STATE OF MINNESOTA
IN SUPREME COURT
Case No. A04-866

Minnesota Voyageur Houseboats, Inc.,
a Minnesota corporation,

Debtor,

Las Vegas Marine Supply, Inc., a
Nevada corporation, et al.,

Appellant,

vs.

Northern National Bank,
n/k/a Wells Fargo Bank,

Respondent,

APPELLANT'S BRIEF AND APPENDIX

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LEGAL ISSUE

When all contractual payments on a term note have been made when due, and the bank's records indicate that no payments are due on the note and that the note is not in default despite the bank's knowledge of a technical default, is there any debt due and owing against which the bank can setoff, absent the bank first accelerating the note?

The Trial Court held in the negative. The Court of Appeals reversed that holding.

Firstar Eagan Bank v. Marquette Bank, 466 N.W.2d 8, 12 (Minn. Ct. App. 1991)

United Seeds, Inc. v. Eagle Green Corp., 389 N.W.2d 571 (Neb. 1986)

STATEMENT OF THE CASE

This case arises out of Appellant Las Vegas Marine's ("Las Vegas Marine") garnishment of the Bank in 1997 in its attempt to collect on a judgment it held against Debtor Minnesota Voyageur Houseboats, Inc. ("Minnesota Voyageur"). The Trial Court, the Honorable Terry C. Hallenbeck, rendered summary judgment for Las Vegas Marine and denied Respondent Wells Fargo Bank's (the "Bank") cross motion for summary judgment. Minnesota Voyageur was not involved in the motion or the appeal. The Court of Appeals reversed the judgment of the Trial Court. *Minnesota Voyageur Houseboats, Inc. v. Las Vegas Marine*, 690 N.W.2d 762 (Minn. Ct. App. 2005). This Court granted review by Order date March 15, 2005.

FACTS

Las Vegas Marine obtained a judgment against Minnesota Voyageur in Nevada on January 7, 1997. (Appendix ("App.") 16.) Las Vegas Marine caused the judgment to be entered in the district court in Duluth in Minnesota on February 13, 1997. (Id.). The Minnesota court notified Las Vegas Marine and Minnesota Voyageur of entry of the judgment. (App. 15 – 17.)

Before the judgment was entered, Minnesota Voyageur had borrowed money from the bank now known as Wells Fargo[1]. Minnesota Voyageur executed a promissory note in the amount of $530,160.00 in favor of the Bank on August 24, 1994 (the Term Loan"). (App. 29.) To secure the Term Loan, Minnesota Voyageur executed a Security Agreement in which it granted the Bank a security interest in certain of its assets, namely accounts, equipment, fixtures, inventory, and general intangibles. (App 31). Filed financing statements provided notice of the security interest to the public. (App. 36, 37.) The Bank in its answers to Las Vegas Marine's interrogatories valued the collateral at $750,000. (App. 75.) In addition, the sole shareholder of Minnesota Voyageur, James Klapmeier, executed a Third Party Pledge and pledged $450,565 37 in certificates of deposit to secure the indebtedness of his company. (App 112 – 115.)

The terms of the Security Agreement provided specific events of default, including if Minnesota Voyageur:

> (a) fails to make any payment under this Agreement or any other indebtedness to Lender when due;
>
> * * *
>
> (f) permits the entry or service of any garnishment, judgment, tax levy, attachment or lien against Owner [Minnesota Voyageur], any guarantor, or any of their property;

The Security Agreement further states

> If there is a default under this Agreement, Lender shall be entitled to exercise one or more of the following remedies without notice or demand (except as required by law):
>
> (a) to declare the Obligation immediately due and payable in full;
>
> * * *
>
> (h) to set off Owner's obligations against any amounts due to Owner including, but not limited to, monies instruments, and deposit accounts maintained with lender;

(App. 33.) The Term Note contains virtually identical language. (App. 30.) The remedy of acceleration, option "(a)" was not automatic, but needed to be exercised by the Bank.

[1] Previously known as First National Bank of International Falls and Northern National Bank.

The Term Note required Minnesota Voyageur to annually make three payments of principal and interest of $21,000 each. The payments were to be made on July 1, August 1 and September 1. (App. 29) As of August 20, 1997, Minnesota Voyageur had made its July 1, August 1, and September 1 payments for 1997 on the Term Loan. (App. 38 - 39.) Minnesota Voyageur made payments of $10,000 on June 24, $12,000 on June 30, $15,000 on July 14, $6,000 on July 21, $15,000 on August 4, and $5,000 on August 18, 1997. (Id.). According to the terms of the Term Note, Minnesota Voyageur owed no more payments to the Bank until July 1998. (App. 29).

