounts maintained at the out-of-state bank. The Court took the position that these wire transfers were immaterial to the case because from Park Bank's perspective, the funds remained in the control of Koss after the transfer even though Park Bank's policy required a wire transfer agreement to initiate such wire

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transfers, and Koss did not have one. Koss was unable to explain why wire transfers sent to other Koss bank accounts would have raised suspicions on the part of any Park Bank employee.

It is helpful to note that according to the Concurring Opinion neither "the amount and number of transactions carried out on an account containing fiduciary funds, nor the mere names of payees on checks drawn on that account, should be sufficient to create bad faith liability based on Bank's action in paying such checks." And in this case, over a period of ten years of the officer's embezzlement, a period during which Park Bank issued more than 60,000 cashier's checks, and 49 bank employees issued the 359 cashier's checks requested by the Koss officer, was not sufficient to establish "bad faith" and liability based on Park Bank's action in paying such checks over such a period of time.

In the end, Park Bank won this case at the trial court level, on appeal at the Court of Appeals level and at the Supreme Court level, regardless of which definition of "bad faith" was applied by the courts. The facts simply did not justify a finding under any of these definitions that Park Bank acted in bad faith and the courts therefore determined Park Bank was not liable to Koss for the embezzlement.

WBA wishes to thank Atty. John Knight, Boardman & Clark, llp for providing this article. ■

Supreme Court Issues Ruling on Koss Corp v. Park Bank Case Addressing Definition of Bad Faith Under Uniform Fiduciary Act

On January 29, 2019, the Wisconsin Supreme Court (Court) issued its opinion in the Koss Corporation v. Park Bank case (Koss Corp.). The case involved the definition of "bad faith" under Wisconsin's Uniform Fiduciary Act (UFA). Previously, there was little case law in Wisconsin interpreting "bad faith" under the UFA. WBA filed with the Wisconsin Supreme Court an amicus brief in support of Park Bank's position.

An employee embezzled approximately $34 million from Koss Corporation over a period of ten years. The employee used multiple methods to embezzle funds. Methods included obtaining cashier's checks for personal expenditures, instructing other, non-signatory employees to request checks, taking and cashing checks made payable to cash, and initiating wire transfers to out-of-state banks. After the employee pled guilty, Koss Corporation sought relief against Park Bank under the UFA, claiming Park Bank acted in bad faith in those transactions. The Milwaukee Circuit Court dismissed all claims against Park Bank. The Wisconsin Court of Appeals affirmed the lower court, and the Wisconsin Supreme Court affirmed that decision.

Two conclusions are clear from the Court's decision. First, Park Bank's conduct did not amount to bad faith. Second, negligence does not prove bad faith. However, a disagreement between the lead opinion and the concurring opinions disrupted the opportunity to clearly define "bad faith." This article will discuss what is clear from the Court's opinion, what is unclear, and how the opinion affects Wisconsin banks.

Koss Corp. involves the question of whether a bank can be held liable for the actions of a third party fiduciary. Specifically, whether a bank can be held liable for acting in "bad faith" in its transactions with an employee embezzling millions from a corporate deposit account. The UFA provides protections from such liabilities and was adopted by Wisconsin in 1925. Wis. Stats. Section 112.01(9) of the UFA provides standards whereby a bank can obtain protection from claims involving the acts of a customer's fiduciaries. In this case, that section forms the basis of Koss Corporation's claim that Park Bank acted in bad faith. The Court broke 112.01(9) down into three standards by which a bank could be liable:

1. When a bank had actual knowledge of the unlawful conduct of a fiduciary;

[1] The UFA provides protections for banks. This case was unique in that the UFA was presented as the basis for a complaint rather than as a defense. The Court's opinion is still significant in understanding that defense.

successor in interest as soon as successor in interest status is confirmed.

A bank should consider whether or not requiring an Acknowledgment is practical. For example, are systems set up to differentiate confirmed successors in interest – those who have signed an Acknowledgment, those who have not signed an Acknowledgment, and those who don't receive an Acknowledgment because they are obligated on the mortgage loan? Either way, whether or not a bank requires an Acknowledgment should be in the policy.

Finally, once a successor in interest is confirmed and the bank has received a signed Acknowledgment, if required, the successor in interest must be treated as a borrower and receive all notices and communications, as required, that would have been provided to the transferor borrower under the Mortgage Servicing Rules. Of course, some sensitive personal information related to the loan may be omitted, as described above.

Are there any Small Servicers Exemptions from the Successor in Interest Requirements?

Generally speaking, there is no exemption for small servicers as it relates to the successor in interest provisions. Small servicers should be prepared to comply with the successor in interest requirements, as described above. Small servicers should note, however, that they retain the same exemptions with respect to confirmed successors in interest as they had when servicing the transferor borrower/customer. This is because confirmed successors in interest "stand in the shoes" of the borrower/customer. For example, small servicers are exempt from providing periodic statements to borrowers for covered mortgage loans. A small servicer retains this exemption from providing a successor in interest with a periodic statement. In contrast, small servicers must comply with requirements to provide a payoff statement when requested by a successor in interest, as there is no existing exemption for small servicers.

For additional information regarding these and other requirements under the Mortgage Servicing Rules, visit the CFPB's Mortgage Servicing Implementation Page at https://www.consumerfinance.gov/policy-compliance/guidance/implementation-guidance/mortserv/

WBA wishes to thank Atty. Lauren C. Capitini, Boardman & Clark, llp for providing this article. ■

The Horizon Bank v. Musikantow Case: Unexpected Contract Interpretation Means Banks Need to Revisit Their Guaranty and Stipulation Language

On March 6, 2018, the Wisconsin Supreme Court issued its decision in the case of *Horizon Bank, NA v. Marshalls Point Retreat LLC*. The facts in the case, as well as the legal arguments raised, are somewhat complex, and the Court's decision raises some troubling issues for lenders in the state.

The Case

This case involved a typical lending situation. The bank made a loan to a borrower, secured by an upscale house in Sister Bay, Wisconsin. The owner of the borrower provided an unlimited guaranty of the debt. After multiple unsuccessful attempts to sell the property, the borrower defaulted. The bank brought one action under which it sought *both* to foreclose upon the property and to obtain a judgment on the guaranty. Importantly, before the sheriff's sale of the property, the parties (including the guarantor) entered into a negotiated stipulation in which they agreed in writing to resolve all issues in one proceeding and agreed to the terms of an "order of judgment."

The order for judgment stated that the borrower owed the bank approximately $4 million, and granted the bank a money judgment in the same amount against the guarantor. The key language of the stipulation is the following:

> "[t]he amount paid to [the bank] from the proceeds of [the] sale of the Premises, remaining after

> deduction by [the bank] of the amount of interest, fees, costs, expenses, disbursement and other charges paid or incurred by [the bank] not included in the monetary judgment against [the guarantor] . . . shall be credited by [the bank] on said monetary judgment.

Pursuant to the order, the property was sold at a sheriff's sale. The bank was the only bidder, with a credit bid of $2,250,000. The bank then moved to have the trial court confirm the sale pursuant to §846.165 of the Wisconsin Statutes (the foreclosure statutes). The bank asserted that its credit bid represented the property's "fair value", and submitted two valuation affidavits in support. The guarantor voluntarily chose not to provide evidence that the fair value of the house was higher. As dictated by the stipulated judgment, the bank moved the trial court to reduce the amount of the money judgment against the guarantor by the amount of bank's winning credit bid. The trial court determined "fair value" for the property to be the $2,250,000 sale value, and confirmed the sale. The sale of the property for $2,250,000 by sheriff's sale to the bank is not being challenged in this case.

At issue is the amount to be credited against the money judgment under the guaranty. The guarantor, apparently not liking the amount of the bank's winning credit bid and, consequently, not liking the deal he struck in the stipulation, asked the trial court to not rule on the credit to be applied to the amount he owed on the guaranty. The trial court granted the guarantor's motion and left open the question of the amount of the credit against the guaranty. The bank argued that this should not have happened because the stipulation both (i) governs the question of how much to credit against the judgment under the guaranty, and (ii) requires the trial court to apply the credit bid amount to reduce the obligation due under the guaranty. The Court of Appeals agreed with the bank. The case was then appealed to the Wisconsin Supreme Court, and the WBA filed an amicus brief in support of the bank.

At the Supreme Court, the guarantor raised various arguments under §846.165, along with constitutional due process claims. The foundational issue that underpins this case is this: the bank received the property for a credit bid of $2,250,000, and the bank believed the stipulation requires the guarantor's obligation for the debt to be reduced by the $2,250,000. The guarantor believed that the bank took possession of property worth much more than $2,250,000, and that his obligation under the guaranty should be reduced by the (higher) actual value of the property. The bank, the WBA and the Court of Appeals all agree that this is really a contract interpretation case, and that under the stipulation signed by the guarantor, the trial court should have applied the sale proceeds to the guarantor's obligation.

The Decision

In a long decision, the Wisconsin Supreme Court decided for the guarantor. The Court agreed that this is really a contract case, but interpreted the contract (the stipulation) very differently than the bank, the WBA and the Court of Appeals. The Court essentially re-wrote the stipulation into a different contract. The stipulation language is "[t]he amount paid to [the bank] from the proceeds of [the] sale of the Premises . . . shall be credited by [the bank] on said monetary judgment." The Court decided that this meant the "fair value" established in the foreclosure hearing was the *minimum amount* to be credited to the guaranty, even though the contract said nothing about "minimum amount." The Court sent the case back to the trial court to determine the value of the house for purpose of determining the amount to be credited to the guarantor's obligation. This means that Horizon Bank will have to litigate the value of the property twice, and potentially have one value for purposes of the mortgage debt and a totally different value for the guaranty. The Court stated that decoupling the confirmation of sale from the guaranty credit determination was within the trial court's discretion. This creates uncertainty and makes it difficult for lenders to price loans, and raises concerns about how courts will interpret guarantees and stipulations already in place. The WBA is disappointed with the decision and believes that the stipulation, under standard contract principles, is clear.

What the Decision Means for Wisconsin Lenders

Banks are not looking for "good deals" when they credit bid. Banks are not real estate companies. They are not looking to take back property. However, sometimes they end up having to bid at the sheriff's sale, as happened here, because no one else bid on the house. Banks will have to take the results of this case into account when they end up in a credit bid situation that also involves a guarantor.

Primarily, banks will have to think about the language of their stipulations and guarantees, and use language that is crystal clear about the amount that will be credited to the guarantor's obligation as a result of the sale of the borrower's collateral. The guaranty used in the *Horizon* case was a LaserPro form, which did not include <u>any</u> language specifically addressing the amount to be credited to the guarantor's obligation in the event of a credit bid. The <u>existing</u> WBA guaranty used by FIPCO already has language stating that "[i]f, in any action to realize upon any collateral securing the Obligations, the collateral that is the subject of such action is sold, the amount of the Obligations which is secured by such collateral shall be reduced by the price for which such collateral is sold, whether by credit bid of Lender or otherwise, even if the collateral sold is worth more than the sale price." We expect that a court, interpreting the WBA guaranty language as it is currently written, would apply the amount of the credit bid for collateral to the guaranty, and solely that amount. However, FIPCO will be reinforcing the WBA guarantees in light of the *Horizon* case.

Under current guarantees and stipulations, banks need to be aware that a guarantor may argue the value of the collateral for purposes of a foreclosure is different than the value of the collateral for purposes of reducing the guarantor's obligation under the guaranty. The result is that banks may have to litigate "fair value" twice in situations where they have a guarantor. When laying out the foreclosure/collection strategy, banks will need to decide with their counsel whether to join foreclosure claims with guaranty claims, or proceed separately, and if separately, which action to undertake first.

WBA wishes to thank Atty. Kirsten E. Spira, Boardman & Clark, llp for providing this article. ■

Bankruptcy Trustee May Clawback Funds; Safe Harbor for Financial Institutions Preserved

On February 27, 2018 the United States Supreme Court reached a decision in *Merit Management Group, LP v. FTI Consulting, Inc.*, 2018 WL 1054879 (*Merit*). The case involves a bankruptcy trustee (trustee) attempting to recover money received as part of a transaction between financial institutions (also known as clawback provisions). Trustees have the ability under the Bankruptcy Code to avoid certain transfers based on the value of the property during the debtor's insolvency. A safe harbor to this avoidance prevents such transfers from being undone when made for the benefit of a financial institution. Both the avoidance and the safe harbor was interpreted by the Court in this case, making the decision important for financial institutions looking to protect certain transfers during bankruptcy proceedings.

In *Merit*, a financial institution made a loan to a business to buyout its competitor. The transfer of funds for the buyout was made between the lender and another financial institution acting as an escrow agent. The business seeking to buyout its competitor subsequently failed, and filed for bankruptcy. A bankruptcy trustee sued to clawback $16.5 million of the transferred funds from the competitor's shareholders through the avoidance provision of the Bankruptcy Code discussed above. The shareholder argued that the safe harbor protected the transfer under the theory it was made for the benefit of a financial institution.

The District Court ruled that the safe harbor applied because the financial institutions transferred or received funds in connection with a "settlement payment" or "securities contract." The Court of Appeals reversed on the grounds that the safe harbor did not protect transfers in which financial institutions "served as mere conduits." The United States Supreme Court affirmed the Court of Appeals decision, ruling that the transfer falls outside of the safe harbor.

The result of the ruling makes it easier for bankruptcy trustees to recover money received through certain transactions. However, in *Merit* the safe harbor for the benefit of a financial institution was asserted by shareholders not the financial institutions. The Court stressed that, while in this situation it did not apply, the safe harbor still applies to protect a trustee's avoidance that targets a financial institution.

Thus, while the Court limited the application of the safe harbor, it still remains intact for use by financial institutions. For example, if the trustee were to seek recovery from the financial institutions affecting the transfer, the financial institution may have found more success in asserting the safe harbor. ■

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Thus, while the Court limited the application of the safe harbor, it still remains intact for use by financial institutions. For example, if the trustee were to seek recovery from the financial institutions affecting the transfer, the financial institution may have found more success in asserting the safe harbor. ■

2. Contact the three major credit bureaus (Experian, Trans Union and Equifax) via phone immediately to request a fraud alert be placed on your file. Once again, explain that you are a victim of identity theft and ask that they grant no new credit without your approval. Again, follow up with a letter to the agency documenting your request.

3. File a report with your local police department and request a copy of the report. This is good documentation to have on hand to prove your identity has been stolen as you begin the process of restoring your credit and good name.

4. Document all of your actions and keep copies of everything.

On Wednesday, September 20 WBA partnered with the Wisconsin Department of Agriculture, Trade and Consumer Protection, and Madison's News 3 to hold a livestream with a panel of experts answering consumer questions about the data breach. This two-hour event is another resource available to those with questions and concerns regarding Equifax. The video of the full event is available at this link.

Contact information for the three major credit bureaus.

Experian:
Order credit report: 888-397-3742
Report fraud: 888-397-3742
www.experian.com

Trans Union:
Order credit report: 800-888-4213
Report fraud: 800-680-7289
www.tuc.com

Equifax:
Order credit report: 800-685-1111
Report fraud: 800-525-6285
www.equifax.com ■

Court Dismisses Most of CFPB's Claims in TCF Bank Lawsuit

In March, WBA joined 12 other state bankers associations by signing on to an amicus brief filed by the Minnesota Bankers Association (MBA) for a Consumer Financial Protection Bureau (CFPB) lawsuit against TCF Bank, based in Wayzata, Minnesota. The lawsuit challenged the way TCF Bank had implemented the Regulation E "Opt-in" rules, which addressed overdrafts caused by electronic transaction cards. Rather than settling the case, TCF Bank chose to fight the allegations, filing a motion to dismiss the CFPB's claims. Considering this lawsuit could have a far-reaching impact on overdraft programs and retroactive application of regulations, WBA felt it appropriate to lend support to TCF Bank and MBA's amicus brief.

On Friday, September 15, the United States District Court for the District of Minnesota issued an order, granting TCF Bank's motion to dismiss CFPB's claims that TCF Bank violated Regulation E.

Regulation E "Opt-in" rules required banks to take action not only for new customers, but it also applied to all of the banks' existing customers. That situation presented significant challenges for banks to maintain compliance.

The Regulation E claims were especially troubling for the banking industry as a whole; CFPB acknowledged that TCF Bank provided all the proper Regulation E Opt-in disclosures and notices. They acknowledged that every customer that opted-in to overdraft coverage for card transactions had given affirmative consent. But CFPB said that because "consumers rarely read written disclosures," CFPB would look beyond the written disclosures and consider the bankers' verbal explanations of the written disclosures.

Verbal explanations of the written disclosures are not required by Regulation E. In the amicus brief, the Court was urged to reject this new, unwritten requirement and to enforce Regulation E as it is written. Otherwise, this would set a new legal standard which would result in considerable uncertainty and new significant liability for all financial institutions. The Court agreed with these arguments, specifically stating that it appreciated the state bankers associations' amicus brief, concluding that the bank had in fact complied with Regulation E, and refused to read CFPB's additional, unwritten requirements into the regulations.

CFPB also filed claims against TCF Bank for deceptive acts or practices as to new customers, and abusive acts or practices as to new customers, which were not dismissed, but the Court did limit those claims. It dismissed the UDAAP claims that related to actions taken by the bank before the effective date of the Dodd-Frank Act, which created the "abusive" standard and the date that the CFPB became operational. Thus, avoiding the legal precedent of retroactively enforcing regulations on actions that occurred before the regulations existed.

With respect to the remaining, limited claims, the bank continues to believe that it has both the law and the facts on its side. All the issues discussed in the amicus brief that could widely impact the banking industry have been decided, all of which have followed the recommendations of the brief. ■

Another Court Declares Bank UCC Filing Ineffective – This Time For Incorrect Location of Debtor's Name On UCC Filing Form

Earlier this year there was a court case in Indiana[1] that declared a UCC financing statement ineffective because the debtor's middle name was misspelled. In that case, the name of the debtor on the UCC financing statement did not appear exactly the same as the debtor's name on the debtor's unexpired driver's license. Now, in another UCC financing statement case, the United States Bankruptcy Court, Eastern District, Wisconsin, in *Bruce A. Lanser, Trustee v. First Bank Financial Centre*, 568 B.R. 797 (March 17, 2017), declared a bank's UCC financing statement ineffective because the name of the debtor was placed on the wrong line of the filing form. In this case, the name of the debtor, who is an individual, was placed on the organization debtor line rather than the individual debtor line of the UCC financing statement.

