community BANKER

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Welcome to the latest issue of the COMMUNITY BANKER.

The Community Banker is prepared by attorneys at Olson & Burns P.C. to provide information pertaining to legal developments affecting the field of banking. In order to accomplish this objective, we welcome any comments our readers have regarding the content and format of this publication. Please address your comments to:

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The attorneys at Olson & Burns represent a wide range of clients in the financial and commercial areas. Our attorneys represent more than 30 banks throughout North Dakota.

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You are asking . . . .

Q: Mr. Smith died and he owes the bank money; his family hasn't opened a probate estate yet and we don't know if they will. I was told that the bank can open a probate – is this correct?

A: If 45 days have elapsed since the death of Mr. Smith and a probate has not been opened, your bank, as a creditor, may petition for appointment as personal representative under N.D.C.C. § 30.1-13-03. The bank can't do this until 45 days after the death of the decedent, and it must be done within three years after the death of the decedent in the county in which the decedent resided at the time of death. N.D.C.C. § 30.1-13-01. Keep this tool in mind and see a reputable attorney to act as soon as the 45 days are up.

Q: A customer died owing the bank money on an outstanding loan. Can the bank utilize the right of setoff on deposit accounts that have Pay on Death (POD) beneficiaries when there is an outstanding loan balance owed by the deceased account owner.

A: Yes. North Dakota does have a statute that allows banks to setoff against a POD account the amount due under a loan, before the Bank pays out the account balance to the POD beneficiary. The law says that Without qualifying any other statutory right to setoff or lien and subject to any contractual provision, if a party is indebted to a financial institution, the financial institution has a right to setoff against the account. The amount of the account subject to setoff is the proportion to which the party is, or immediately before death was, beneficially entitled under section 30.1-31-08 or, in the absence of proof of that proportion, an equal share with all parties.

N.D.C.C. § 30.1-31-20. Under N.D.C.C. § 30.1-31-08, during the lifetime of all parties an account belongs to the parties in proportion to the net contribution of each to the amount on deposit, unless there is clear and convincing evidence of a different intent.

In other words, if the account is a joint account with a POD, the Bank must look at what sums the parties were entitled to during their lifetime, and then may setoff what the debtor owes to the Bank out of what the debtor is entitled to under the account. If the parties are married, in the absence of proof otherwise, the net contribution of each is presumed to be an equal amount – so the Bank could setoff half of the account to pay off a married debtor's loan. If the account holder was the sole owner of the account, the Bank is entitled to setoff the entire amount in the account against the loan because that deceased account holder was entitled to all of the funds in the account before death. In all cases, the POD beneficiary comes behind the Bank – the Bank just has to figure out what percentage of the account belonged to the deceased account holder if he or she were alive. See your attorney if you aren't sure!

Q: Regarding setoff of a Pay on Death account, we have a deceased debtor/account owner who was the sole owner of four different accounts. Each account had one beneficiary. If Mrs. White is the sole owner of the four accounts, and there are four separate beneficiaries, is there a required way to determine which account we should take the money from? Can we divide the loan amount by four and take an equal amount from each account?

A: The first answer to what you can setoff would lie in your account agreement, which probably refers to setting off "account(s)" rather than referring to a specific account.

In the event of a sole owner with more than one account, the law does not specify how setoff may be undertaken. However, it seems that dividing the loan amount by four and taking an equal amount from each account would be the most equitable way to do it.

There may be other issues, such as one account only has $1,000 in it and one has $800,000 in it, but those are variables that the Bank can figure out at the time of setoff – what's fair? The law does not state which account must bear the burden of setoff – if there are any instructions on that matter, it would be in the account agreement.

Q: A POD account was paid out to the POD beneficiaries several months after the death of the account owner – no one said that we shouldn't pay out the funds. Now, the personal representative of the deceased account owner wants the information about how much money was in those accounts and who it was paid to. Are we permitted to give this information to him?

A: If he requests the information in his role as the personal representative, the bank must provide it because the rights of creditors and others come before the POD beneficiaries. Under N.D.C.C. § 30.1-31-12, if the estate doesn't have sufficient assets to pay claims against the estate (and statutory allowances to the surviving spouse and children), the personal representative may proceed to get back the money paid to the POD beneficiary. A transfer under a POD designation is not effective against the estate to the extent its needed to pay creditors' written claims against the estate. Creditors who make a written claim to the money in the account come before the POD beneficiaries' right to the money.

The POD beneficiary who receives payment from an account after death of a party is liable to account to the personal representative for a proportionate share of the amount received to which the decedent, immediately before death, was beneficially entitled. N.D.C.C. § 30.1-31-12(2). For example, if the owner was the sole owner, the beneficiary would be liable to account to the personal representative for 100% of the money in the account. There would be a proceeding under the probate to get that money back from the beneficiary if necessary.

Generally, the bank is protected from liability if it pays the funds to the beneficiary in accordance with the terms of the account and it won't be involved in the probate proceeding unless the bank had prior written notice from a party, spouse, heir, devisee, or the personal representative that it shouldn't make payment to the POD beneficiary under the terms of the account. See N.D.C.C. § 30.1-31-19(2).

Q: Are attorney's fees provisions in loan documents enforceable? We currently include them, but we know they aren't enforceable in North Dakota.

A: Whether the provision is enforceable depends whether the loan is enforced under North Dakota state law or in bankruptcy court, which is a federal court. Under N.D.C.C. § 28-26-04, "Any provision contained in any note, bond, mortgage, security agreement, or other evidence of debt for the payment of an attorney's fee in case of default in payment or in proceedings had to collect such note, bond, or evidence of debt, or to foreclose such mortgage or security agreement, is against public policy and void."

If the loan document is clearly a note, bond, mortgage, or security agreement, the attorney's fees provision will not be enforced in state court. Even if the document does not bear the exact name of one of those instruments, it will likely still fall under the statute through the catchall "other evidence of debt."

However, despite N.D.C.C. § 28-26-04, we advise lenders to include attorney's fee provisions in loan documents because an oversecured creditor in a bankruptcy proceeding in North Dakota may collect attorney's fees incurred during the course of the bankruptcy if the security agreement provides for the payment of such fees. Accordingly, with an eye toward a possible bankruptcy, lenders do include language for the payment of attorneys' fees incurred in protecting the collateral or enforcing the agreement in all documents. The attorneys' fees provisions are disregarded in state court actions, but they are enforceable and are valid in bankruptcy court.