Minnesota Voyageur also had a loan in which the IRRRB had participated (the IRRRB Loan"). The Bank assumed the lead bank role on the IRRRB Loan pursuant to an Agreement and Assignment of Note dated August 24, 1994. (App. 40 – 41.) The IRRRB Loan required single annual payments of $21,000 each September 30. (App. 75, 120.) The payment history on the loan indicates that Minnesota Voyageur typically made several payments on the IRRRB Loan, many times in arrears. (App. 42.) However, in 1997, Minnesota Voyageur made a $19,831.20 payment on the IRRRB loan on August 20, 1997. (Id.) Or Minnesota Voyageur made a $20,000 payment on the IRRRB Loan on August 20 as reflected on the *other* "Loan Accounting System Note Transcript Statement" which the Bank has produced in this action. (App. 124.)[2] The bank president and CEO testified in 1997 that the Bank merely serviced the IRRRB Loan, so the difference between the $20,000 Minnesota Voyageur paid on August 20, and the amount credited to the IRRRB loan may have been a servicing fee for the Bank. (App. 42, 120, 121, 124.)

Notes of the Bank's president, Keith Sutherland, dated August 6, 1997, reflect that he spoke to someone about "judgment on dealer sale of boat, $140,000. Is judgment on legal fees?"

[2] The difference is seen in the interest column.

Mr. Sutherland testified that he would have known about the Las Vegas Marine judgment against Minnesota Voyageur no later than August 6, 1997. (App. 23, 28.)

On August 20, 1997, Las Vegas Marine garnished the Bank by certified mail. (App. 52.) On August 21, 1997, Las Vegas Marine served Minnesota Voyageur with the garnishment papers (App. 126.)

On August 19, 1997, the daily balance in Minnesota Voyageur' checking account at the Bank was $71,093.17. (App. 65.) On August 20, 1997, the Bank paid several of Minnesota Voyageur' checks, numbers 18281, 18282, 18283, 18284, 18294, 18295, 18300, 18305, and 18306. In addition to the $20,000 check, #18305 (August 20, 1997 payment on the IRRRB Loan), the checks honored the day of the garnishment total $10,042.45 (App 64, 73.) The bank records reflect that the daily balance in the Minnesota Voyageur' checking account on August 20, 1997, was $40,703.28. (App. 65.) This daily balance reflects the checks honored and another small debit.

On August 21, 1997, the daily balance in the Minnesota Voyageur checking account at the Bank was $4,317.89. (App. 65.) This reflected the setoff by the Bank that day in the amount of $40,700, payments of several checks (numbers 18265, 18280, 18291 and 18292), and two credits. The Bank took its setoff in the form of a cashier's check dated August 21. (App. 70, 73.) It then applied the $40,700 to the Term Loan on August 22. (App. 39.) The Bank continued to allow Minnesota Voyageur to use its account, and it honored Minnesota Voyageur's checks on August 22, 25, 27, and 28, allowing overdrafts on August 22 and 25. (App 64 - 65.) In fact, Minnesota Voyageur continued to use its account uninterrupted until at least November. (App. 65 – 69) (the last month for which records were sought in discovery).

All payments owing on the Term Loan were current when the Bank setoff and applied the $40,700 to the Term Loan. (App. 38 - 39.) The Bank did not accelerate the Term Loan, did not notify Minnesota Voyageur that the Term Loan was due and payable, and still treated the Term Loan as performing. (App. 85.)

Las Vegas Marine deposed Mr. Sutherland soon after the garnishment. It had served a subpoena requesting documents relating to the Bank's answers to interrogatories. Mr. Sutherland refused to answer questions about the third party guarantor or the nature of the collateral pledged to secure the Minnesota Voyageur Term Loan because, in the words of counsel for the Bank,

> we have talked to an independent party who pledged collateral against this particular loan who has specifically directed us not to disclose any information about his identity or any information about his financial circumstances or any information about him at all.

(App. 118.) The "independent party" turned out to be James Klapmeier, the sole shareholder of Minnesota Voyageur. (App. 112 - 113.)