The bank made a loan to Voboril Financial, LLC. The loan was guaranteed by Stephen R. Voboril ("Stephen" in this article) who then executed a security agreement granting the bank a security interest in a promissory note payable to Stephen in the amount of $104,000. The bank filed a UCC financing statement to perfect its security interest in the promissory note, and in doing so mistakenly placed Stephen's name, who as the owner of the collateral is the "debtor" for UCC filing purposes, on the organization line rather than on the individual line in the debtor's name section of the form. In effect, the bank identified the debtor on the UCC financing statement as an organization rather than as an individual by placing it on the organization line rather than on the individual line in the debtor's name section.

This misidentification meant that a search of the UCC records in accordance with DFI's search procedures would not reveal the UCC financing statement filed against Stephen because DFI maintains a separate database for each type of debtor. DFI stores the names of individual debtors in files that include only the names of individuals and not the names of organizations, and it stores the names of organizations in files that include only names of organizations and not the names of individuals. In this case, DFI entered the filed UCC financing statement into the database that contains the names of organizations because the debtor's name placed on the UCC financing statement was identified as an organization. DFI search logic depends on whether the name searched is identified as an individual or an organization. Consequently, a search request in this case specifying Stephen as an individual would not locate the UCC financing statement filed against Stephen where he is identified as an organization.

Wisconsin law creates a "safe harbor" that may help save a UCC financing statement containing an incorrect name of a debtor if a searcher can nevertheless find the filing in the ordinary course of a search. Unfortunately, DFI enters the name in its database exactly as it is set forth in the filed UCC financing statement even if it appears that the name of the individual has been included in the field designated for an organization. DFI's search of the name "Stephen R. Voboril" stored in the individual name files would not disclose the financing statement filed against Stephen R. Voboril and stored in the organization name files, and therefore the "safe harbor" was not available. As a result, the bank's security interest in the promissory was not perfected and not protected from a claim by the trustee in the bankruptcy who has the legal power to avoid an unperfected security interest. As a side note, the bank could have perfected its security interest in the promissory note by taking possession of the note (as an "instrument" under the UCC), but apparently it did not do so in this case.

Like the earlier case in which a UCC financing statement was declared ineffective because the debtor's middle name was misspelled, in this case we have a similar circumstance where the correct name of the debtor owning the collateral was simply put on the wrong line on the UCC financing statement form making the UCC financing statement ineffective. According to the Court "following the Wisconsin filing office rules, a filer must correctly designate a debtor as either an individual or an entity because that determines the name's database and the applicable search logic of the filing office." Clearly, great care must be taken when identifying debtor names in UCC financing statements. The smallest of mistakes can lead to substantial losses.

WBA wishes to thank Atty. John Knight, Boardman & Clark llp, for providing this article.

This article is neither intended to be, nor should it be construed as, legal advice. If legal advice is needed, the reader should seek assistance from its own legal counsel.

[1] *In re: Ronald Markt Nay, Sherry L. Nay, Debtors, Mainsource Bank, Plaintiff, v. Leaf Capital Funding, LLC, Defendant, 563 B.R. 535 (Bankr. S. D. Ind. January, 2017).* ■

defense, the bank would not be able to recoup, for example, any fees or charges, etc., assessed to the account. To avoid this situation, an institution should consider requiring a joint account, with joint and several liability, be opened between the minor and a parent, guardian or other individual who has reached the age of majority. If the minor raises the defense, in this type of account, the contract will remain valid with respect to the remaining party, and such party will still be liable for all fees and charges assessed on the account even if such fees and charges are attributable to the minor's activity on the account. Of course, an institution may also wish to consult with its own legal counsel regarding the risks and benefits of other accounts the institution may offer.

Q3: If a custodian dies but did not appoint a successor custodian, does a parent automatically become the new custodian?

A3: No. As stated in Wis. Stat. § 54.888(4), if a custodian is ineligible, dies or becomes incapacitated without having effectively designated a successor and the minor has attained the age of 14 years, the minor may designate as successor custodian, an adult member of the minor's family, a conservator of the minor, as defined in Wis. Stat. § 54.01(3), or a trust company. If the minor has not attained the age of 14 years or fails to act within 60 days after the ineligibility, death or incapacity, the conservator of the minor becomes successor custodian. If the minor has no conservator or the conservator declines to act, the transferor, the legal representative of the transferor or the custodian, an adult member of the minor's family or any other interested person may petition the court to designate a successor custodian.

So, a minor, who has reached the age of 14, may designate a new custodian, within 60 days, by executing and dating an instrument of designation before a subscribing witness other than the successor. If beyond 60 days, the minor's parent, or other person, as noted above, may petition the court to become the custodian. However, a parent does not automatically become the custodian, nor has the right to transact on a WUTMA account.

If the custodian had designated a successor custodian, at the time the custodian opened the WUTMA account, for instance, this type of issue could have been avoided.

Q4: What if a custodian wants to close out a WUTMA account with my financial institution? Do I write the check to the custodian? Do I write the check to the beneficiary?

A4: As the funds are still subject to the WUTMA provisions, it is best practice to write the check to [name of minor] by [name of adult custodian] under WUTMA. In using this language, another financial institution will know that the funds are subject to WUTMA and can accurately identify the minor beneficiary and the adult custodian.

As a resource to its members, Wisconsin Bankers Association's legal department provides information related to banking laws and regulations. For specific questions regarding WUTMA accounts, please email wbalegal@wisbank.com or call (608) 441-1200. ■

Wisconsin Supreme Court Enforces Jury Waiver Provision In Commercial Loan Note

In a recent case, the Wisconsin Supreme Court held that a jury waiver provision in a commercial loan note is enforceable against the borrower under Wisconsin law. According to the Supreme Court, the right of a person to waive his or her right to a jury trial is settled law under the Wisconsin Constitution. The Supreme Court also held that the bank does not need to provide proof in the case that the borrower knowingly and voluntarily agreed to the jury waiver provision. The borrowers were seeking a jury trial in the case, and the bank took the position that the borrowers waived their right to a jury trial pursuant to the jury waiver provision in the note. The name of the case is Taft Parsons, Jr. v. Associated Banc-Corp (2017 WI 37) and the decision was released by the Court on April 13, 2017. The WBA filed a legal brief in the case in support of Associated Banc-Corp and approval of the jury waiver provision.

This decision by the Supreme Court states a clear approval of a practice followed by some banks in Wisconsin of including jury waiver provisions in notes and other loan documents in commercial loan transactions. This decision provides reassurance to those banks which choose to include jury waiver provisions in their commercial loan documents, including the

Judicial Spotlight

WBA Business Guaranty forms, that those jury waiver provisions are enforceable under Wisconsin law. Model jury waiver provisions have also been provided to banks at various WBA loan documentation workshops in the past. Based on this decision the WBA plans to review its commercial loan documents to determine whether jury waiver provisions would be an appropriate addition to those forms going forward.

We suggest that it would be best for banks to not include jury waiver provisions in consumer credit transactions subject to the Wisconsin Consumer Act without first obtaining written DFI approval of that practice under the Wisconsin Consumer Act. WBA intends to submit such a request for approval to DFI. ■

Regulatory Spotlight

CFPB Issues Proposed Rule to Delay Prepaid Accounts Final Rule.

The Consumer Financial Protection Bureau (CFPB) has issued a proposed rule delaying the **10/01/2017** effective date of the rule governing Prepaid Accounts under the Electronic Fund Transfer Act and the Truth in Lending Act by six months, to **04/01/2018**. Comments are due **04/05/2017**. The notice may be viewed at: https://www.gpo.gov/fdsys/pkg/FR-2017-03-15/pdf/2017-05060.pdf. *Federal Register*, Vol. 82, No. 49, 03/15/2017, 13782-13785.

CFPB Issues Proposed Rule Amending Regulation B.

CFPB has proposed amendments to Regulation B to permit creditors additional flexibility in complying with Regulation B in order to facilitate compliance with Regulation C, to add certain model forms and remove others from Regulation B, and to make various other amendments to Regulation B and its commentary to facilitate the collection and retention of information about the ethnicity, sex, and race of certain mortgage applicants. Comments are due **05/04/2017**. The notice may be viewed at: https://www.gpo.gov/fdsys/pkg/FR-2017-04-04/pdf/2017-06195.pdf. *Federal Register*, Vol. 82, No. 63, 04/04/2017, 16307-16321.

CFPB Issues Supervisory Highlights.

CFPB has issued the fourteenth edition of its Supervisory Highlights. In this issue of Supervisory Highlights, CFPB reports examination findings in the area of consumer reporting. These observations include findings from examinations at consumer reporting companies and at companies that furnish information to consumer reporting companies. The notice may be viewed at: https://www.gpo.gov/fdsys/pkg/FR-2017-04-06/pdf/2017-06904.pdf. *Federal Register*, Vol. 82, No. 65, 04/06/2017, 16808-16817.

CFPB Issues Notice of Assessment of Remittance Rule.

CFPB has issued a notice requesting comment on an assessment of its regulations related to consumer remittance transfers under the Electronic Fund Transfer Act (subpart B of Regulation E) in accordance with the Dodd-Frank Act. CFPB is requesting comment on its plans for assessing these regulations as well as certain recommendations and information that may be useful in conducting the planned assessment. Comments are due **05/23/2017**. The notice may be viewed at: https://www.gpo.gov/fdsys/pkg/FR-2017-03-24/pdf/2017-05681.pdf. *Federal Register*, Vol. 82, No. 56, 03/24/2017, 15009-15014.

FFIEC Issues Joint Report to Congress.

The Federal Financial Institutions Examination Council (FFIEC) is publishing a report entitled Joint Report to Congress, March 2017, Economic Growth and Regulatory Paperwork Reduction Act prepared by four of its constituent agencies: The Board of Governors of the Federal Reserve System (FRB), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Association (NCUA). The notice may be viewed at: https://www.gpo.gov/fdsys/pkg/FR-2017-03-30/pdf/2017-06131.pdf. *Federal Register*, Vol. 82, No. 60, 03/30/2017, 15900-15979.

FFIEC Suspends Comment Period for Proposed Revised Policy Statements.

FFIEC has suspended the public comment period for the Proposed Revised Policy Statements as of **04/04/2017**. The comment period was scheduled to close on **04/10/2017**. The suspension of the comment period will allow the President's appointees the opportunity to review and consider this action. The notice may be viewed at: https://www.gpo.gov/fdsys/pkg/FR-2017-04-04/pdf/2017-06596.pdf. *Federal Register*, Vol. 82, No. 63, 04/04/2017, 16399.

liquidity, bank operations, or other factors. The goal of any supervisory plan regarding brokered deposits would be to not disrupt an IDI's operations as it attempts to improve its capital category.

If the IDI is adequately capitalized for PCA purposes, the IDI may request a waiver from FDIC to retain or accept brokered deposits. Even when the IDI is undercapitalized for PCA purposes, FDIC deals with each brokered deposit situation involving accounts that are not time deposits on a case-by-case basis.

Resources

FDIC Law, Regulations and Related Acts: www.fdic.gov/regulations/laws/rules/index.html

See "Brokerage Activities": www.fdic.gov/regulations/laws/rules/4000-100.html#brok ■

Wisconsin Supreme Court Clarifies that Builder's Risk Policy Benefiting Construction Lender Does Not Terminate When Homeowners's Policy is Put in Place

Notice 2016-12

The Wisconsin Supreme Court declared in a recent case that a homeowner's policy on property under construction put in place prior to the house being completed and sold was not "permanent property insurance" under the builder's risk policy protecting the developer and the construction lender. The Court's decision means that the existence of the homeowner's policy during the construction period did not end coverage under the builder's risk policy. This is a good result for Wisconsin banks. The case is *Fontana Builders, Inc. et al. v. Assurance Company of America*, (2016 WI 52).

The Facts in the Case

AnchorBank made construction loans to Fontana Builders, Inc. to build a house, secured by mortgages on the property. James Accola was the president and sole owner of Fontana, and also the prospective buyer of the house under construction. As would typically be required by the construction lender, Fontana procured from Assurance Co. of America typical builder's risk insurance on the house under construction and the bank was listed as loss payee on the insurance policy. Accola arranged for a separate loan from Anchor to purchase the house from Fontana after construction, and in fact moved in before construction was complete. Anchor required Accola to procure a homeowner's policy as a condition to funding the home purchase loan. Accola arranged for homeowner's insurance from Chubb in his and his wife's name before construction was complete and before ownership of the house transferred to them.

Shortly after the Accolas moved in but before they owned the house, there was a fire and the house was damaged. Accola sought coverage under his personal homeowner's policy. Chubb and Accola, without the bank's involvement, entered into a confidential settlement agreement under which they settled for a significant sum Accola's claims for damages caused by the fire, including loss to personal property, and for temporary living expenses. Despite that payout, some of which went to Anchor, the majority of Anchor's loans remained unpaid. Fontana subsequently brought a suit against Assurance to recover its damages under the builder's risk policy, and Anchor intervened.

The only provision of the builder's risk policy at issue was a typical termination provision which states that coverage ends "[w]hen permanent property insurance applies." The question before the Wisconsin courts was whether the homeowner's policy in this case constituted "permanent property insurance" that "applies" such that the builder's risk policy terminated when the homeowner's policy was put in place.

In the first trial, the trial court granted summary judgment to Fontana, holding that the builder's risk policy applied as a matter of law. This meant that the presence of a homeowner's policy prior to the end of construction and transfer of the property to the homeowner did

not end coverage under the builder's risk policy. A jury trial on damages resulted in a sizable verdict in favor of Fontana both for property damage and for Fontana's bad faith claim against Chubb. Assurance appealed.

The Court of Appeals remanded the case back to the trial court on the grounds that the trial court should not have held as a matter of law that the builder's risk policy applied. At the second trial, the jury heard evidence about the confidential settlement agreement with Chubb, including the large amount paid by Chubb. With that evidence in mind, the jury was asked to interpret the language of the builder's risk policy. The jury decided that the homeowner's policy was "permanent property insurance" which ended coverage under the builder's risk policy. The Court of Appeals upheld this finding, and Fontana and the bank appealed to the Supreme Court.

The WBA submitted an amicus brief to the Supreme Court, asserting that the Court of Appeals' decision was not supported under Wisconsin law. The WBA made it clear that the lower court's decision would create risks and losses for construction lenders under current loans, create new risks to construction lenders for future loans, and result in unnecessary harm to the construction industry in Wisconsin.

The Court's Decision

The Supreme Court clarified that the interpretation of this insurance contract is a question of law that a court reviews *de novo*. It was an error, said the Court, for the jury in the second trial to interpret the meaning of "permanent property insurance" in the builder's risk policy.

The Supreme Court decided that the homeowner's policy was not "permanent property insurance" which ended coverage under the builder's risk policy. The principal reason given by the Court was that the insurable interests of Fontana in the property, as the builder of the house and as a separate legal entity from its owner (Accola), was distinct from Accola's interests in the property as the prospective homeowner and current occupant. The fact that Accola happened to be the sole owner of Fontana did not change this analysis because corporations are legally distinct from their shareholders. Because their insurable interests in the property were different, the homeowner's policy insuring Accola's interest did not trigger the builder's risk termination provision.

The Court recognized the underlying risks to the construction industry of the Court of Appeals' decision:

> "Empowering prospective purchasers to terminate a builder's insurance coverage – even without the builder's knowledge of the termination – would risk substantial mischief in the construction industry by undermining builders' reasonable expectations."

The Court acknowledged that banks making loans to home buyers often require purchasers to obtain insurance on the property prior to disbursing loan funds. If putting the homeowner's insurance in place in anticipation of closing voids the builder's risk insurance, then the construction lender would find itself unprotected even if construction continues and the prospective sale ultimately fails to close.

The Supreme Court remanded the case back to the trial court to determine damages.

Impact on Construction Lending

The Court of Appeals' decision would have adversely impacted construction lending in Wisconsin. It would have meant that under current loans, construction lenders may have a period of time in which they are uninsured and may not even realize this has happened. The decision would have created new risks and hassle for construction lenders going forward. The Supreme Court fortunately agreed with the builder, the bank and the WBA that the Court of Appeals' decision should be overturned. The *Fontana* decision means a construction lender generally should be able rely on its builder's risk policy (as they currently are typically drafted) through the construction period, even if the lender providing financing for the purchase of the property, for practical reasons, asks the prospective buyer to procure an owner's policy prior to closing on the purchase.

There are some caveats, however. The *Fontana* decision makes a point of discussing the fact that the builder (a company) and Accola (the individual) are legally distinct entities. If the exact same person or entity developing the property with construction financing will own the property after the construction is done, then there may

Judicial Spotlight

be some risk under *Fontana* because the "insurable interests" of the builder and the prospective owner are arguably closer than they were in *Fontana*. If the builder and the prospective owner are identical, a construction lender may want to make sure that the owner's policy does not attach until the moment the property is purchased and permanent financing is in place. If the property is to be occupied by such person during the term of construction financing, the lender should make sure the policy insuring the interests of such person does not cover the real property (*i.e.* is not an owner's policy), but instead is limited, for example, to the person's personal belongings and protection against personal injuries.

Finally, we cannot predict what insurance companies will do in the wake of the *Fontana* decision. This case was dealing with very specific coverage termination language, which is currently common in builder's policies. Insurers may change their policies as a result of *Fontana*, and there may be policies already in existence which contain different coverage language. Construction lenders should review the terms of builder's policies carefully, including the terms governing when coverage ends. If the policy contains language relating to other insurance policies that is different than the provision interpreted in *Fontana*, the lender will need to evaluate what this language means, or consult with counsel. A construction lender will need to determine whether allowing the prospective owner to put homeowner's insurance in place during the term of the construction financing creates risk for the lender, and if so, will need to take steps to address that risk.

WBA wishes to thank Atty. Kristen Spira, Boardman & Clark llp., for providing this article. ■

Regulatory Spotlight

Agencies Issue Final and Interim Final Rules to Adjust CMPs for Inflation.

- The Bureau of Consumer Financial Protection (CFPB) has issued an interim final rule to adjust the civil monetary penalties (CMPs) within its jurisdiction for inflation, as required by the Federal Civil Penalties Inflation Adjustment Act, as amended. Please see the interim final rule for the specific calculation and adjusted CMP amounts. Comments are due **07/14/2016**. The interim final rule is effective **07/14/2016**. Copies of the interim final rule may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2016-06-14/pdf/2016-14031.pdf. *Federal Register*, Vol. 81, No. 114, 06/14/2016, 38569-38572.

- The Federal Deposit Insurance Corporation (FDIC) has issued an interim final rule to amend its rules of practice and procedure to adjust the maximum amount of each civil money penalty (CMP) within its jurisdiction to account for inflation. The action is required by the Federal Civil Penalties Inflation Adjustment Act, as amended. Please see the interim final rule for the specific adjustments. Comments are due **09/01/2016**. The interim final rule is effective **08/01/2016**. Copies of the interim final rule may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2016-06-29/pdf/2016-15027.pdf. *Federal Register*, Vol. 81, No. 125, 06/29/2016, 42235-42243.

- The Office of the Comptroller of the Currency (OCC) has issued an interim final rule to implement inflation adjustments to civil money penalties (CMPs) that OCC may impose. The Federal Civil Penalties Inflation Adjustment Act, as amended, requires all federal agencies with the authority to enforce CMPs to evaluate those CMPs each year to ensure that they continue to maintain their deterrent value and promote compliance with the law. Please see the interim final rule for the adjusted CMP amounts. Comments are due **08/30/2016**. The interim final rule is effective **08/01/2016**. Copies of the interim final rule may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2016-07-01/pdf/2016-15376.pdf. *Federal Register*, Vol. 81, No. 127, 07/01/2016, 43021-43028.

- The Department of Housing and Urban Development (HUD) has issued an interim final rule to

3. Also file a UCC financing statement with Wisconsin DFI (assuming the debtor is a Wisconsin resident or an organized entity under Wisconsin law) identifying the debtor and the collateral, including a description of the seller's interest in the land contract as discussed above. Also include in the description any other personal property than the Bank is taking a security interest in and perfecting.

These additional steps and the additional filings and recording fees may be preferable to litigating the issue in court. Finally, the bank should review its practices and procedures in this area and its adoption of any of the suggestions above with the bank's legal counsel.

WBA wishes to thank Atty. John Knight, Partner, Boardman and Clark llp, for providing this article.

Unpaid Previously Assessed Condominium Fees Do Not Survive Foreclosure of the Property.

Notice 2016-08

In *Walworth State Bank v. Abbey Springs Condominium Association, Inc.* the issue before the Wisconsin Supreme Court (Court) was whether unpaid condominium association dues that were terminated by foreclosure can be reinstated and required to be paid by the new owner before having access to the condominium facilities. Because the outcome of this case would significantly impact condominium lending in Wisconsin, WBA participated as an amicus throughout the appellate process. Ultimately, Walworth State Bank prevailed. The Court held that Abbey Springs' condominium policy of suspending a subsequent owner's access to facilities due to previously unpaid assessment fees ties the unpaid assessment debt to the units themselves, thereby impermissibly reviving an interest that had been previously extinguished by a foreclosure action. In the State of Wisconsin a valid foreclosure of a mortgage terminates all interests in the foreclosed real estate that are junior to the mortgage being foreclosed and whose holders are properly joined or notified under applicable law. Before analyzing the Court's decision, looking to the background is necessary.

Background

Abbey Springs has a membership and guest policy that suspends both current unit owners and subsequent owners from the recreational facilities if unpaid assessments attributed to the unit are more than 90 days past due. Additionally, according to the bylaws, "no unit owner may exempt himself from liability…by abandonment of his unit" Units 18 and 19 were two single-family residences that had accumulated unpaid assessments in the amount of $13,225.32. Walworth State Bank held a first-lien real estate mortgage on those units and initiated a foreclosure action against the owners in 2012. The action named Abbey Springs as a defendant because of its claim of unpaid assessments attributable to the units.

In January 2013 the Walworth Country Circuit Court entered a Foreclosure Judgment. In addition to amounts owed to Walworth State Bank the court's order and judgment provided that the current owners and Abbey Springs were "forever barred and foreclosed of all right, title, interest, lien or equity of redemption" in and to the property. On April 29, 2013, the circuit court confirmed a sheriff's sale of the property to Walworth State Bank.

Walworth State Bank arranged for the property to be sold to new buyers. However, before closing, Abbey Springs issued a letter to Walworth State Bank stating that the outstanding assessments would be satisfied if "the seller pays Abbey Springs $13,225.32." As a result, the new buyers refused to close on the property. Ultimately, under protest, Walworth State Bank paid the prior owners' unpaid assessments of $13,225.32 to complete the sale of the property to the new owners. Walworth State Bank later filed suit against Abbey Springs, asking the circuit court to declare Abbey Springs' policy in violation of Wisconsin law and requesting the amount of $13,225.32 for the assessments paid under protest.

Procedure

The circuit court granted Walworth State Bank summary judgment, determining that Abbey Springs' policy violated Wisconsin law by holding new owners jointly and severally liable for the prior owners' unpaid assessments in violation of Wisconsin Statute 703.165(2) and by affecting the quality and marketability of the property's title in violation of Wisconsin Statute 703.10(6). The court of appeals reversed that decision, holding that the policy was not contrary to any Wisconsin statute. Specifically, it held that Wisconsin Statute 703.165(2) does not govern liability for unpaid assessments in an involuntary grant such as the sheriff's sale that occurred here. The Wisconsin Supreme Court reversed the court of appeals on the grounds that resurrecting unpaid condominium association dues to be required to be paid by new condominium owners is in violation of Wisconsin foreclosure law.

Analysis

The Court held that a lien created by unpaid condominium association dues terminates upon foreclosure and any remaining fees cannot be passed on to the new owner. The Court first determined that the court of appeals was incorrect in its application of Wisconsin Statute 703.165(2). The Court found that the statutory language indicates that in a voluntary grant a new owner is held jointly and severally liable for unpaid assessments owed by the prior owner. The Court found that that section pertaining to voluntary grants of property has no bearing on the involuntary grant at issue here. The liability of a new owner for the outstanding debt

of the prior owner under an involuntary grant is not directly addressed in Chapter 703 and the Court refused to address it. Furthermore, the Court did not find it necessary to address the argument that Abbey Springs' Membership and Guest Policy renders title to the units unmarketable.

The Court based its decision in favor of Walworth on Wisconsin foreclosure law. Under Wisconsin Statute 703.165(3) unpaid condominium assessments constitute a lien on the units on which they are assessed. Assessments include penalties for violations of the declaration, bylaws, or association rules. The unpaid assessments to Abbey Springs created a lien on the units. However, under Wisconsin Statute 703.165(5), a first mortgage recorded prior to the making of the assessment has priority over a lien for unpaid condominium assessments. In this case Walworth's mortgage interest took priority over Abbey Springs' lien based on unpaid assessments. Thus, the foreclosure judgment eliminated Abbey Springs' lien.

Abbey Springs argued that although its lien was extinguished by foreclosure the underlying unpaid assessments still survived in connection to the sold property. The court agreed that the debt survived but disagreed that it attached to the sold property. The Court instead asserted that the debt remained enforceable against the previous owners rather than the new owners because the foreclosure extinguished the lien as well as all right and interest Abbey Springs had in the property.

The Court concluded that Abbey Springs' policy could not tie an unpaid assessment debt by previous owners to the units themselves allowing them to impermissibly revive an interest previously extinguished by the foreclosure action. ■

REGULATORY SPOTLIGHT

Agencies Seek Comment on Revision to County Exposure Report Forms.

The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (FRB), and Federal Deposit Insurance Corporation (FDIC) (collectively, the Agencies) seek comment on revisions to the Country Exposure Report (FFIEC 009) and Country Exposure Information Report (FFIEC 009a) forms. FFIEC 009 is filed quarterly with the Agencies and provides information on international claims of U.S. banks, savings associations, bank holding companies, and savings and loan holding companies that is used for supervisory and analytical purposes. FFIEC 009a is a supplement to FFIEC 009 and provides publicly available information on material foreign country exposures of U.S. banks, savings associations, bank holding companies, and savings and loan holding companies that file the FFIEC 009 report. The Agencies have proposed to have reporting institutions provide their Legal Entity Identifier (LEI) on the cover page of each report beginning **09/30/2016**, only if an institution already has an LEI. An institution that does not have an LEI would not be required to obtain one for purposes of reporting it on the 009 and 009a forms. Comments are due **06/13/2016**. Copies of the notice may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2016-04-14/pdf/2016-08586.pdf. *Federal Register*, Vol. 81, No. 72, 04/14/2016, 22163-22165.

Agencies Seek Comment on Revision to Regulatory Capital Reporting Form.

The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (FRB), and Federal Deposit Insurance Corporation (FDIC) (collectively, the Agencies) seek comment on revisions to the Regulatory Capital Reporting for Institutions Subject to the Advanced Capital Adequacy Framework (FFIEC 101) form. The proposed revisions to FFIEC 101 are consistent with the revised regulatory capital rule approved by the Agencies in July 2013, as amended by subsequent revisions to the supplemental leverage ratio (SLR). The proposed collection of SLR data in Tables 1 and 2 of FFIEC 001 Schedule A would apply to all banking organizations subject to the advanced approaches risk-based capital rule, unless one of the exceptions listed in the notice applies. Separately, the proposed collection of SLR data in Tables 1 and 2 of FFIEC 101 Schedule A would apply to any U.S. intermediate holding companies formed or designed for purposes of compliance with FRB's Regulation YY that are advanced approaches banking organizations. Comments are due **06/17/2016**. The Agencies have also issued a correction to the notice to correct the date cited for the initial reporting of the Legal Entity Identifier by advanced approaches banking organizations. The correction also extends the original comment date to **06/27/2016**. Copies of the notice may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2016-04-18/pdf/2016-08892.pdf. *Federal Register*, Vol. 81, No. 74, 04/18/2016, 22702-22707. Copies of the correction may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2016-04-27/pdf/2016-09871.pdf. *Federal Register*, Vol. 81, No. 81, 04/27/2016, 24940.

CFPB Finalizes Interim Final Rules under Consumer Financial Protection Laws.

The Bureau of Consumer Financial Protection (CFPB) has issued a final rule regarding Title X of the Dodd-Frank Act (DFA) which transferred rulemaking authority for a number

Summary

Effective for mortgages filed on or after **April 27, 2016**, Wisconsin now has shorter redemption period for 1-4 family residential property. Wisconsin law regarding abandoned property has also been revised to incorporate recent Wisconsin Supreme Court rulings. Separately, FDIC has issued an FIL to clarify its supervisory expectations for financial institutions dealing with abandoned property. 2015 Wisconsin Act 376 may be found at: http://docs.legis.wisconsin.gov/2015/related/acts/376.pdf. FDIC's FIL may be found at: https://www.fdic.gov/news/news/financial/2016/fil16014.pdf. ■

JUDICIAL SPOTLIGHT

Federal Court Approves Practice That Allowed A Wisconsin State Bank To Take And Perfect Assignment Of Seller's Interest In Land Contract For Collateral Purposes.

Notice 2016-07

The United States Court of Appeals for the Seventh Circuit, which Circuit includes Wisconsin, recently interpreted Wisconsin law and approved the practice followed by a Wisconsin state bank to take and perfect its lien on a seller's interest in a land contract. The case is *Blanchards, Debtors, and Liebzeit, Trustee in Bankruptcy, v. Intercity State Bank*, Case No. 14-C-1527, decided by the Court on April 14, 2016. This Court decision may be instructive to other Wisconsin banks when taking similar collateral to secure loans. However, it is also important for Wisconsin banks to understand that the favorable interpretation of Wisconsin law by the Federal Court in this case may be persuasive with state courts in Wisconsin but is not binding as precedent. A Wisconsin state court could conceivably reach a different decision under the same or similar facts.

The Facts

The Blanchards sold a residential property in Marathon County on land contract and accepted a partial payment upfront of $30,000 from the buyer. As agreed by the Blanchards and the buyer, the Blanchards then obtained a mortgage loan of $142,000 from the Bank using the same property as collateral to indirectly receive the payment of the remainder of the purchase price. So, under the terms of the land contract, the Blanchards received money immediately from the down payment paid by the buyer and the proceeds of the mortgage loan made by the seller's Bank. The mortgage was recorded in the real estate records.

The Bank did not obtain a separate specific assignment of the land contract for collateral purposes relying instead on the description of collateral in its recorded mortgage to include the seller's interest in the land contract as additional collateral. The Bank used a WBA 428 Real Estate Mortgage which includes broad language to describe the property subject to the mortgage. According to the WBA 428 Real Estate Mortgage used by the Bank, the Blanchards agreed to mortgage the described property to the Bank and granted a mortgage lien on "all privileges, hereditaments, easements and appurtenances, all rents, leases, issues and profits, all claims, awards and payments made as a result of the exercise of the right of eminent domain, all existing and future improvements and all goods that are or are to become fixtures." Clearly, this is a long legal description of collateral subject to the mortgage, but in this case this long legal description of collateral subject to the mortgage allowed the Court to declare that the seller's interest in the land contract is sufficiently described by the mortgage and to declare the Bank the winner in this case.

The Bank also did not file a UCC financing statement with DFI, again relying instead on its recorded mortgage to perfect its interest in the seller's interest in the land contract as additional collateral.

A few years after the transaction described above, the Blanchards filed for bankruptcy, and the trustee in bankruptcy attempted to step ahead of the Bank's recorded mortgage so that it could use the seller's interest in the land contract as an asset for the benefit of unsecured creditors. In support of the trustee's attempt to knock out the Bank's mortgage, the trustee argued that the mortgage could attach only to real property and that the seller's interest in the land contract was personal property and therefore could not be subject to a recorded real estate mortgage. The trustee also argued that the Bank never attached a lien to the personal property consisting of the seller's interest in the land contract and therefore the seller's interest in the land contract should be available to the trustee for the benefit of unsecured creditors.

The Court had to answer three primary questions:

1. Is the seller's interest as a vendor under a land contract a proper subject of a mortgage to secure the Bank's loan to the seller?

2. Is the collateral description in the WBA Real Estate Mortgage used by the Bank broad enough to include the seller's interest in the land contract as additional collateral even without a description of the specific land contract in the mortgage?

3. Under Wisconsin law, is a mortgage recorded in the real estate records effective for the Bank to perfect a lien on a seller's interest in a land contract rather than by filing a UCC financing statement with DFI?

The Results

The Court ruled in the Bank's favor on each of the three primary questions listed above. The Court's ruling in response to each of these questions was as follows:

1. Is the seller's interest as a vendor under a land contract a proper subject of a mortgage to secure the Bank's loan to the seller? The Court concluded that the seller's interest under the land contract was a proper subject of the mortgage to secure the Bank's loan to the seller. The Court determined that Wisconsin law has long recognized that it is possible to mortgage a seller's interest under a land contract.

2. Is the collateral description in the WBA Real Estate Mortgage used by the Bank broad enough to include the seller's interest in the land contract as additional collateral even without a description of the specific land contract in the mortgage? The Court reviewed the language quoted above in the WBA 428 Real Estate Mortgage and concluded that the language was broad enough to grant the Bank a lien on the land contract payments.

3. Under Wisconsin law, is a mortgage recorded in the real estate records effective for the Bank to perfect a lien on a seller's interest in a land contract rather than by filing a UCC financing statement with DFI? The Court concluded that the Bank's recorded mortgage was an effective way to perfect a lien on a seller's interest in a land contract. It is important to note, however, that the Court did not decide whether a UCC filing would also be effective to perfect a lien on a seller's interest in a land contract. The Court concluded it was not necessary to decide this additional question since the Court had already decided in this case that a mortgage recorded in the real estate records is one effective way to perfect a lien on a seller's interest in a land contract. According to the Court, "although the Bank did not perfect its security interest under UCC procedures, it did the real estate equivalent by recording its mortgage in the county land records. That action was effective to perfect its security interest."

The Court concluded that the Bank's mortgage is a valid lien on the Blanchards' interest in the Property and all of their "rights in the real property", including the rights to enforce the land contract, collect payments from the land contract buyer and foreclose the land contract if the land contract buyer defaults.

Some Practical Suggestions

Because this decision by a Federal Court interpreting Wisconsin law is not a binding precedent on Wisconsin state courts, it will continue to be important for banks in Wisconsin to be careful about selecting the multiple options affecting their practices when taking and perfecting a lien on a seller's interest in a land contract. It may be prudent for a bank to perfect its lien on a seller's interest in a land contract in multiple ways just in case a subsequent state court decides that one or the other of the ways to perfect a lien on a seller's land contract interest is required and that the other way is ineffective. The Court in this case noted in its decision that different states follow different practices for recording the assignment and lien on a land contract's seller's interest, including some states which require only a UCC filing and some states which require both a filing under the UCC and a separate recording in the real estate records. This Court noted that some writers "acknowledge that a prudent mortgagee may want to record in the county land records as well as filing under the UCC." That may be a good practice for banks to follow under these circumstances.

These are a few specific practical suggestions for a Wisconsin state bank when taking a lien on a seller's interest in a land contract:

1. In addition to the broad language typically included in standard mortgage forms, include a specific assignment of the seller's interest in the land contract. This language could read similar to the following if the bank is using a WBA 428 Real Estate Mortgage:

   a. Include the following description of the seller's interest in the land contract in the Description of Property where the legal description of the Property is included: "Mortgagor also conveys and assigns to Lender for collateral purposes Mortgagor's interest in that certain land contract dated _____, recorded in the office of the Register of Deeds of _____ County, Wisconsin, as Document No. _____ in _____ relating to the sale of the Property as the same may be amended from time to time."

   b. The mortgage must also of course include a description of the real property which is subject to the mortgage.

Record the mortgage in the real estate records in the county where the property is located with language either sufficiently broad to include a seller's interest in a land contract or specific language related to that specific land contract as described in 1.a. above.

2. Consider using the WBA 237 Assignment of Land Contract rather than a mortgage as a form more specifically intended for taking an assignment of either the seller's or the buyer's interest in a land contract specifically identified in the document, provided the bank is not taking other collateral interests in the property that would need to be evidenced by a mortgage, and record the assignment of land contract in the real estate records where the property is located.

3. Also file a UCC financing statement with Wisconsin DFI (assuming the debtor is a Wisconsin resident or an organized entity under Wisconsin law) identifying the debtor and the collateral, including a description of the seller's interest in the land contract as discussed above. Also include in the description any other personal property than the Bank is taking a security interest in and perfecting.

These additional steps and the additional filings and recording fees may be preferable to litigating the issue in court. Finally, the bank should review its practices and procedures in this area and its adoption of any of the suggestions above with the bank's legal counsel.

WBA wishes to thank Atty. John Knight, Partner, Boardman and Clark llp, for providing this article.

Unpaid Previously Assessed Condominium Fees Do Not Survive Foreclosure of the Property.