After Las Vegas Marine moved the district court to allow it to bring this action against the Bank pursuant to the garnishment statute, a junior secured creditor of Minnesota Voyageur foreclosed her blanket security interest in the assets of Minnesota Voyageur, and the assets comprising her security were sold on February 3, 1998 at a sheriff's sale. The purchaser of almost all of the assets was the sole shareholder of Minnesota Voyageur, James Klapmeier. (App. 134- 137.) In connection with the foreclosure sale, the Bank, Minnesota Voyageur, and Mr. Klapmeier (signing individually and as the president of Minnesota Voyageur) stipulated that all of the secured parties including the Bank released their security interests in the assets of Minnesota Voyageur. (App. 143). They further stipulated that entry of judgment in Minnesota by Las Vegas Marine was an event of default under the Term Note and Security Agreement.

(App. 140.) As a result of the foreclosure sale, the Term Loan and the IRRRB Loan were paid in full, and Mr. Klapmeier indemnified the Bank as to all liability and attorneys' fees and costs resulting from this action. (App. 38 - 39, 42; 145.)

ARGUMENT

1. Standard Of Review

This Court reviews the trial court's award of summary judgment *de novo*. This Court determines whether there are any genuine issues of material fact and whether the trial court erred in it application of the law. *Hedged Inv. Partners, L.P. v. Norwest Bank Minnesota, N.A.*, 578 N.W.2d 765, 769 (Minn. Ct. App. 1998). The parties do not contend that there are any genuine issues of material fact.

2. Setoff Is An Equitable Remedy For Those Who Act Equitably

The Bank argues that is has both equitable and contractual setoff rights. Setoff is an ancient right most often attributed to banks. *See* Jack Justice, *Setoff Against A Depositor Facing Bankruptcy: A Question of Timing* Banking L.J. 310 (1990). Setoff is an equitable remedy and "he who seeks equity must do equity." *Firstar Eagan Bank v. Marquette Bank*, 466 N.W.2d 8, 12 (Minn. Ct. App. 1991) (citations omitted). "Unclean hands" precludes use of an equitable remedy, and the unclean hands need not be of a fraudulent nature. A party may be denied equitable relief where the result occasioned by the party's conduct will be unconscionable either in benefit to the party or injury to another. *Hruska v. Chandler Assoc., Inc. 372 N.W.2d 709, 715* (Minn. 1985). The irregularities in the actions the Bank took in response to the garnishment make it appear as if the Bank colluded with its customer to deny Las Vegas Marine any recovery; something that would not be sanctioned by any court. *See Frierson v. United Farm Agency, Inc*, 868 F.2d 302, 305 (8th Cir. 1989). And even in the absence of any equitable concerns, mechanically the Bank did not properly setoff, no matter how the undisputed facts are viewed.

3. <u>The Prerequisites for Setoff Were Not Met</u>

The process of setoff involves the offsetting of mutual debts. The common scenario is the bank whose customer maintains an account at the bank and who borrows money from the bank. If the customer does not repay its indebtedness, the bank may be able to setoff against funds in the customer's account. But this ancient right of setoff cannot be exercised by a bank at will. Certain conditions must be present: the debts must be mutual; the funds used for the setoff must belong to the debtor; and the *existing indebtedness must be due and owing at the tine of the setoff.*[3] *Firstar Eagan Bank,* 466 N.W.2d at 12 *citing* Barkley Clark, *The Law of Bank Deposits, Collections and Credit Cards* §14.06, at 14 – 18 (3d ed. 1990)(emphasis added).

The debts appear to be mutual: Minnesota Voyageur borrowed money as evidenced by the Term Note, and Minnesota Voyageur owned the account at the Bank. For the purpose of this analysis, we will assume the funds in the account belonged to Minnesota Voyageur although the source of the funds has never been established. The third condition to setoff is not met, however. There was no mature debt. Minnesota Voyageur had made all of its payments on the Term Note as of August 18 – two days before the Bank received the garnishment. Minnesota Voyageur was current (in fact ahead) on its installment loan and it owed the Bank nothing when the Bank received the garnishment.

Noted banking law commentator Barkley Clark has observed that

> If the debt carries a specific maturity date rather than being payable on demand, the bank must be very careful not to exercise setoff until the date arrives.

[3] Insolvency of the debtor satisfies the maturity obligation. Minnesota Voyageur was not insolvent.