Notice 2016-08

In *Walworth State Bank v. Abbey Springs Condominium Association, Inc.* the issue before the Wisconsin Supreme Court (Court) was whether unpaid condominium association dues that were terminated by foreclosure can be reinstated and required to be paid by the new owner before having access to the condominium facilities. Because the outcome of this case would significantly impact condominium lending in Wisconsin, WBA participated as an amicus throughout the appellate process. Ultimately, Walworth State Bank prevailed. The Court held that Abbey Springs' condominium policy of suspending a subsequent owner's access to facilities due to previously unpaid assessment fees ties the unpaid assessment debt to the units themselves, thereby impermissibly reviving an interest that had been previously extinguished by a foreclosure action. In the State of Wisconsin a valid foreclosure of a mortgage terminates all interests in the foreclosed real estate that are junior to the mortgage being foreclosed and whose holders are properly joined or notified under applicable law. Before analyzing the Court's decision, looking to the background is necessary.

Background

Abbey Springs has a membership and guest policy that suspends both current unit owners and subsequent owners from the recreational facilities if unpaid assessments attributed to the unit are more than 90 days past due. Additionally, according to the bylaws, "no unit owner may exempt himself from liability…by abandonment of his unit" Units 18 and 19 were two single-family residences that had accumulated unpaid assessments in the amount of $13,225.32. Walworth State Bank held a first-lien real estate mortgage on those units and initiated a foreclosure action against the owners in 2012. The action named Abbey Springs as a defendant because of its claim of unpaid assessments attributable to the units.

In January 2013 the Walworth Country Circuit Court entered a Foreclosure Judgment. In addition to amounts owed to Walworth State Bank the court's order and judgment provided that the current owners and Abbey Springs were "forever barred and foreclosed of all right, title, interest, lien or equity of redemption" in and to the property. On April 29, 2013, the circuit court confirmed a sheriff's sale of the property to Walworth State Bank.

Walworth State Bank arranged for the property to be sold to new buyers. However, before closing, Abbey Springs issued a letter to Walworth State Bank stating that the outstanding assessments would be satisfied if "the seller pays Abbey Springs $13,225.32." As a result, the new buyers refused to close on the property. Ultimately, under protest, Walworth State Bank paid the prior owners' unpaid assessments of $13,225.32 to complete the sale of the property to the new owners. Walworth State Bank later filed suit against Abbey Springs, asking the circuit court to declare Abbey Springs' policy in violation of Wisconsin law and requesting the amount of $13,225.32 for the assessments paid under protest.

Procedure

The circuit court granted Walworth State Bank summary judgment, determining that Abbey Springs' policy violated Wisconsin law by holding new owners jointly and severally liable for the prior owners' unpaid assessments in violation of Wisconsin Statute 703.165(2) and by affecting the quality and marketability of the property's title in violation of Wisconsin Statute 703.10(6). The court of appeals reversed that decision, holding that the policy was not contrary to any Wisconsin statute. Specifically, it held that Wisconsin Statute 703.165(2) does not govern liability for unpaid assessments in an involuntary grant such as the sheriff's sale that occurred here. The Wisconsin Supreme Court reversed the court of appeals on the grounds that resurrecting unpaid condominium association dues to be required to be paid by new condominium owners is in violation of Wisconsin foreclosure law.

Analysis

The Court held that a lien created by unpaid condominium association dues terminates upon foreclosure and any remaining fees cannot be passed on to the new owner. The Court first determined that the court of appeals was incorrect in its application of Wisconsin Statute 703.165(2). The Court found that the statutory language indicates that in a voluntary grant a new owner is held jointly and severally liable for unpaid assessments owed by the prior owner. The Court found that that section pertaining to voluntary grants of property has no bearing on the involuntary grant at issue here. The liability of a new owner for the outstanding debt

enforced under the doctrine of promissory estoppel. If the Act had not prevented the use of the doctrine of promissory estoppel that failure would have provided a significant loophole through which enforcement of alleged oral agreements or promises could have been attempted notwithstanding the protections provided by the Act. Fortunately, this loophole was not included in the Act.

Notwithstanding the protection for banks and other financial institutions from the use of the doctrine of promissory estoppel, the Act does not prohibit actions or claims against banks or other financial institutions for fraudulent representations or misrepresentations under Wisconsin law, including Wisconsin's Deceptive Trade Practices Act under Section 100.18, Wisconsin Statutes. In general, Wisconsin's Deceptive Trade Practices Act protects the public from representations made with the intent to induce an obligation that were untrue, deceptive or misleading and caused the other party a financial loss. Although it is unlikely a bank or other financial institution would engage in such conduct, the failure of the Legislature to protect banks and other financial institutions from actions based on such allegations could be a concern in connection with an egregious fact situation involving a bank or other financial institution. For this reason, the Act cannot be seen as an absolute and total protection for banks and other financial institutions against all actions if those actions are based upon these certain allegations that are exceptions under the Act.

Finally, the Act first applies to an action commenced against a bank or other financial institution on or after December 18, 2015. Since the Act is specifically made applicable to "actions" commenced on or after December 18, 2015, one could reasonably argue that the Act is retroactive with respect to alleged oral agreements made prior to December 18, 2015.

What might all of this mean to standard bank practices? As has always been the case, written agreements meeting the requirements of the Act continue to be enforceable against banks. It is best for banks to be clear and cautious with respect to those written agreements. Further, if written documents are not intended to be enforceable agreements, it would be best to clearly indicate in the document that it is not intended to be a binding agreement between the parties. Banks would be well advised to consult with their counsel regarding the appropriate disclamatory language. Therefore, with respect to written agreements, there probably will be no change going forward for banks other than to continue to follow best practices when preparing and distributing written agreements. Regarding oral communications, banks will probably be less concerned that their oral discussions may lead to enforceable agreements since oral discussions under this Act cannot be enforced as binding agreements absent fraudulent representation or misrepresentation.

In summary, the adoption of this Act in Wisconsin should help put an end to concerns by banks and their counsel over the legal effect of oral discussions between banks and their customers absent fraudulent representation or misrepresentation. I have always cautioned banks in my discussions with them that in Wisconsin verbal contracts may be enforceable. I am pleased to say my advice is no longer appropriate thanks to this recent helpful change in Wisconsin law.

WBA wishes to thank Atty. John Knight, Partner, Boardman and Clark llp, for providing this article. ■

JUDICIAL SPOTLIGHT

Court Says "Suspicion" of Improperly-Pledged Collateral Reduces Creditor's Position in Bankruptcy.

On January 8, 2016, the Seventh Circuit Federal Court of Appeals issued an opinion in *In re Sentinel Management Group* finding that Bank of New York Mellon Corp. (BNYM) forfeited its position as a senior secured creditor in Sentinel Management Group's (Sentinel) bankruptcy because it was on "inquiry notice" that collateral for loans had been unlawfully pledged. This decision has important implications for Wisconsin banks in lending transactions.

Sentinel, a cash-management firm, was in the business of investing cash from consumers in liquid low-risk securities and also traded on its own account. To finance its own trades, Sentinel borrowed money from BNYM—up to $573

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million in 2007. Because Sentinel did not own enough assets to fully secure these loans, Sentinel pledged securities it had purchased for its customers with customer money in violation of federal law and the contracts between Sentinel and its customers. Both federal law and the contracts required the securities be held in accounts separate from Sentinel's own assets. Sentinel was forbidden to pledge the assets in the non-asset accounts to BNYM as security for its own loans.

In August 2007, with an outstanding loan balance of $312 million owed to BNYM, Sentinel declared bankruptcy after experiencing severe trading losses in a tenuous securities market. After receiving notification that BNYM planned to liquidate the collateral pledged to secure the loan, the bankruptcy trustee refused to classify BNYM as a senior secured creditor with respect to the $312 million loan. The trustee considered the transfers of customer assets to accounts that Sentinel used to collateralize the loans from BNYM to be fraudulent transfers.

Pursuant to the Bankruptcy Code, BNYM would be able to retain its interest and enforce the obligation against Sentinel if BNYM accepted the pledge of assets "in good faith." BNYM would not have acted in good faith, however, if it had inquiry notice, which according to various court cases, signifies an awareness of suspicious facts that would lead a reasonable firm, acting diligently, to further investigate and discover wrongdoing by doing so. After reviewing the district judge's findings, the Seventh Circuit Court held that BNYM was, in fact, on inquiry notice and thus did not accept Sentinel's pledge of collateral in good faith rendering it an unsecured creditor in Sentinel's bankruptcy proceeding.

The court held that suspicion raised in an email by a Director of BNYM as to Sentinel's pledge of collateral at 100x its capital, along with his question as to the beneficiaries of the collateral, was sufficient to place BNYM on inquiry notice because this was "information that would cause a *reasonable* person to be suspicious enough to investigate" the legitimacy of the collateral. The court went on to write, however, that this was not the only evidence that BNYM was on inquiry notice—in fact, the district court judge had found inquiry notice "over and over again." The evidence at trial suggested that BNYM was in possession of Sentinel's audited financial statements and other information which indicated that the collateral must have come from the segregated customer accounts. Furthermore, the evidence suggested that employees of BNYM had knowledge, or at least suspicions, that Sentinel was in violation of segregation requirements and thus may not have rights to the collateral. The overwhelming evidence led the court to conclude that BNYM had not acted in good faith when accepting Sentinel's unlawfully-pledged collateral. Consequently, BNYM lost its secured creditor status and became an unsecured creditor in the bankruptcy proceeding.

The court went on to address whether or not the conduct of BNYM was sufficiently egregious to justify the application of the doctrine of equitable subordination, which would allow the bankruptcy court to further reduce BNYM's priority in the bankruptcy. Pursuant to case law, the conduct must be seriously inequitable and cause harm to other creditors. The court held, in agreement with the district court judge, that this high standard was not met. The conduct of BNYM was negligent, which is not an adequate basis for imposing equitable subordination, according to the Seventh Circuit. Thus, the bank remains an unsecured creditor in the bankruptcy proceeding.

This decision has important implications for banks in Wisconsin. If a bank wishes to retain its secured creditor status in a bankruptcy proceeding or the ability to avoid a fraudulent transfer of assets in a loan transaction, the *Sentinel* decision requires closer attention be paid to asset pledges when suspicions are raised. Although *Sentinel* arose in the bankruptcy context, it also has the potential to be applied more broadly under Wisconsin's Uniform Fraudulent Transfer Act. Further, the facts of the case raise enforceability issues under the UCC's provision addressing the requirements necessary to support the enforceability of a security interest. If your bank has any suspicion that assets are being unlawfully pledged in a credit transaction, it would be prudent for the bank to thoroughly investigate that suspicion in order to properly secure the loan.

WBA wishes to thank Atty. Lauren Capitini, Boardman and Clark llp, for providing this article. ■

REGULATORY SPOTLIGHT

Agencies Issue Correction to EGRPRA Proposal.

The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (FRB), and Federal Deposit Insurance Corporation (FDIC) (collectively, the Agencies) have issued a correction to a proposed rule that was published in the *Federal Register* on **12/23/2015**, regarding the Agencies' regulatory publication and review under the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). In the previously published proposal, make the following corrections: (1) On page 79728 the table heading "Chart A—Categories and Regulations Addressed in this Fourth **Federal Register**

WISCONSIN BANKERS ASSOCIATION
Compliance Journal

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Read "Special Focus" for an overview of recent U.S. Supreme Court decisions regarding how disparate-impact claims may be brought under the Fair Housing Act and how junior mortgage holders' interests were protected from debtors attempting to void junior liens under the Bankruptcy Code. Next, turn to "Regulatory Spotlight" for a final rule issued by CFPB to delay the effective date for the TILA/RESPA integrated disclosure rule. Finally, see "Compliance Notes" for a link to CFPB's recently posted final TILA/RESPA integrated disclosure webinar and revised interagency examination procedures. ■

SPECIAL FOCUS

Recent U.S. Supreme Court Cases Affecting Financial Institutions.

Notice 2015-7

Below are two recent U.S. Supreme Court cases that will affect Wisconsin's financial institutions. The following is an overview of each case and how each may impact the industry laws and regulations or business practices.

Supreme Court Affirms Disparate-Impact Claims May Be Brought Under Fair Housing Act.

In the recent decision *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.,* the U.S. Supreme Court ruled that disparate-impact claims may be brought under the Fair Housing Act of 1968 (FHA). As a result of the decision, financial institutions will continue to be subject to claims of discrimination under the FHA for neutral policies and practices that cause unintended discriminatory effects.

The case focused on the distribution of federal tax credits to developers by the Texas Department of Housing and Community Affairs (Department). The Department allocated the tax credits to development projects based on certain criteria including financial feasibility of the project, income level of the tenant, and whether the housing units would be built in a neighborhood with good schools. The Inclusive Communities Project, Inc. (ICP), a Texas-based nonprofit corporation that assists low-income families in obtaining affordable housing, sued the Department under the FHA. The ICP alleged that the Department was causing segregated housing patterns by disproportionately allocating tax credits, with too many credits allocated for housing in predominantly black inner city areas and too few in predominantly white suburban neighborhoods.

The Federal district court ruled in favor of the ICP and issued a remedial order requiring the addition of new selection criteria for tax credits to be used by the Department. While an appeal was pending in the Fifth Circuit of the U.S. Court of Appeals, the Secretary of Housing and Urban Development (HUD) issued new regulations interpreting the FHA, which incorporated disparate-impact liability. On appeal and consistent with past precedent, the Fifth Circuit held that disparate-impact claims are recognized or "cognizable" under the FHA, but remanded the case to the district court on the merits, relying on the new HUD regulations. The Department then petitioned the U.S. Supreme Court to determine whether disparate-impact claims may be brought under the FHA.

In a 5-4 split decision, the U.S. Supreme Court determined that disparate-impact claims may be brought under the FHA. The Court ruled that recognition of disparate-impact claims is consistent with the FHA's central purpose – "to eradicate discriminatory practices within a sector of the Nation's economy." The decision confirms that institutions may be held liable for fair lending violations under the FHA if their policies or practices disproportionately exclude or burden certain persons on a prohibited basis, even if such policies or practices are applied equally to all applicants.

In its decision, the Court clarified that to bring a claim of discrimination based on a disparate-impact theory of liability, a plaintiff "must allege facts at the pleading stage or produce statistical evidence demonstrating a causal connection between the policy or practice and the disparate-impact." If a plaintiff fails to show that the policy or practice causes a discriminatory effect, there is no liability. If the plaintiff establishes a causal connection, the burden then shifts to the defendant to show that the policy or practice is necessary to achieve one or more legitimate, non-discriminatory interests (referred to in other contexts as the "business necessity" defense). However, even if the defendant does have a compelling business justification for implementing the policy, the plaintiff may still succeed by demonstrating that other policies or practices could serve the defendant's interests with a less discriminatory effect.

The Court also indicated that if disparate-impact liability exists, courts should focus on eliminating the offending practice as opposed to penalizing the offenders, cautioning that if courts do find liability under a disparate-impact theory, "remedial orders must be consistent with the Constitution," and "concentrate on the elimination of offending practice that arbitrarily operates invidiously to discriminate on the basis of race."

The Supreme Court's decision clarifies that institutions are subject to claims of discrimination under the FHA under a disparate-impact theory of liability. The decision may also reduce the likelihood of legal challenges to the application of disparate-impact to other fair lending laws, such as Equal Credit Opportunity Act (ECOA). The Consumer Financial Protection Bureau and other prudential banking regulators take the position that institutions can be liable for fair lending violations under a disparate-impact theory of liability under ECOA as well as the FHA. Unlike the FHA, which is limited to residential real estate-related transactions or loans secured by residential real estate, ECOA governs all commercial and consumer loan transactions.

In light of the Supreme Court's decision, institutions should be cognizant of consumer and commercial lending policies and practices that increase risk of disparate-impact liability. Red flags that may indicate increased risk of liability include a lack of documentation of business justifications for underwriting or pricing models, granting financial institution employees broad discretion in product pricing, and inadequate internal procedures and controls governing employees' exercise of discretion.

An essential component of reducing the risk of disparate-impact liability is identifying and documenting the necessary business purpose for implementing a particular practice or policy. When developing lending-related policies and practices, institutions should provide documented evidence that the policy or practice is necessary for business purposes and based on non-discriminatory factors. Also, institutions should ask whether available alternatives exist that will achieve the same business goals but may have less risk of a disparate-impact on protected classes, when performing internal reviews. Regulators also recommend reviewing internal lending data in all product areas for disparities in pricing, underwriting or marketing to determine whether lending practices are having unintended discriminatory effect on a prohibited basis.

Discretion in pricing may also result in inadvertent discrimination, even if discretion is based on non-prohibited factors. Implementing mechanisms that reduce pricing discretion, such as flat fee structures, fees based on a fixed percentage of credit extended, and caps on discretionary adjustments or charges, can reduce risk of disparate-impact liability. If loan officers or branch managers are permitted to exercise discretion in pricing, consider employing policies that outline the application of discretion with identifiable parameters, clearly define policy exceptions and require documentation of the business necessity underlying the policy.

Going forward, banks should continue to focus on developing and maintaining strong fair lending compliance programs that incorporate policies and practices that reduce fair lending risk, including the risk of disparate-impact. Fair lending compliance programs should address underwriting, product development, sales, marketing, and vendor management practices. Compliance programs should: require involvement by compliance personnel in strategic decisions or significant changes to lending products, practices or policies; incorporate regular fair lending training for employees involved in marketing, originating or underwriting loan transactions, include ongoing monitoring and review of policies and practices; and analyze internal lending data for potential fair lending violations.

It is important to remember that prudential banking regulators have recognized the disparate-impact theory of liability for some time prior to the U.S. Supreme Court's decision. Consequently, existing fair lending compliance programs may already incorporate some of the risk mitigation strategies discussed above. However, given this recent decision, it would be prudent for institutions to take a more critical look at existing policies and practices with an eye toward fair lending compliance and particular focus on potential disparate-impact liability.

WBA wishes to thank Atty. Patrick Neuman of Boardman and Clark LLP for providing this article. Atty. Neuman may be reached at 608/283-1774 or pneuman@boardmanclark.com.

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Junior Mortgage Holders' Interests Protected by U.S. Supreme Court.

In a recent U.S. Supreme Court decision, junior mortgage holders' interests have been protected. In *Bank of America v. Caulkett* and *Bank of America v. Toledo-Cardona*, the court held that a debtor in a Chapter 7 bankruptcy proceeding may not void a junior mortgage lien under the Bankruptcy Code when the debt owed on the senior mortgage lien exceeds the current value of the collateral if the creditor's claim is both: (a) secured by a lien on the property; and (b) allowed under the Bankruptcy Code. The following article briefly outlines the Court's rationale.

The two cases have similar facts and were therefore consolidated. The debtors, Caulkett and Toledo-Cardona, each have two mortgage liens on their homes. Bank of America holds the junior mortgage lien on each home. The amount owed on each debtor's senior mortgage lien was greater than each home's current market value. Bank of America's junior mortgage liens were considered entirely "underwater"; Bank of America would receive nothing if the properties were sold.

In 2013, the debtors each filed for Chapter 7 bankruptcy. In their respective bankruptcy filings, each moved to void the junior mortgage liens under section 506 of the Bankruptcy Code. Section 506 provides, "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." 506(d) would permit the debtors to strip-off (or void) Bank of America's junior mortgages only if Bank of America's right to repayment (or claim) from the debtors, is "not an allowed secured claim."

Subject to some exceptions not relevant to the particular case, a claim filed by a creditor is deemed "allowed" under section 502 of the Bankruptcy Code if no interested party objects or if, in the case of an objection, the Bankruptcy Court determines that the claim should not be allowed under the Bankruptcy Code. The parties agree that Bank of America's claims meet this requirement and are "allowed" claims under section 502. They did not agree, however, on whether Bank of America's claims were "secured" within the meaning of Bankruptcy Code section 506(d).

In determining whether Bank of America's claims were "secured" within the meaning of section 506(d), the Court relied upon a decision it made previously in a 1992 case, *Dewsnup* v. *Timm*, 502 U.S. 410. In Dewsnup, a Chapter 7 debtor wanted to "strip down" (or reduce) a partially underwater lien under section 506(d) of the Bankruptcy Code to the value of the collateral. Specifically, the debtor wanted to reduce her debt of approximately $120,000 to that of $39,000 which was the value of the collateral securing her debt at the time of bankruptcy. The debtor relied on the statutory definition of "allowed secured claim" in section 506(a) and argued that her creditors' claims were "secured only to the extent of the judicially determined value of the real property on which the lien [wa]s fixed." The Court disagreed with her and determined that a debtor could not strip down the creditors' lien to the value of the property under section 506(d) because the creditors' claim [wa]s secured by a lien and ha[d] been fully allowed under section 502 of the Bankruptcy Code. In the 1992 Dewsnup case, the Court defined the term "secured claim" in section 506(d) to mean a claim that is supported by a security interest in property, regardless of whether the value of that property would be sufficient to cover the claim.

The Court used the 1992 definition of "secured claim" in the Bank of America case and because both of Bank of America's claims were secured by liens and both were allowed under section 502, Caulkett and Toledo-Cardona cannot void Bank of America's claims. The Court, relying upon the reasoning of the 1992 case, determined that a debtor in a Chapter 7 bankruptcy proceeding may not void a junior mortgage lien under section 506(d) when the debt owed on a senior mortgage lien exceeds the current value of the collateral. The Bank of America claims were not void. The entire case may be pulled from the following link: http://www.supremecourt.gov/opinions/14pdf/13-1421_p8k0.pdf. ■

REGULATORY SPOTLIGHT

Agencies Issue Semiannual Regulatory Agendas.

- As noted in the June edition of this publication, the Bureau of Consumer Financial Protection (CFPB) has published its Spring 2015 semiannual regulatory agenda. The agenda has now been published in the *Federal Register*. Information in the agenda is current as of **05/05/2015**. Copies of the agenda may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2015-06-18/pdf/2015-14373.pdf. *Federal Register*, Vol. 80, No. 117, 06/18/2015, 35116-35119.

- The Board of Governors of the Federal Reserve System (FRB) has issued its semiannual regulatory agenda. FRB anticipates considering the regulatory matters indicated within the agenda during the period **05/01/2015** to **10/30/2015**. The next agenda will be published in fall 2015. Comments may be submitted anytime during the next six months. Copies of the

WISCONSIN BANKERS ASSOCIATION
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Read "Judicial Spotlight" for an overview of important court decisions regarding MLO compensation, Wisconsin's notice/prejudice statutes, the sale of abandoned property and the forfeiture of previously collected fees by an unlicensed adjustment service company. Next, turn to "Regulatory Spotlight" for a proposed rule regarding CFPB's temporarily suspension to the submission of credit card agreements. Finally, turn to "Compliance Notes" for a reminder of potential ECOA violations by charging one fee for a joint credit report ordered for an application between married joint applicants, but charging a higher fee for separate individual credit reports for unmarried joint applicants. ■

JUDICIAL SPOTLIGHT

Recent Court Cases Affecting Financial Institutions.

Notice 2015-3

Below are several recent court cases which will affect Wisconsin's financial institutions. The following is an overview of each case and how each may impact industry laws and regulations or business practices.

U.S. Supreme Court Upholds Department of Labor's Interpretive Rule that "typical MLOs" are Non-exempt: *Perez* v. *Mortgage Bankers Association*.

For several years now, we have been following the issue of whether mortgage loan officers are exempt or non-exempt from the overtime provisions of the Fair Labor Standards Act ("FLSA"). The United States Supreme Court recently issued a decision that effectively ends the discussion…for now.

In 1999 and 2001, the Department of Labor ("DOL") issued opinion letters stating that mortgage loan officers ("MLOs") are non-exempt and must be paid overtime under the FLSA. Then in 2004, the DOL issued the current FLSA regulations on overtime exemptions. The 2004 regulations for the first time included examples of positions that would be considered exempt and non-exempt under the administrative exemption. One of the examples states, "employees in the financial services industry … generally meet the administrative exemption" depending on their day-to-day activities. However, that same section of the rules ends, "an employee whose primary duty is selling financial products does not qualify for the administrative exemption."

Following the 2004 rules, the Mortgage Bankers Association ("MBA") requested that the DOL issue a new opinion letter regarding the exempt status of MLOs in light of the revised regulations. In 2006, the DOL issued an opinion letter finding that MLOs fell under the administrative exemption under the 2004 regulations. In 2010, however, the DOL reversed course and issued an "Administrator's Interpretation" concluding that MLOs have the primary duty of making sales for their employers and therefore do not qualify for the administrative exemption.

MBA sued to challenge the Administrator's Interpretation, arguing that because the new guidance was inconsistent with the 2004 rule, the DOL was required to follow formal rulemaking procedures (which require notice and public comment on proposed rules). The case before the U.S. Supreme Court, therefore, was not directly concerning whether MLOs meet the administrative exemption, but rather whether the DOL could shift its position regarding MLO exempt status without following the formal notice and comment process. To answer this question, the Supreme Court looked to the plain language of the Administrative Procedure Act ("APA") and ruled that the notice and comment process required for formal rules does not apply to "interpretative rules," such as the DOL's Administrator's Interpretation. (The Court refused to address the argument that the 2010 Administrator's Interpretation was a formal legislative rule – as opposed to an interpretative rule – because MBA had not raised this issue with the lower courts.)

So what does the Supreme Court's ruling mean for banks?

In short, it means that until the DOL, Congress, or the courts issue contrary guidance, banks must comply with the DOL's current view that MLOs cannot be treated as exempt under the administrative exemption. While the DOL's Administrator's Interpretation does not have the force and effect of law, courts weighing these issues in lawsuits typically give deference to the agency's position, even if it is in the form of an "interpretive rule" rather than formal regulatory guidance. Courts will generally follow the agency's interpretation, unless it is found to be "arbitrary and capricious."

The Supreme Court's decision does not, however, mean that banks must necessarily treat all MLOs as non-exempt. Aside from the administrative exemption, it is possible that other exemptions might apply. For example, in the past some banks have been successful in treating certain MLOs as exempt under the outside sales exemption. Banks have also attempted to assert that their MLOs qualify for the commissioned sales employee exemption for retail and service establishments, but these attempts have largely been rebuffed by the courts, which have held that financial institutions are not retail or service establishments. Regardless of the exemption being relied upon, before treating any MLOs as exempt, it is crucial that a bank determine that all of the requirements for the exemption are met. This should be done in consultation with legal counsel.

The Supreme Court's decision also raises concerns regarding the unstable nature of agency guidance. What happens if the DOL decides to change course yet again? The Court addressed these concerns by pointing out that the FLSA contains a safe-harbor provision that shelters regulated industries (like banks) from liability when they have acted in conformance with previous agency interpretation. Specifically, the FLSA provides that "no employer shall be subject to any liability" for failing "to pay minimum wages or overtime compensation" if it demonstrates that the "act or omission complained of was in good faith in conformity with and in reliance on any written administrative regulation, order, ruling, approval, or interpretation" of the DOL, even when that guidance is later "modified or rescinded."

So, for now, the DOL's stance that typical MLOs are non-exempt under the administrative exemption of the FLSA is the law. Financial institutions should review this issue and address the exempt/non-exempt status of such employees accordingly.

WBA wises to thank Atty. Jennifer S. Mirus of Boardman and Clark LLP for providing this article. Atty Mirus may be reached at 608/283-1799 or jmirus@boardmanclark.com.

Wisconsin Supreme Court Exempts Certain Policies From the Notice/Prejudice Statutes: *Anderson* v. *Aul.*

Under statutes that have been on the books since 1979, liability insurers in Wisconsin have been required to prove that they were prejudiced by a policyholder's late notice before they could deny that policyholder's claim based on late notice. These statues, Wis. Stat. §§ 631.18 and 632.26, are generally referred to as the notice/prejudice statutes. On February 25, 2015, the Wisconsin Supreme Court issued a decision in *Anderson v. Aul*, 2015 WI 19 that dramatically changes the legal landscape for policyholders that fail to provide timely notice of a claim. Under *Anderson,* liability policies issued on a "claims made and reported" basis are not subject to the notice/prejudice statutes. As a result, a policyholder that provides late notice on a "claims made and reported" liability policy can be denied coverage even if the insurer is not prejudiced by the late notice. *Anderson* is likely to impact a broad swath of Wisconsin policyholders because many professional liability, directors and officers liability, and employment practices liability policies are issued on a "claims made and reported" basis. It is critical for policyholders with these types of policies to adopt proper safeguards to ensure they give timely notice of any claims. Under *Anderson,* failure to give timely notice under a "claims made and reported" policy will automatically result in a forfeiture of coverage.

In *Anderson,* Attorney Thomas Aul represented Melissa and Kenneth Anderson in a real estate transaction related to the purchase of certain commercial property in downtown Delafield, Wisconsin. After the transaction was closed, the Andersons made a claim against Attorney Aul, alleging that he had an unwaivable conflict of interest in the transaction, that he should not have represented them, and that the transaction was unfair and unreasonable to the Andersons as a result. The Andersons notified Attorney Aul in December of 2009 that they were dissatisfied with his legal representation. Unfortunately, Attorney Aul did not report the Andersons' claim to his professional liability carrier at that time. In fact, Attorney Aul did not report the Andersons' claim against him until more than a year later, when the Andersons filed a complaint against him in circuit court.

Attorney Aul's insurer, Wisconsin Lawyers Mutual Insurance Company ("WLMIC"), denied coverage for the Andersons' claim because Attorney Aul did not report the claim to WLMIC during WLMIC's policy period. WLMIC argued that its policy was a "claims made and reported policy," which, according to WLMIC, means that the policy did not provide coverage to begin with unless the claim was reported during the policy period. In response, Attorney Aul admitted that he failed to report the Andersons' claim within the policy period, but argued that he was still entitled to coverage because WLMIC was not prejudiced by the late

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notice. Attorney Aul noted that Wisconsin's notice/prejudice statutes prevent an insurer from denying coverage based on late notice unless it can prove it suffered prejudice as a result of the late notice.

The Wisconsin Supreme Court ultimately agreed with WLMIC, essentially holding that the notice/prejudice statutes do not apply to "claims made policies and reported" policies. Although the logic upon which *Anderson* was decided appears flawed, it is still binding law in Wisconsin. As a result, Wisconsin policyholders must be vigilant in making sure that they report claims to their insurers in a timely fashion. Although the notice requirements of each policy may vary, the safest practice is to assume immediate notice is required until proven otherwise. Even if your current liability policies are not written on a "claims made and reported" basis, the *Anderson* decision makes it likely that they will be in the future.

WBA wishes to thank Atty. Lee M. Seese of Michael Best & Friedrich LLP for providing this article. Atty. Seese may be reached at 414/223-2502 or lmseese@michaelbest.com.

Circuit Court May Order Sale of Abandoned Property: *Bank of New York* v. *Carson*

In *Bank of New York* v. *Carson* the Wisconsin Supreme Court recently affirmed a court of appeal's decision that when a court determines a property is abandoned, Wisconsin Statutes section 846.102 authorizes the circuit court to order a mortgagee to bring the property to sale after the redemption period. The Court further concluded that the circuit court must order the property to be brought to sale within a reasonable time after the redemption period; the circuit court's determination of what constitutes a reasonable time should be based on the totality of the circumstances in each case. The following is a brief description of the underlying facts and the Supreme Court's rationale from its opinion.

Carson purchased a home in Milwaukee in 2007 through Countrywide Home Loans (Countrywide). After Carson defaulted on her payments, Countrywide and Carson entered into an agreement to modify the terms of the loan. Carson again defaulted on her payments. The Bank of New York (Bank), as trustee for Countrywide, filed a complaint against Carson seeking judgment of foreclosure and sale of the home. Attempts to serve Carson at her Milwaukee home were unsuccessful. The process server observed that the home appeared to be vacant. The Bank then published notice of the foreclosure action in a local newspaper; Carson did not file an answer or otherwise dispute the foreclosure. In 2011, the loan servicer for Countrywide filed a City of Milwaukee Registration of Abandoned Property in Foreclosure form for the property.

In the foreclosure action the circuit court: entered judgment for the Bank; determined Carson owed the Bank and that the property was not owner occupied; and directed that the property shall be sold at any time after three months from the date of judgment. The court also enjoined both parties from committing waste on the property and specified that the Bank may take action the secure and winterize the property if Carson abandoned it. After the judgment the Bank did not act to secure the property and the property was repeatedly burglarized and vandalized. The City of Milwaukee imposed municipal fines on Carson for failure to upkeep the property.

By November 2012, the Bank had not sold the property and had no plans to sell it. Carson filed motion to amend the circuit court's judgment to include a filing that the property was abandoned and order that the Bank sell the property upon the expiration of five weeks of the date of entry of the amended judgment, pursuant to Wis. Stats. s. 846.102. To support her claim that the property was abandoned, Carson: referred to the process server's previous observation that the property appeared vacant; produced her own affidavit that she had terminated her utilities, the property had been vandalized, doors and windows were boarded, and that the garage had been damaged by fire; produced the form filed by the loan servicer with the City of Milwaukee to register the property as abandoned; and produced violation notices she had received from the City regarding the fact that the property was unkempt. The circuit court denied Carson's motion stating s. 846.102 does not specifically grant it the authority to sell the property at a specified time. Carson appealed to the court of appeals; the court of appeals agreed with Carson.

Wisconsin Stat. s. 846.102 governs the enforcement of mortgage liens on abandoned properties. In particular, paragraph (1) of the section provides:

> In an action for enforcement of a mortgage lien if a court makes an affirmative finding upon proper evidence being submitted that a mortgaged premises has been abandoned by the mortgagor and assigns, judgment shall be entered…except that the sale of such mortgaged premises shall be made upon the expiration of 5 weeks from the date when such judgment is entered.

In the Bank's argument to the Supreme Court it asserted that s. 846.102 does not require the Bank to sell a property after it obtains a judgment of foreclosure and the redemption period has passed. The Bank maintained that the language of the statute section is permissive, not mandatory, and that it cannot be forced to sell a property. The Bank further argued that even if the statute does mandate that the Bank sell the abandoned property after the redemption period, the statute provides no deadline for doing so. As a result, the Bank's position was that it was free to execute on its judgment at any time within five years after rendition of the judgment and that the circuit court had no authority to order the Bank to sell the property at a specific time.

The Supreme Court declined to adopt the Bank's argument. In its decision, the Court determined s. 846.102 authorizes a court to order a mortgagee to bring a property to sale. The Supreme Court also determined that based upon the

statute's context and its legislative history, s. 846.102 was intended to help municipalities deal with abandoned properties in a timely manner and declined to interpret the section so as to permit properties "to languish abandoned for five years."

The Supreme Court further interpreted the statute section to require the circuit court to order the property to be brought to sale within a reasonable time after the five week redemption period. The Court admitted that what is to be considered "reasonable time" will vary based upon the circumstances of each case, but that the circuit court is in the best position to determine that fact based upon the arguments and evidence on the issue. The Supreme Court left it with the circuit court to determine, after review of the totality of circumstances, what is a reasonable time for each case.

As stated above, the Supreme Court affirmed the court of appeal's decision and remanded the case to the circuit court for further proceedings to determine whether the Milwaukee property was abandoned since that determination had not actually been made by the circuit court.

Financial institutions must work closely with bank's own legal counsel to determine the best course of action for the institution when dealing with a defaulted mortgage-secured loan given the Supreme Court's decision in this case; the full opinion may be found at: http://www.wicourts.gov/sc/opinion/DisplayDocument.pdf?content=pdf&seqNo=135211.

Court of Appeals Affirms DFI Complaint: *Morgan Drexen, Inc.* v. *Wisconsin Department of Financial Institutions (Division of Banking)*

Financial institutions may be interested to know that the District II Court of Appeals has affirmed the Ozaukee County Circuit Court's opinion in the case of *Mortgage Drexen, Inc. v. Wisconsin Department of Financial Institutions (Division of Banking)*. In the case, the Wisconsin Department of Financial Institutions (DFI) filed a complaint and notice of hearing against Morgan Drexen, Inc., which provided debt settlement services by counseling individuals to stop paying creditors and pay Morgan Drexen to work on their behalf with their creditors. Morgan Drexen paid itself from the funds and paid the creditors on behalf of the debtors. In January 2015 Morgan Drexen had accumulated $4.2 million in fees and paid $4 million in settlements to creditors. A hearing examiner ordered Morgan Drexel to disgorge itself of the fees and pay $1.89 million forfeiture for operating as an unlicensed "adjustment service company." The order was affirmed by the circuit court; Morgan Drexen appealed.

Wisconsin Statute section 218.02(1)(a) defines an "adjustment service company" as a company or individual engaged as principal in the business of prorating the income of a debtor to the debtor's creditor(s), or of assuming the obligations of any debtor by purchasing the accounts the debtor may have with the debtor's several creditors, in return for which the principal receives a service charge or other consideration.

The court of appeals affirmed the order saying Morgan Drexel did not show that the hearing examiner's interpretation of the statutes was unreasonable or that disgorgement was in error. The court of appeals' decision may be found at: http://www.wicourts.gov/ca/opinion/DisplayDocument.pdf?content=pdf&seqNo=135490 . ■

manufactured and modular homes and multiple properties; coverage of preapproval programs and temporary financing; how to report a transaction that involved multiple financial institutions; reporting the action taken on an application; and reporting the type of purchaser for a covered loan.