Clark, § 14.05[1], at 14-10 and update at § 18.05. The law does not leave a bank completely without options if its installment customer is current on its payments and the bank receives a garnishment. Again, Barkley Clark advises banks how to deal with this situation:

> [A]ny promissory note worth its salt will contain an acceleration clause making the entire unpaid balance due and payable upon the debtor's default. Thus, once default occurs, the bank is free to exercise setoff. The security agreement, mortgage document, or deposit contract should contain a very broad definition of this criminal term so that acceleration can be triggered under a wide variety of circumstances.* * * Tied to this list of events of default *must be an acceleration clause, both in the note and in the security documents.*

(Id.)(Emphasis added). In other words, an event of default allows the bank to accelerate the indebtedness so there is a debt to setoff against. The Terms Note gave the Bank the right to declare a default, or accelerate, in the event of default – however, the Term Note required the Bank to take action to accelerate, acceleration was not automatic. (App. 30.) The Bank has consistently agreed that it did not accelerate.

a. Reference to the UCC Shows No Debt Was Due and Owing

The Court of Appeals held that the non-payment or covenant defaults sufficed to make the entire debt due and owing. The Minnesota Voyageur's default of which we are aware was to allow the judgment to be entered against it in January 1997. This is called a "covenant default" or "technical default." *C.f., Connecticut v. Doehr*, 501 U.S. 1, 11 (1991) (attachment may cause a technical default on a mortgage); *Frierson v. United Farm Agency*, 868 F.2d 302, 304 (8th Cir. 1989)(a type of default inserted in notes to allow the lender to declare a note in default even when a relatively minor problem arises). In the interrogatories it answered as a part of the garnishment, the Bank claimed that the default triggering the setoff was the service of the garnishment itself. (App. 76.)

The Uniform Commercial Code ("UCC") does not apply to set off. *Firstar Eagan Bank v. Marquette Bank,* 466 N.W.2d at 11; Minn. Stat. §336.9-104(i) (2000). However, the UCC does apply to the Term Note and Security Agreement, and it provides the answer to whether the debt was "due and owing." An explanation under the UCC of the difference between a demand note and a note payable over time at specific intervals, such as the Term Note, is instructive. A demand note is considered due and payable upon issuance. *Larson v. Vermillion State Bank,* 567 N.W.2d 721, 723 (Minn. Ct. App 1997) (cites omitted). As such, a demand note does not carry with it an implied duty of good faith, as does a term note. *Id.* Minnesota law reads into every commercial transaction an implied duty of the parties to act in good faith. *Id.* Under that good faith requirement, a term note may not be accelerated unless the holder has a good faith belief that its prospect of payment is impaired. *Id.*; Minn. Stat. §336.1-208 (1996). If a covenant default automatically rendered a note due and payable, there would be no need for acceleration and no lawsuits regarding the good faith of the lender exercising acceleration. Acceleration is not required for setoff, but acceleration is required to make anything due and payable on a term note that has been paid according to its terms. In this case, if Minnesota Voyageur had not made its August 1, 1997 $21,000 payment, then the Bank could have set off $21,000 without acceleration because the $21,000 would have been due and owing.

The Bank admittedly did not accelerate, nor could it have possibly made the argument that it in good faith believed that its prospects for repayment were impaired: on the date of the garnishment it held liquid collateral in the form of certificates of deposit in excess of the amount of the indebtedness, and it also possessed a first security interest in collateral it valued at $750,000. Its continued honoring of checks (including overdrafts after the setoff) on the day of and for months after the garnishment and its failure to ever deem the loan non-performing or in default is further evidence that the Bank was anything but insecure about its prospects for repayment of the Term Note.

b. The Garnishment Did Not Cause A Default On August 20, 1997

The Bank in its answers to the interrogatories served with the garnishment summons averred that the default that caused it to setoff was service upon *the Bank* of the garnishment summons.

> We are claiming an offset in the amount of $40,700 which basically represents the amount in the checking account as of the day of receiving the garnishment. This offset is based on language of our promissory note which states that default occurs should the borrower permit the entry or service of any garnishment. Under the Rights of Lender on default, the bank has the right to setoff against any instruments or deposit accounts held by the borrower.