Conclusion

On 07/24/2014, CFPB issued a proposed rule to revise Regulation C to incorporate not only changes made to HMDA by Congress under section 1094 of the Dodd-Frank Act, but to also make changes CFPB believes would improve upon the data collected and streamline the manner in which financial institutions collect and report HMDA data. The bottom line—CFPB's proposal will require the collection and reporting of additional data by more financial institutions than ever before. While WBA routinely advocates directly with state and federal agencies on behalf of Wisconsin's financial institutions, it is imperative for all financial institutions to review CFPB's HMDA proposal and send comments to CFPB regarding the proposal's specific impact on the institution. To further assist in this process, WBA will make a draft comment letter available for members' use near the comment period deadline. In preparation for use of the draft letter, each institution must consider how it would be specifically impacted by the proposal so that the institution can incorporate specific examples and economic data into its letter (*e.g.*, estimated costs to the institution if new staff need be hired or trained as a result of the proposal). Specific information is *critically* important for CFPB to fully comprehend any impact which may occur as a result of what it has proposed. As mentioned above, comments are due **October 22, 2014**. The proposed HMDA rule may be found at: http://www.consumerfinance.gov/newsroom/cfpb-proposes-rule-to-improve-information-about-access-to-credit-in-the-mortgage-market/. ■

JUDICIAL SPOTLIGHT

Wisconsin Supreme Court Decides Two Important Collection Cases

In the first case, titled *Associated Bank N.A., and SB1 Waukesha County, LLC, v. Decade Properties, Inc.*, 2014 WI 62, decided on July 15, 2014, the Supreme Court addressed the priority of two competing unsecured judgment creditors, SB1 Waukesha County, LLC ("SB1"), and Decade Properties, Inc. ("Decade"). Each unsecured creditor had a judgment against a common defendant ("Collier"). SB1 was the first unsecured judgment creditor with a docketed money judgment against Collier and the first to levy on that judgment against specific personal property of Collier. Decade argued that when it served Collier with an order to appear at a supplemental proceeding to discover financial assets prior to the levy by SB1, it thereby perfected a common law creditor's lien on all of Collier's personal property and therefore had priority over SB1. This was a fight between two unsecured judgment creditors over rights to certain assets of the debtor. UCC Article 9 does not apply to this case. Although banks are often secured creditors and unaffected by this particular case, they may also be unsecured judgment creditors at times and these priority rules determined by the Supreme Court may be important to them and their lawyers.

The Supreme Court decided that Decade as an unsecured judgment creditor does not obtain a blanket lien on all personal property of the debtor simply because it served an order on the debtor to appear for supplement proceedings. Further, Decade had not entered its judgment in the lien docket records of the county due to a clerk error, and the Supreme Court decided that an undocketed judgment cannot obtain an execution against personal property of the debtor. So, Decade was not able to prevent SB1 from pursuing collection from Collier's personal property.

The Supreme Court noted that entering a judgment in the judgment and lien docket system in the county does not create a statutory lien on the debtor's personal property. Instead, the judgment creditor obtains an unsecured interest with regard to the debtor's personal property against which it may levy. A judgment creditor will typically have to take further steps to enforce the judgment, such as by levy on the personal property. The Supreme Court concluded that the judgment creditor which first identifies and levies against specific personal property of the debtor has a superior interest to other judgment creditors who have taken no such action regarding the identified personal property. The Supreme Court acknowledges that where there are two judgment creditors with docketed money judgments and each attempts to levy against identified personal property of the debtor, or when a perfected secured party's rights are at issue, further analysis may be necessary to determine priorities.

Accordingly, an order to appear for supplemental proceedings will not create an interest that is superior to the interest of a docketed judgment creditor which has levied against specific personal property, and a judgment creditor obtains an interest in the defendant's specific personal property superior to other unsecured creditors only when it dockets its money judgment, identifies the specific personal property and levies on that property. In this case,

SB1 was the first judgment creditor with a docketed money judgment to levy against specific personal property of the debtor and therefore had priority over Decade in regard to that specific personal property. This case will be of particular importance to attorneys representing unsecured creditors in the collection and enforcement of judgments and obtaining priority rights over other unsecured creditors.

In the second case, titled *Attorney's Title Guaranteed Fund v. Town Bank and Heartland Wisconsin Corp.*, 214 WI 63, decided on the same day as the *Associated Bank* case described above, the Supreme Court addressed the rights of a secured creditor with a perfected security interest in collateral under UCC Article 9 versus the rights of an unsecured judgment creditor. The secured creditor and the unsecured judgment creditor were fighting over priority to the proceeds of the debtor's legal malpractice claim. The secured creditor, Heartland Wisconsin Corp. ("Heartland"), claimed that the debtor had granted it a security interest in the legal malpractice claim and its proceeds as collateral to secure a debt which Heartland then perfected by making a UCC filing before Town Bank, an unsecured creditor, obtained a judgment and levy against the proceeds of the legal malpractice claim. Town Bank claimed that it had perfected a common law creditor's lien on all of the debtor's personal property by serving the debtor with an order to appear at a supplemental proceeding, similar to the claim made by Decade in the case discussed above and with a similar result.

The Supreme Court decided that Heartland was entitled to priority because it obtained a security interest in the malpractice claim proceeds and perfected the security interest by a UCC filing before Town Bank obtained an interest in those proceeds by a levy on its judgment as an unsecured creditor. Heartland with the previously perfected UCC Article 9 security interest prevailed over Town Bank which subsequently obtained a judgment and levy on the same personal property. The Supreme Court relied upon its decision in *Associated Bank, N.A. v. Collier*, discussed above. Town Bank argued it had priority because it obtained and docketed its judgment, including obtaining an order requiring the debtor to appear at a supplemental proceeding, before Heartland obtained its perfected UCC Article 9 security interest. The Supreme Court disagreed and reached the same conclusion it did in the *Associated Bank* case discussed above, and that is that a judgment creditor with a docketed money judgment obtains an interest superior to other judgment creditors and certain secured creditors only by levying against specific personal property and not simply by an order that the debtor appear before a supplemental proceeding.

The Supreme Court determined that the first creditor to obtain an interest in the proceeds of the malpractice claim that is superior to other creditors wins in this case. The Supreme Court noted that a judgment creditor with a docketed money judgment against the debtor can obtain a prior right in specific personal property only by levying against that property. That had not occurred in this case. The Supreme Court further noted that a judgment creditor does not have a blanket lien on all of the debtor's personal property, contrary to Town Bank's argument in this case and Decade's argument in the *Associated Bank* case described above. So, for Town Bank to win this case, it had to levy on its judgment before Heartland obtained a perfected UCC Article 9 security interest in the proceeds, and Town Bank had not done so. Because Town Bank did not levy before Heartland obtained its UCC Article 9 security interest in the proceeds of the legal malpractice claim perfected by a UCC filing, Heartland had the prior interest in the proceeds from the legal malpractice claim and won the case.

The Supreme Court acknowledged that Heartland had the edge in this dispute because it had taken a UCC Article 9 security interest perfected by a UCC filing on property that the debtor did not yet have. Town Bank with its judgment as an unsecured creditor could only levy against specific property which required that the property be in existence. Heartland by obtaining a UCC Article 9 security interest in the proceeds of the legal malpractice claim perfected by a UCC filing had taken the steps necessary so that the moment the debtor obtained the proceeds of the legal malpractice claim Heartland's security interest became perfected. The ability of a party to take a security interest in after-acquired property and achieve perfection the moment the debtor acquires rights in the after-acquired property is a prime example of the special status of secured creditors under Wisconsin law, said the Supreme Court. If the Supreme Court were to accept Town Bank's argument in this case, that would take away the specially protected status of secured creditors according to the Supreme Court. The Supreme Court determined it would be inappropriate and potentially harmful to secured lenders if a judgment creditor could obtain a superior blanket lien on all of the debtor's personal property simply by getting a judgment and obtaining an order to appear at a supplemental proceeding.

The Supreme Court recognized that there are circumstances under which a judgment creditor would have priority over a UCC Article 9 security interest, such as when the judgment creditor executes on personal property before a UCC Article 9 secured creditor perfects its security interest in that property. A secured creditor when considering a loan and the taking of a security interest in personal property may be well advised to determine whether there are unsatisfied judgments against the debtor and if there are whether any judgment creditor has levied on personal property before the secured creditor makes the loan and takes a security interest in the personal property. If those circumstances exist and predate the UCC perfection by the secured creditor, the secured creditor is likely to lose in a priority dispute with the judgment creditor with respect to specific personal property subjected to the previous levy by the judgment creditor.

WBA wishes to thank Atty. John Knight, Chair of Banking Group, Boardman and Clark llp, for providing this article. ■

JUDICIAL SPOTLIGHT

Wisconsin Supreme Court Approves Business Practice Followed In Wisconsin In Sale of Notes and Mortgages.

In a recent case titled *Dow Family, LLC, v. PHH Mortgage Corporation and U.S. Bank, N.A.*, 2014 WI 56, decided by the Wisconsin Supreme Court on July 10, 2014, the Supreme Court determined that a mortgage securing a note sold to a purchaser is automatically assigned to the purchaser of the note under the "mortgage follows the note rule". Under that rule, the purchaser of the note is not required to produce a written assignment of the mortgage in order to foreclose on the mortgage. The WBA appeared as an amicus in this case and encouraged the Supreme Court to affirm the "mortgage follows the note rule" in Wisconsin and to declare that when a note is sold the mortgage securing the note is automatically assigned to the purchaser of the note. This rule is important as the legal foundation for certain long-standing banking practices. Mortgage Electronic Registration Systems, Inc. ("MERS") also appeared as amicus in this case.

In this case, PHH Mortgage Corporation was the servicer of the note secured by the mortgage and there was no corresponding written assignment of the mortgage. The Dow Family, LLC, a purchaser of real property subject to the mortgage securing the note sold to the purchaser of the note, argued that the mortgage was unenforceable because the purchaser of the note could not provide a written assignment of the mortgage. The Dow Family, LLC, as the purchaser of the property, was aware of the existence of the mortgage securing the sold note because the mortgage was noted in a title insurance commitment provided to the purchaser of the property.

Banks and others regularly buy and sell notes secured by mortgages on real property in this state, and for various business reasons when buying those notes and mortgages may not obtain a separate written assignment of each mortgage or record a separate assignment of each mortgage in the county real property records. These purchasers of notes and mortgages act in reliance on the long-standing rule of law that the mortgage automatically transfers to the purchaser of the note. The WBA encouraged the Supreme Court to uphold the long-standing rule of law in Wisconsin stating that a mortgage securing a note automatically transfers to the purchaser of the note under the "mortgage follows the note rule". Such a holding by the Supreme Court would not, of course, preclude a purchaser of a note and mortgage from obtaining a separate written assignment of each mortgage securing each note and recording the separate assignment of each mortgage with the local register of deeds if that is the practice the purchaser would prefer to follow in the transaction. It would be a perfectly acceptable, prudent and lawful practice to follow.

The WBA believed it would be inefficient and lead to unintended windfalls to others and potential harm to banks and other purchasers of notes secured by mortgages if the Supreme Court were to hold otherwise and thereby allow the note and the mortgage securing the note to become

separated thereby making the mortgage unenforceable. Further, because this rule is followed in most states, uniformity with respect to this rule is important in interstate commerce involving the sale and purchase of notes and mortgages.

The WBA also encouraged the Supreme Court to hold that the automatic assignment of a mortgage to the purchaser of the note does not need to be in writing under Wisconsin's statute of frauds requiring certain transactions be in writing because the transaction satisfies an exception in the statute for transfers occurring "by operation of law". The WBA believed that the automatic transfer of a mortgage to the purchaser of the note under the "mortgage follows the note rule" qualifies under the exception for transfers occurring "by operation of law". Therefore, this transfer should be excluded from the types of transactions governed by Wisconsin statute of frauds which requires that transactions subject to the statute of frauds be in writing. The Supreme Court agreed with the WBA.

Importantly, the Supreme Court confirmed in this case the continuing applicability of the "mortgage follows the note rule" in Wisconsin. Banks may continue to follow this lawful practice in connection with the purchase of notes and mortgages in Wisconsin, including purchases on the secondary market, purchases of branches from other banks, purchases of loans and mortgages from sother lenders and purchases of mortgage loans held by failed banks. The WBA believed an abrupt change in this rule of law would cause substantial disruption and harm to existing transactions where banks and others relied in good faith on the current rule. If the rule were to change as a result of this case, some notes would become unsecured as a result of the change in the law and the loss of the mortgages securing those notes would create unintended windfalls to others.

The Court of Appeals held that under the doctrine of equitable assignment, the mortgage automatically transferred with the note without the need for a written assignment. The Dow Family, LLC, asked the Supreme Court to find that the mortgage securing the note is unenforceable and cannot be foreclosed and that the Supreme Court reverse the decision of the Court of Appeals approving the enforceability of the mortgage. The WBA agreed with the Court of Appeals and encouraged the Supreme Court to approve the decision by the Court of Appeals.

The WBA is pleased that the Supreme Court supported its position in this case, and held that an unwritten and unrecorded assignment of the mortgage is enforceable. The Supreme Court said:

> "We agree ... that the doctrine of equitable assignment is alive and well in Wisconsin."
>
> "Therefore, under the doctrine of equitable assignment we hold that a mortgage automatically passes by operation of law under the assignment of a mortgage note .... Accordingly, we affirm the Court of Appeals' decision, and conclude that the doctrine of equitable assignment applies and does not violate the statutes of fraud."

This decision by the Supreme Court affirms the legality of a long-standing business practice followed by banks and others in connection with the purchase of notes and mortgages securing those notes. The assignment of a mortgage need not necessarily be in writing. The fact that the mortgage is of record is sufficient. This long-standing legal rule operates without harm to borrowers who obviously know they gave a mortgage on the property to secure the note and without harm to buyers of the property who know of the existence of the recorded mortgage as shown in the title insurance commitments provided to them. A buyer of the property may protect its interest by making sure the recorded mortgage is satisfied.

Finally, while it continues to be an appropriate and acceptable practice for purchasers of notes and mortgages to obtain written assignments of those mortgages and to record those written assignments with the local register of deeds, such a practice is not required as a matter of law based on this decision by the Supreme Court. This decision may be particularly important to purchasers of notes and mortgages when purchasing those notes and mortgages in bulk where a written assignment for each mortgage may not be practical as determined by the purchaser after consulting with counsel. Fortunately, based on this decision by the Supreme Court and its interpretation of the current law in Wisconsin, the assignment of a mortgage securing a note "follows the note" and is automatically assigned to the purchaser of the note. ■

WBA wishes to thank Atty. John Knight, Partner, Boardman and Clark llp, for providing this article.

Paying agents must maintain records to demonstrate compliance with the rule, including written procedures describing the methodology for complying with the requirements, for at least three years.

The notification requirement has no effect on state escheatment laws.

The final rule may be found at: http://www.gpo.gov/fdsys/pkg/FR-2013-01-23/pdf/2013-01269.pdf. ■

JUDICIAL SPOTLIGHT

Lender Wins $17 Million Lawsuit In Illinois Against Guarantor

In a recent case decided by the United States Court of Appeals for the Seventh Circuit, located in Chicago, the court confirmed a decision made earlier by the U.S. District Court in Northern Illinois granting judgment for the lender and against a guarantor for $17 million. *Inland Mortgage Capital Corporation v. Chivas Retail Partners, LLC, et al.,* 740 F. 3d 1146 (decided January 29, 2014). Although the case was decided under Illinois and Georgia law, it nevertheless adds to the body of case law in several states, including Wisconsin, holding that guarantors are not beneficiaries of anti-deficiency statutes intended to benefit borrowers. The case may also be helpful to lenders in Wisconsin because the jurisdiction of the United States Court of Appeals for the Seventh Circuit includes the federal courts in Wisconsin.

The Facts

The lender, Inland Mortgage Capital Corporation, made a loan to Harbins Crossing TC in the amount of $60 million to buy a tract of land in Georgia on which Harbins wanted to build a shopping center anchored by a national retail store. The lender obtained a guaranty of the loan from Chivas Retail Partners, LLC. Harbins defaulted on the loan (apparently because the national retail store decided not to locate in the proposed shopping center) and the lender foreclosed on the mortgage securing the loan. The foreclosure proceeding was a nonjudicial proceeding, a proceeding which is not available to lenders under Wisconsin law.

The lender made a credit bid of $7 million at the foreclosure sale and became the owner of the property. Under Georgia law, a lender which obtains property in a nonjudicial foreclosure sale cannot obtain a deficiency judgment against the borrower unless a Georgia court confirms that the auction conformed to Georgia law. In Georgia a court cannot confirm the sale unless it is satisfied that the property sold at the auction sale at its true market value. The Georgia court denied the lender's request for confirmation of the sale apparently because the court thought the land was worth more than $7 million.

Since the Georgia court denied confirmation of the sale and the lender was unable to obtain a deficiency judgment against the borrower, the lender invoked the guaranty and brought a lawsuit against the guarantor in Illinois for the difference between what it had paid for the property (the $7 million credit bid) and the unpaid balance of the debt and other costs and expenses ($24 million). The lender sought the difference between $24 million and $7 million—an amount equal to $17 million—from the guarantor. The U.S. District Court in Northern Illinois awarded judgment against the guarantor for $17 million. The guarantor appealed the decision to the U.S. Court of Appeals. The U.S. Court of Appeals affirmed the judgment granted by the U.S. District Court against the guarantor in the amount of $17 million. The decision by the U.S. Court of Appeals in this case is the subject of this article.

The Law

The guarantor argues in this appeal to the U.S. Court of Appeals that the $17 million judgment against it is a "deficiency judgment" and since a Georgia court had determined the property was worth more than $7 million the lender is not entitled to **any** deficiency judgment against **anyone**, including the guarantor. The U.S. Court of Appeals disagreed and determined that the lender "is not seeking a deficiency judgment." According to the U.S. Court of Appeals, a deficiency judgment is sought against the borrower and the borrower in this case is Harbins, not the guarantor. According to the U.S. Court of Appeals, there is nothing to prevent the lender from suing the guarantor. Furthermore, according to the U.S. Court of Appeals, the purpose of a loan guaranty is to make the lender whole if the borrower is unable to repay the loan in full. The fact that a Georgia court prevented the lender from obtaining full repayment by the borrower is what triggered the guarantor's liability to the lender as a guarantor of the debt.

The guarantor also argued that the $17 million judgment was a windfall to the lender because it is likely to recover more than the amount of the debt and the amount it paid for the property. The U.S. Court of Appeals rejected this argument based on language in the guaranty that the guarantor agrees to pay the unpaid balance even if the collateral was worth more than what the lender paid for it. The guaranty agreement in this case included language helpful to the U.S. Court of Appeals in this case. The guaranty agreement provided that "if Lender forecloses on any real property collateral . . . the amount of the debt may

be reduced only by the price for which the collateral is sold at the foreclosure sale, even if the collateral is worth more than the sale price; and Lender may collect from Guarantor even if Lender, by foreclosing on the real property collateral, has destroyed any rights Guarantor may have to collect from Borrower or anyone else." The U.S. Court of Appeals commented that the guaranty agreement guarantees the lender an amount equal to the difference between what it pays for the land and the unpaid balance of the loan to the borrower, even if the land is worth more than what the lender paid for it. The guaranty agreement couldn't be more clear. Nor is there any argument, according to the U.S. Court of Appeals, that the agreement is unconscionable or unlawful, even though it indeed has built into it the possibility of a windfall to the lender.

Based on the U.S. Court of Appeals' interpretation of the law, the facts in this case and good language in the guaranty agreement, the lender prevailed on its $17 million lawsuit against the guarantor.

In Wisconsin

What if this case had been brought in Wisconsin under Wisconsin law? Would the lender have the same good fortune as it did in this lawsuit under Illinois and Georgia law?

Like the law interpreted by the U.S. Court of Appeals in the case described above, Wisconsin law also provides that Wisconsin's anti-deficiency statute does not apply to the liability of a guarantor which is based on a separate and distinct contract from the liability of the borrower. *Bank Mutual v. S.J. Boyer Construction*, Supreme Court of Wisconsin, 2010 WI 74 (decided July 9, 2010). So the good news in Wisconsin is that its anti-deficiency statute at Wis. Stat. §846.103(2) does not apply to the liability of a guarantor under separate contract and therefore a similar case brought in Wisconsin should turn out with substantially the same result as the result in the U.S Court of Appeals on this issue. A guarantor is not protected by the applicable anti-deficiency statute.

As discussed above, the guarantor also argued in this case that the $17 million judgment was a windfall to the lender because the lender is likely to recover more than the amount of the debt and the amount it paid for the property. The U.S. Court of Appeals rejected this argument by the guarantor based on language in the guaranty agreement. A favorable result to a lender on this argument is less likely in Wisconsin, however. Wisconsin law bars over-recovery, and the amount a lender can recover from a guarantor must be reduced by what the lender has received from the debtor, namely the value of the mortgaged property to which it took title. *McFarland State Bank v. Sherry, et al.*, 2012 WI App. 4 (decided December 22, 2011). Further, Wisconsin has another and separate anti-deficiency statute at Wis. Stat. §846.165(2) which requires foreclosed property be sold at its "fair value". It is not clear whether this particular anti-deficiency statute at §846.165(2) in Wisconsin would be available for the protection of a guarantor under a separate guaranty agreement. There is, however, a strong policy argument in Wisconsin that Wisconsin's courts have generally refused to extend the protections of the anti-deficiency statutes to guarantors.

Bank Practices

Given these various cases, a bank should consider the following practices when dealing with a default situation if guarantors are involved:

1. Banks should make sure their guaranty forms contain a provision allowing the bank to credit bid without affecting the amount owed by the guarantor. To address this point the WBA guaranty forms were revised to allow the bank to credit bid without decreasing the amount of the debt owed by the guarantor. The revised WBA guaranty forms have a revision date of (8/11) or later and are currently available from FIPCO® in hard copy and software. The revised guaranty forms are helpful although banks cannot be absolutely certain that a court will hold in the bank's favor on this issue. FIPCO also intends to further modify the WBA guaranty forms to incorporate certain of the guaranty language approved by the U.S. Court of Appeals in the *Inland Mortgage Capital Corporation v. Chivas Retail Partners, LLC, et al.* case as discussed above. In light of this recent U.S. Court of Appeals decision, banks should review their guaranty forms to make sure that the documents give them the flexibility to pursue the remedies discussed in this article.

2. Consider carefully the amount of the credit bid. A bank may be tempted to bid low on the credit bid to preserve a larger deficiency judgment against the borrower and the guarantor. To confirm a sheriff's sale, though, the court must find that the property was sold for "fair value." Wisconsin courts have held that "fair value" is not the same as "market value" and that fair value is the amount an able and willing buyer will reasonably pay for the property for the use to which the property has been or reasonably may be put. The Wisconsin Supreme Court held that fair value was a reasonable value that does not "shock the conscience of the court." In determining the fair value of a property the bank should consider any appraisals on file and whether to obtain an updated appraisal, the sale prices of similar properties, the tax assessment on the property, whether the property has been listed for sale and the listing price, the amount a willing buyer would pay for a property that it may not have been able to inspect and other specific factors about a particular property. If the bid is low, the bank will have to be prepared to show why the winning credit bid is for fair value.

3. Banks should discuss their foreclosure practices with their legal counsel.

Summary

The decision by the U.S. Court of Appeals in the *Inland Mortgage Capital Corporation v. Chivas Retail Partners, LLC* case should be helpful to Wisconsin banks in connection with their collections against guarantors in Wisconsin. The decision by the U.S. Court of Appeals confirms the unavailability of an anti-deficiency statute in another state for the protection of a guarantor, similar to case law in Wisconsin confirming the unavailability of an anti-deficiency statute in Wisconsin for the protection of a guarantor. However, courts in Wisconsin may arrive at a different result than the ruling by the U.S. Court of Appeals in this case regarding the issue of a windfall to the lender. The U.S. Court of Appeals said it is not an issue because the language in the guaranty form permits such a windfall to the lender. In Wisconsin, however, an appellate court has determined that a lender's recovery from a guarantor must be reduced by what the lender received from the debtor, namely the value of the mortgaged property to which it took title. So there are some important similarities between the ruling by the U.S. Court of Appeals and case law in Wisconsin on some of the issues, and there are a few important differences between the case law in Wisconsin and the ruling of the U.S. Court of Appeals regarding the right of a lender to the benefit of a windfall in connection with a foreclosure sale. ■

WBA wishes to thank Atty. John Knight, Partner, Boardman and Clark llp, for providing this article.

REGULATORY SPOTLIGHT

CFPB Seeks Comment on Proposed Information Collection on Debt Collection Survey.

The Bureau of Consumer Financial Protection (CFPB) seeks comment on a proposed information collection entitled Debt Collection Survey from the Consumer Credit Panel. CFPB plans to conduct a mail survey of consumers to learn about their experiences interacting with the debt collection industry. The survey will ask consumers about their experiences with debt collectors, such as whether they have been contacted by debt collectors in the past, whether they recognized the debt that was being collected, and about their interactions with debt collectors. The survey will also ask consumers about their preferences for how they would like to be contacted by debt collectors, opinions about potential regulatory interventions in debt collection markets, and about their knowledge of their legal rights regarding debt collections. Comments are due **05/06/2014**. Copies of the notice may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2014-03-07/pdf/2014-05010.pdf. *Federal Register*, Vol. 79, No. 45, 03/07/2014, 13043-13044.

FRB Issues Proposed Rule to Amend FCRA Identity Theft Red Flags Rule.

The Board of Governors of the Federal Reserve System (FRB) has issued a proposed rule to amend its Identity Theft Red Flags rule, which implements section 615(e) of the Fair Credit Reporting Act (FCRA). The Red Flag Program Clarification Act added a definition of "creditor" in FCRA section 615(e) that is specific to section 615(e). Accordingly, the proposed rule would amend the definition of "creditor" in the Identity Theft Red Flags rule to reflect the definition of that term as added by statute. The proposed rule would also update a cross-reference in the Identity Theft Red Flags rule to reflect a statutory change in rulemaking authority. Comments are due **04/21/2014**. Copies of the proposed rule may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2014-02-20/pdf/2014-03264.pdf. *Federal Register*, Vol. 79, No. 34, 02/20/2014, 9645-9647.

FRB Proposes Repeal of Regulation DD.

FRB has issued a proposed rule to repeal its Regulation DD, 12 CFR part 230, which was issued to implement the Truth in Saving Act (TISA). Title X of the Dodd-Frank Act transferred rulemaking authority for a number of consumer financial protection laws, including TISA to the Bureau of Consumer Financial Protection (CFPB). In December 2011, CFPB published an interim final rule establishing its own Regulation DD to implement TISA. CFPB's interim final rule substantially duplicates FRB's Regulation DD. Accordingly, FRB has proposed to repeal its Regulation DD. Comments are due **04/21/2014**. Copies of the proposed rule may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2014-02-20/pdf/2014-03266.pdf. *Federal Register*, Vol. 79, No. 34, 02/20/2014, 9647-9649.

FRB Extends ANPR Physical Commodity Activities Comment Period.

On **01/21/2014**, FRB published in the *Federal Register* an advance notice of proposed rulemaking (ANPR) on various issues related to physical commodity activities conducted by financial holding companies and the restrictions imposed on these activities to ensure they are conducted in a safe and sound manner and consistent with applicable law. Due to the range and complexity of the issues addressed in the ANPR, FRB has extended the comment period. Comments are due **04/16/2014**. Copies of the ANPR may be obtained from

area within a certain distance from the edge of a navigable water, as outlined in Wisconsin statute section 59.692(1)(b). Previously, with certain exceptions, if a city or village annexed a county shoreland area after a specified date and that area, before annexation, was subject to a county shoreland ordinance, then the county shoreland ordinance would continue to be in effect and would be enforced by the annexing city or village.

Act 80 eliminated the requirement that the annexing city or village continue to keep the ordinance in effect and enforce the ordinance. Instead, Act 80 requires cities and villages to enact shoreland zoning ordinances by **July 1, 2014**, that apply to any shoreland area annexed by a city or village after May 7, 1982, and any shoreland area that was subject to a county shoreland zoning ordinance prior to being incorporated as a city or village. The Act provides minimums for what the ordinance must contain. Act 80 also provides that provisions of a shoreland zoning ordinance that were applicable to shorelands prior to annexation or incorporation continue in effect until the city or village enacts its own shoreland zoning ordinance with the minimum requirements set forth in the Act. Lastly, Act 80 provides that a city or village shoreland zoning ordinance does not apply to lands adjacent to an artificially constructed drainage ditch, pond, or stormwater retention basin if the ditch, pond, or basin is not hydrologically connected to a natural navigable water body. Act 80 took effect **December 14, 2013**, and may be found at: https://docs.legis.wisconsin.gov/2013/related/acts/80.pdf. ■

JUDICIAL SPOTLIGHT

Wisconsin Court of Appeals Case Makes Having Both Lender Name and Address on Real Property-Related Filing Documents A Best Practice

A recent decision of Wisconsin's Fourth District Court of Appeals may have a significant impact on mortgage lenders. The opinion in *Juneau County v. Associated Bank, N.A., et al*, 2013 WI APP 29 (January 31, 2013) upheld a lower court's decision that a county government in a tax lien foreclosure matter is not required to search outside of the records pertaining to the affected property in the office of the register of deeds in order to obtain the mortgage holder's address for the purpose of providing direct notice of the foreclosure to the mortgage holder.

Sebastian Madej owned two lots of real property in Necedah, Wisconsin, financed by notes and mortgages in favor of the Bank. The two mortgages were recorded in the County's office of the register of deeds on 08/12/2003. Neither recorded mortgage lists an address for the Bank.

Madej repeatedly failed to pay taxes on the two lots. In 2008, the Bank mailed a payment to the county treasurer to satisfy Madej's 2003 and 2004 delinquent taxes. The Bank's cover letter to the county treasurer, accompanying the payment, listed the Bank's address as "1305 Main Street, Stevens Point, Wisconsin 54481". The enclosed check listed the Bank's address "1200 Hansen Road, Green Bay, Wisconsin 54304."

In December 2009, Madej defaulted on the mortgages, prompting the Bank to file foreclosure actions in circuit court. The Bank recorded a lis pendens for each lot with the office of the register of deeds on 12/10/2009. The recorded lis pendens did not list an address for the Bank, but did list the circuit court case numbers for the corresponding foreclosure actions. The complaints filed in those foreclosure actions listed 1305 Main Street as an address for the Bank.

In April 2010, the circuit court entered default judgments in the Bank's foreclosure actions against Madej. Also in April 2010, the Bank mailed payment to the county treasurer to satisfy Madej's 2006 delinquent taxes. The county treasurer sent tax receipts to the Bank at the 1305 Main Street address reflected on the two checks comprising the payment. Before a sheriff's sale scheduled for 11/23/2010, the Bank settled with Madej and moved to vacate the foreclosure judgments. On December 2 and 6, 2010, the Bank recorded two discharges of lis pendens with the office of the register of deeds. No address for the Bank appeared on the recorded discharges of lis pendens. Neither Madej or the Bank paid the taxes owed on the two lots for 2007-2009.

On 11/30/2010, the County filed a notice of commencement of proceeding in rem to foreclose tax liens, along with a petition and list of ninety-four parcels with unpaid tax liens on which the County sought to foreclose. Madej's two lots were included on that list. In preparation for mailing foreclosure notices to interested parties, the County used the services of a title company to perform title searches to obtain the names and addresses of the owners and secured creditors of each affected parcel from the register of deeds' records to each parcel. The title insurance company reported that the Bank, a mortgage holder of Madej's two parcels, had an "unknown" address because none was found in the records relating to those parcels at the register of deeds office. The County published the foreclosure notice according to the statutory requirements, identifying the affected properties by parcel number, but did not attempt to

mail notice to the Bank in absence of any "ascertainable" address. The court found that the County had complied with the statutory procedures, and determined that the County had no obligation "to look beyond the office of the Register of Deeds to find information that was ascertainable."

Although the opinion above is limited in scope, the consequences were harsh—the foreclosure judgment vested ownership of the two parcels with the County, the Bank's security interest in the property was extinguished, and the property was conveyed to a third party.

It is strongly suggested that in space provided within mortgage filing forms for identifying the lender include both the lender's name and complete mailing address (number, street, city, state and zip code). FIPCO® documents include an area where this information may be provided. Lenders should also review mortgages, land contracts, real estate security agreements, mortgage subordination agreements, and other recordable documents in their existing loan portfolio to determine whether a correct address for the financial institution has been included. Financial institutions should consult its attorney to determine whether an affidavit of correction referencing the recordable document and providing the institution's complete address should be recorded with the register of deeds. ■

REGULATORY SPOTLIGHT

Agencies Issue Semiannual Regulatory Agendas.

- The Bureau of Consumer Financial Protection (CFPB) has published its semiannual regulatory agenda. CFPB anticipates considering the regulatory matters identified within the agenda between **11/01/2013**, and **10/31/2014**. The agenda includes: (1) proposed regulations concerning Home Mortgage Disclosure Act (HMDA) data to be collected and appropriate format, procedures, information safeguards, and privacy protections for information compiled and reported under HMDA; (2) a final rule on integrated mortgage disclosures under the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA), which was published in the *Federal Register* on **12/31/2013**; (3) a final rule to amend Regulation CC, which implements the Expedited Funds Availability Act; and (4) the development of proposed regulations concerning business lending data to be collected under Regulation B. The next agenda will be published in the spring of 2014 and will update the agenda through the spring of 2014. The information in the agenda is current as of **09/06/2013**. Copies of the agenda may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2014-01-07/pdf/2013-29701.pdf. *Federal Register*, Vol. 79, No. 4, 01/07/2014, 1241-1244.

- The Board of Governors of the Federal Reserve System (FRB) has published its semiannual regulatory agenda. FRB anticipates considering the regulatory matters identified in the agenda between **11/01/2013**, and **04/30/2014**. The agenda includes: (1) proposed amendments to Regulation CC to facilitate the industry's ongoing transition to fully electronic interbank check collection and return; (2) a final rule to amend Regulation LL, which governs savings and loan holding companies (SLHCs), and Regulation MM, which governs SLHCs in mutual form; (3) regulatory action on Regulation KK, which establishes margin and capital requirements for covered swap entities; and (4) the completed final rule with respect to regulatory capital requirements and implementation of Basel III. Comments regarding the agenda may be submitted anytime during the next six months. Copies of the agenda may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2014-01-07/pdf/2013-29647.pdf. *Federal Register*, Vol. 79, No. 4, 01/07/2014, 1289-1292.

- The Federal Deposit Insurance Corporation (FDIC) has published its semiannual regulatory agenda. The agenda contains information about FDIC's current and projected rulemakings, existing regulations under review, and completed rulemakings. FDIC has also issued a correction to the agenda. Copies of the agenda may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2014-01-07/pdf/2013-29649.pdf. *Federal Register*, Vol. 79, No. 4, 01/07/2014, 1281-1287. Copies of the correction may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2014-01-15/pdf/R1-2013-29649.pdf. *Federal Register*, Vol. 79, No. 10, 01/15/2014, 2758-2759.

- The Department of the Treasury (Treasury) has published its semiannual regulatory agenda. Copies of the agenda may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2014-01-07/pdf/2013-29638.pdf. *Federal Register*, Vol. 79, No. 4, 01/07/2014, 1209-1211.

- The Small Business Administration (SBA) has published its semiannual regulatory agenda, which provides a summary of all current and projected rulemakings, existing regulations, and completed actions by SBA. SBA seeks comment on any aspect of the agenda. Copies of the agenda may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2014-01-07/pdf/2013-29643.pdf. *Federal Register*, Vol. 79, No. 4, 01/07/2014, 1227-1233.

Conclusion

CFPB has issued a final rule requiring that a creditor make a reasonable, good faith determination before consummating a mortgage loan that the consumer has a reasonable ability to repay the loan according to its terms. Creditors may comply with the rule by meeting the general ability to repay standard, which requires consideration and verification of eight specified factors in underwriting the loan. Alternatively, a creditor may originate a "qualified mortgage" by meeting separate requirements, which will provide the creditor with greater legal protection and certainty. The rule creates five categories of qualified mortgages, two of which are temporary in nature. The final rule becomes effective **January 10, 2014**.

CFPB has also issued proposed rules to clarify various provisions of the Ability to Repay/Qualified Mortgage rule, including the use of GSE and federal agency eligibility requirements in determining QM status; the determination of debt and income for purposes of originating QM loans; and which compensation paid to retailers of manufactured homes and their employees is counted within the points and fees test. WBA anticipates that CFPB may issue additional proposed rules to amend and clarify the final rule's requirements prior to the rule's effective date.

Each of the final and proposed rules, the list of counties designated as "rural" or "underserved", and various compliance aids created by CFPB may be found at CFPB's Regulatory Implementation web page: www.consumerfinance.gov/regulatory-implementation/.

To assist members in their compliance efforts, WBA has launched a complimentary call program in partnership with the Boardman & Clark LLP law firm to answer members' questions regarding CFPB's mortgage-related rulemakings. The program is available exclusively to WBA members, and will run through the effective date of the Ability to Repay/ Qualified Mortgage rule. Questions beyond the scope of the program, such as requests to draft documents or confer with a bank's board of directors, would require establishment of a lawyer-client relationship with the firm and would result in fees for the additional service. To take advantage of this program, submit questions to WBA's Jennifer Torbeck at 608-441-1244, Heather MacKinnon at 608-441-1246, or Kris Cleven at 608-441-1263, or by email at wbalegal@wisbank.com. Banks which are already clients of the Boardman & Clark LLP law firm may contact John Knight at 608-283-1764, Gail Perry at 608-283-1787, or Patrick Neuman at 608-283-1774.■

JUDICIAL SPOTLIGHT

Wisconsin Supreme Court Dismisses Guarantor Claims Against Wisconsin Bank

The Wisconsin Supreme Court issued an opinion in *Park Bank v. Roger E. Westburg and Sandra L. Westburg* (2013 WI 57), on July 3, 2013, dismissing several counterclaims and affirmative defenses raised by the guarantors of a loan made by Park Bank, Milwaukee, to a local corporation. The claims and defenses were raised by the guarantors in response to the Bank's efforts to collect the loan from the guarantors. According to the Court, all of the claims made by the guarantors against the Bank except for one were derivative claims of the corporation and therefore could not be brought by the guarantors of the loan against the Bank. The Court acknowledges that the issue of whether a guarantor may raise derivative claims in defense to an action seeking payment under a guaranty had not previously been addressed by Wisconsin courts. The WBA participated in the case before the Wisconsin Supreme Court in support of the Bank's position in the case.

The guarantors alleged claims against the Bank for breach of fiduciary duty, breach of duty of good faith and fair dealing under the contract, negligence, breach of duty to disclose and other claims. According to the Court, these claims belonged to the corporation and were not the individual claims of the guarantors that could be raised in defense to the action by the Bank to collect from the guarantors. Such claims raised on behalf of the corporation are called "derivative claims" under the law, and the Court decided that "a guarantor lacks standing to raise derivative claims". The Court quotes favorably from another court decision stating that "guarantors cannot recover on account of injury done [to] the corporation", and "only where a guarantor suffers direct injury . . . may the guarantor pursue direct remedies". The Court concluded that "a guarantor lacks standing to raise derivative claims." The Court determined that with the exception of the one personal claim of the guarantors that the Bank unlawfully denied them access to their personal account, all of the other claims were derivative. The Court dismissed these claims by the guarantors against the Bank. This decision serves as important judicial precedent in our state.

The Court acknowledged that the guarantors may raise certain derivative claims on behalf of the corporation in their capacity as shareholders of the corporation. The guarantors in this case were also shareholders of the corporation. However, in order for them to maintain a

shareholder derivative action, the shareholders are required to comply with certain legal requirements under Wisconsin law, and no argument was made in this case by the guarantors that those legal requirements for derivative actions by shareholders were met in this case.

The guarantors also made a claim against the Bank arising from the Bank's alleged denial of access to their personal deposit account. With respect to this claim the Court determined that even if it was a personal and direct claim of the guarantors against the Bank the claim should be dismissed because the damages alleged by the guarantors did not arise from the Bank's denial of access to their deposit account. The Court said the claimed damages were based on the guarantors' investment losses in the corporation and were not based on the Bank's denial of access to their personal account. In this case, the guarantors were denied access to their account for 7 or 8 days, and any damages alleged must arise from the lack of access to the account during that limited period of time. There were none according to the Court. Therefore, the Court dismissed all of the guarantors' claims.

In addition to dismissing all of the claims made by the guarantors against the Bank, the Court dismissed the guarantors' defenses raised in response to the Bank's efforts to collect on the guaranties. According to the Court, the defenses available to a guarantor are grounded in the specific terms and conditions of the guaranty contract signed by the guarantor. In this case, the guarantors had signed the WBA Continuing (Unlimited) Guaranty form, and the Court quoted favorably from the WBA guaranty form in its decision. The Court noted that the WBA guaranty form is a guarantee of payment and that under the WBA guaranty it provides that payment from the guarantors is required "when due or, to the extent not prohibited by law, at the time any Debtor becomes the subject of bankruptcy or other insolvency proceedings." According to the Court, a guaranty of payment does not condition liability upon the creditor exhausting remedies against the debtor. A creditor is under no obligation to first seek collection from the principal debtor or any other guarantor under a guaranty of payment.

In accordance with the WBA guaranty form, in order for the Bank to demand payment the Bank "need show only that payment is due or that any debtor has become the subject of a bankruptcy or insolvency proceeding." Therefore, the defenses raised by the guarantors in this case must address whether payment is due or whether a debtor has become the subject of a bankruptcy or insolvency proceeding—and they didn't. According to the Court, the guarantors in raising their defenses did not assert that payment is not due or that the debtor was not the subject of bankruptcy or insolvency proceeding. The Court noted that the guarantors did not challenge that the corporation became the subject of an insolvency proceeding when it petitioned for a receivership. Therefore, the Court concluded that the defenses raised by the guarantors do not defeat the Bank's case for judgment in its favor.

The Court concluded that the Bank is entitled to judgment dismissing all of the guarantors' claims and defenses. This decision may be helpful to banks in their legal disputes with guarantors. Banks and their counsel are encouraged to review the decision by the Supreme Court. The decision may be found at: http://www.wicourts.gov/sc/opinion/DisplayDocument.pdf?content=pdf&seqNo=98992. ■

WBA wishes to thank Atty. John Knight, Partner, Boardman and Clark llp, for providing this article.

REGULATORY SPOTLIGHT

Agencies Issue Proposed Rule on Supplementary Leverage Ratio.

The Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) (collectively, the Agencies) have proposed a rule to strengthen the leverage ratio standards for the largest, most systemically significant U.S. banking organizations. Under the proposed rule, bank holding companies with more than $700 billion in consolidated total assets or $10 trillion in assets under custody (covered BHCs) would be required to maintain a tier 1 capital leverage buffer of at least 2 percent above the minimum supplementary leverage ratio requirement of 3 percent, for a total of 5 percent. Failure to exceed the 5 percent ratio would subject covered BHCs to restrictions on discretionary bonus payments and capital distributions. In addition to the leverage buffer for covered BHCs, the proposed rule would require insured depository institutions of covered BHCs to meet a 6 percent supplementary leverage ratio to be considered "well capitalized" for prompt corrective action purposes. The proposed rule would currently apply to the eight largest, most systemically significant U.S. banking organizations. The Agencies have proposed a substantial phase-in period for the rule with an effective date of **01/01/2018**. Comments will be due 60 days after the proposed rule is published in the *Federal Register*. Copies of the proposed rule may be obtained from WBA or viewed at: http://fdic.gov/news/board/2013/2013-07-09_notice_dis_b_res.pdf.

that the information is true and correct to the best of that individual's knowledge, under penalty of perjury.

Lastly, Rule 3002.1 provides a strict 21-day response period for mortgage creditors to file a written response after receiving the Final Cure Notice from the Chapter 13 trustee. The creditor's response must be filed as a supplement to the proof of claim and served on the debtor, the debtor's attorney and the trustee. The response should indicate whether the creditor agrees that the debtor has fully paid the amount required to cure the default on the claim and whether the debtor is otherwise current on all payments. If applicable, the response must also itemize any required cure or postpetition amounts that remain unpaid to the creditor as of the date of the statement.

In light of the fact that the amendments to the Rules have already gone into effect, mortgage lenders and servicers must act promptly to familiarize themselves with the new provisions and incorporate them into their procedures. As the revised Rules and recent court decisions suggest, a creditor's failure to do so may have serious consequences. ■

WBA wishes to thank the co-authors of this informative article, Atty. Paul Lucey, partner, Michael Best & Friedrich LLP, and Atty. Heather Bessinger, associate, Michael Best & Friedrich LLP.

WBA also wishes to note that the forms referenced in the article may be found at: www.uscourts.gov/FormsAndFees/Forms/BankruptcyForms/BankruptcyFormsPendingChanges.aspx.

JUDICIAL SPOTLIGHT

Wisconsin Court of Appeals Case Affects Guarantors' Obligations to Banks

A Wisconsin Court of Appeals recently issued an opinion in *McFarland State Bank v. Sherry, et al.* that affects how banks should pursue remedies against defaulting mortgagors and guarantors. The Court of Appeals held that the amount of the Bank's winning credit bid in the Bank's mortgage foreclosure of the borrower's property should be used to offset the amount that the Bank can subsequently collect from the guarantor of the borrower's obligations.

In the *Sherry* case, the Bank obtained a judgment of foreclosure against the mortgagor for $152,000, and retained the right to collect a deficiency judgment against the mortgagor. At the same time, the Bank also obtained a separate judgment against the guarantor, Sherry, for the same $152,000. Both were default judgments. At the sheriff's sale of the property, the Bank credit bid and purchased the property for $147,000; the principal amount of the debt. The circuit court confirmed the sale and found that the property had a "fair value" of $147,000, as proposed by the Bank.

After the sale, Sherry tendered payment for the difference between the judgment and the amount of the Bank's credit bid (with interest and fees, about $17,000). When the Bank refused to accept the payment, Sherry asked the circuit court for relief from the judgment. The circuit court denied the request, and Sherry appealed the decision, arguing that the fair value of the property should be used to offset the amount he owed to the Bank.

While the appeal was pending, the Bank and Sherry came to an agreement, by which Sherry paid the full amount of the judgment and received the property from the Bank. Despite the agreement the appeal was allowed to continue. Although Sherry was unable to convince the circuit court that the amount of the credit bid should be used to offset the total amount he owed pursuant to his guaranty, the Court of Appeals was persuaded to hold in his favor.

The Court of Appeals rejected the Bank's arguments, some of which were addressed in the written opinion and others of which were ignored. The Bank first argued that the guarantor's obligation was independent of the borrower's

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debt and therefore the Bank's winning credit bid and acceptance of the borrower's property does not affect the guarantor's obligation for the total amount of the debt until the Bank receives payment of the full amount of the debt in cash. The Court of Appeals was unpersuaded and relied heavily on the principle that there is one debt only and the Bank cannot recover twice on the same debt. Further, the Court of Appeals wrote, the guaranty did not unambiguously permit the Bank to collect from the guarantor even though the Bank had already credit bid on the property (the WBA guaranty was not used in this particular loan).

The Court of Appeals wrote that the Bank's ownership of the property is a form of payment, which should offset the amount owed by the guarantor even in a case like this where the Bank had already obtained a judgment for the full amount of the debt against the guarantor. The Court of Appeals further held that the fair value of the property, as determined by the circuit court when it confirmed the sale, should be used to offset the amount owed by the guarantor, regardless of the amount the Bank actually receives when it ultimately sells the property.

The Court of Appeals was similarly unswayed by the Bank's argument that "fair value" for mortgage foreclosure purposes is not the same as the "fair market value" of the property for purposes of offsetting the amount owed by the guarantor, even though previous cases had held that the two phrases did not have the same meaning. The Bank argued that fair value for mortgage foreclosure purposes has a specific meaning, which should not be carried over to calculate the amount by which the guarantor's obligation should be decreased. In the Bank's view, the setoff amount should be equal to the fair market value of the property, which is not necessarily equal to the fair value of the property. The Court of Appeals rejected the Bank's view and held that the amount of the credit bid should be the amount of the setoff against the amount owed by the guarantor.

The Court of Appeals sent the case back to the circuit court to fashion a proper remedy. Because Sherry possessed the property during the appeal process, the Court of Appeals directed the circuit court to order Sherry to give the property back to the Bank and the Bank to offset the "fair value" of the property along with any other equitable remedies the circuit court found necessary.

Given the holding by the Court of Appeals, a bank should consider the following when dealing with a default situation if guarantors are involved:

1. Make sure that the bank's guaranty permits the bank to credit bid or purchase the property without affecting the amount owed by the guarantor. The Court of Appeals made a point of stating that the guaranty was ambiguous about the net amount owed by the guarantor. Banks should make sure their guaranty forms contain a provision allowing the bank to credit bid without affecting the amount owed by the guarantor. To address this point the WBA guaranty forms have been revised to specifically allow the bank to credit bid or accept a deed in lieu of foreclosure without decreasing the amount of the debt owed by the guarantor. The revised WBA guaranty forms, which contain this specific provision, have a form date of (8/11) and are currently available from FIPCO® in hard copy and Financial Link® software. The revised guaranty forms are helpful and fill in one of the gaps noted by the Court of Appeals but until a subsequent court holds that the contractual language is sufficient to not require the bank to offset the credit bid against the amount owed by the guarantor, banks using these revised guaranty forms cannot be absolutely certain that a court will hold in the bank's favor.

2. Consider obtaining collateral for the guaranty. With an unsecured guaranty a guarantor may subsequently give collateral to another lender leaving the bank with fewer assets to pursue in case of default. With a first priority secured lien on the guarantor's collateral, the bank is in a position to recover from the guarantor without worrying that other creditors will be in a better collateral position if the guarantor has financial difficulties.

3. Consider pursuing collection efforts against the guarantor first, if permitted by the terms of the guaranty and the other loan documents. The WBA guaranties permit the bank to elect in what order to pursue collection remedies. This course may not be feasible in all cases but, if possible, exhausting remedies against the guarantor avoids the issue of a credit to the guarantor, and by paying the debt in full, the guarantor becomes entitled to exercise all of the bank's remedies against the defaulting borrower. The guarantor will undoubtedly try to persuade the bank to pursue its remedies against the borrower first. The bank may not be compelled to pursue remedies against the borrower first if the guaranty and the other loan documents permit the bank to pursue remedies in any order it chooses. If the bank wishes to accommodate the guarantor and is willing to foreclose against the borrower's assets first, then it should try to reach an agreement with the guarantor before starting collection efforts against the borrower regarding the net amount owed by the guarantors, how and when setoffs should be applied and any other terms relevant to the particular deal. It is important to have a written, signed agreement in place so that all parties understand and agree on the deal.

4. Consider carefully the amount of the credit bid. A bank may be tempted to bid low on the credit bid to preserve a larger deficiency judgment against the borrower and the guarantor. To confirm a sheriff's sale, though, the court must find that the property was sold for "fair value." Wisconsin courts have held that "fair value" is not the same as "market value" and that fair value is the amount an able and willing buyer will reasonably pay for the property for the use to which the property has been or reasonably may be put. The Wisconsin Supreme Court held that fair value was a reasonable value that does not "shock the conscience of the court." In determining the fair value of a property the bank should consider any

appraisals on file and whether to obtain an updated appraisal, the sale prices of similar properties, the tax assessment on the property, whether the property has been listed for sale and the listing price, the amount a willing buyer would pay for a property that it may not have been able to inspect and other specific factors about a particular property. If the bid is low, the bank will have to be prepared to show why the winning credit bid is for fair value.

In light of this recent Court of Appeals case, banks should review their guaranty forms and other loan documents to make sure that the documents give them the flexibility to pursue all remedies as discussed by this article. As well, banks should discuss their foreclosure practices with their legal counsel.■

REGULATORY SPOTLIGHT

Agencies Issue Joint Final Rule and Technical Amendment on Community Reinvestment Act Regulations.

The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (FRB), and Federal Deposit Insurance Corporation (FDIC) (collectively, the Agencies) have amended their Community Reinvestment Act (CRA) regulations to adjust the asset-size thresholds used to define "small bank" or "small savings association" and "intermediate small bank" or "intermediate small savings association." As required by the CRA regulations, the adjustment to the threshold amount is based on the annual percentage change in the Consumer Price Index. The final rule is effective **01/01/2012**. Copies of the final rule may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2011-12-22/pdf/2011-32727.pdf. *Federal Register*, Vol. 76, No. 246, 12/22/2011, 79529-79531.

Agencies Issue Proposed Rule on Risk-Based Capital Guidelines.

The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (FRB), and Federal Deposit Insurance Corporation (FDIC) (collectively, the Agencies) have issued a notice of proposed rulemaking (NPR) to modify the agencies' market risk capital rules, published in the *Federal Register* on **01/11/2011** (January 2011 NPR). The January 2011 NPR did not include the methodologies adopted by the Basel Committee on Banking Supervision (BCBS) for calculating the standard specific risk capital requirements for certain debt and securitization positions, because the BCBS methodologies generally rely on credit ratings. Under section 939A of the Dodd-Frank Act (DFA), all federal agencies must remove references to and requirements of reliance on credit ratings from their regulations and replace them with appropriate alternatives for evaluating creditworthiness. In this NPR, the Agencies are proposing to incorporate into the proposed market risk capital rules certain alternative methodologies for calculating specific risk capital requirements for debt and securitization positions that do not rely on credit ratings. The Agencies expect to finalize this proposal, together with the January 2011 NPR, in the coming months after receipt and consideration of comments. Comments are due **02/03/2012**. Copies of the proposed rule may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2011-12-21/pdf/2011-32073.pdf. *Federal Register*, Vol. 76, No. 245, 12/21/2011, 79380-79407.

Agencies Seek Comment on Revisions to Call Report.

The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (FRB) and Federal Deposit Insurance Corporation (FDIC) (collectively, the Agencies) seek comment on revisions to the Consolidated Reports of Condition and Income (Call Report) Federal Financial Institutions Examination Council (FFIEC) forms 002 and 002S. On a quarterly basis, all U.S. branches and agencies of foreign banks are required to file the FFIEC 002, which is a detailed report of condition with a variety of supporting schedules. That data is used to augment the bank credit, loan, and depository information needed for monetary policy and other public policy purposes. The FFIEC 002S is a supplement to the FFIEC 002 that collects information on assets and liabilities of any non-U.S. branch that is managed or controlled by a U.S. branch or agency of a foreign bank. On **06/17/2011**, the Office of Management and Budget (OMB) approved the Agencies' emergency clearance requests to implement assessment-related reporting revisions to the Call Report forms effective as of the **06/30/2011**, report date. OMB's emergency approval of the assessment-related reporting revisions extends through the **12/31/2011**, report date. (As separately approved by OMB, **12/31/2011**, is also the final report date as of which the Thrift Financial Report (TFR) will be collected. Savings associations will begin to file the Call Report as of the **03/31/2012**, report date.) Because of the limited approval period associated with OMB's emergency clearance, the Agencies, under the auspices of FFIEC, requested public comment on the assessment-related reporting revisions to which the emergency approval pertained. After considering the comments received on the revisions, the transition guidance for the reporting of subprime and leveraged loans and securities by large and highly complex institutions that was adopted by the Agencies in connection with their emergency clearance