(App. 76.) The Term Note and Security Agreement clearly state that service of the garnishment on the Bank on August 20 did *not* cause Minnesota Voyageur to be in default. The events of default are set forth in the Security Agreement and Term Note and, with respect to service of legal process, state that an event of default will occur if Minnesota Voyageur:

> (f) permits the entry or service of any garnishment, judgment, tax levy, attachment or lien *against Owner [Minnesota Voyageur]*, any guarantor, or any of their property;

(App. 30, 33) (Emphasis added.) Under the terms of the loan documents, default occurred when Minnesota Voyageur was served with the garnishment on August 21, not when the Bank was served with the garnishment. The garnishment statute provides that the garnishee is served when it receives a garnishment summons, Minn. Stat. §571.72 Subd. 2, and a debtor is served when the creditor mails the notice to the debtor. Minn. Stat. §571.72 Subd. 4. Las Vegas Marine served Minnesota Voyageur on August 21, 1997. (App. 126.) There was no default on August 20 when the Bank received the garnishment, and all of the money in the account that day should have been allocated to satisfying the garnishment.

c. Even If There Was A Default, At No Time Did The Bank Accelerate

Even if there had been a default, the Bank did not accelerate the indebtedness. The Bank's position on this issue is undisputed. In deposition on October 6, 1997, the Bank president and CEO of the Bank testified on this topic:

Q. Is the Minnesota Voyageur Houseboats loan still listed as a performing loan at your bank?

A. Yes.

Q. Have you accelerated the indebtedness owing by Minnesota Voyageur Houseboats to your bank?

A. By having the setoff, some people refer to that as acceleration. So I'm not sure if you refer to that as acceleration.

Q. Let me tell you what I am asking. I refer to acceleration as causing the entire amount of a term loan to be due and owing as of the notice of acceleration. So in this instance I'm asking has the bank notified Minnesota Voyageur that the entire $397,666 that is owing less the September 1 payment must now be paid in full?

A. We haven't notified them as of this date.

(App. 85 - 86.) The bank president subsequently confirmed that in 1997 the Bank had never made demand for payment upon Minnesota Voyageur. (App. 123.) The Loan Transcript for the Term Loan also shows no indication of any acceleration of the indebtedness. (App. 38 - 39.) And at the summary judgment hearing, at the court's inquiry, Bank's counsel confirmed that the Bank had not accelerated because it did not need to do so. (App. 95.)

If the Bank did not accelerate the indebtedness, it could not setoff because Minnesota Voyageur did not owe it anything at the time of the garnishment.

i. The Bank's Reliance On Missouri Law Is Misplaced

Relying on Eighth Circuit interpretation of Missouri law, the Bank at the Court of Appeals claimed that it did not ever have to actually accelerate; it just had to possess the power to accelerate. And it claimed that it had had that power to accelerate at all times from the time the judgment was entered against Minnesota Voyageur in Nevada in January 1997. And it claimed that it could and it did sit on that right and allowed Minnesota Voyageur to run hundreds of thousands of dollars through its account, from the time of the default in January 1997 through at least November 1997.

This argument, that a bank need only have the power and need not actually accelerate a current term loan, was not made in the trial court. (App. 87 –104.) It was not a proper argument to make on appeal as the appellate court only reviews arguments presented to and considered by the trial court in making its decision. *Theile v. Stich*, 425 N.W.2d 580, 582 (Minn. 1988). If we are to consider this new argument, then we must consider whether the Bank waived the covenant default – the entry of judgment - by not doing anything after default, even once it irrefutably knew of the default, by August 6, 1997, the date of the Bank president's notes. There is no argument that the judgment was entered in January 1997 and the Bank continued to allow Minnesota Voyageur unfettered use of its accounts and the money in them until at least November 1997. The effect of allowing Minnesota Voyageur to use the account was waiver of the covenant default.

The Eighth Circuit in *Frierson* agreed with the federal district court's disapproval of a bank's selective use of default:

> Most secured loans provide for numerous events which constitute default, may of which are technical in nature and are inserted in the loan documents to enable the lender to declare the note in default when even a relatively minor problem arises with the loan or the debtor. Thus, at any given time many secured loans are technically in default, but are never treated as such by secured creditors. In addition, a secured party will occasionally, as Merchants has done in this case, ignore a default which is more than just a technical default. If a secured creditor with a security interest over all the debtor's property is permitted to rely on a default, technical or not, to prevent another creditor from executing on the debtor's property, while treating the loan as not

> in default when dealing with the debtor and others, severe inequities would result * * * Such an approach would be against both the spirit and the letter of the Uniform Commercial Code. 672 F. Supp. at 1276
>
> Merchants cannot refuse to exercise its rights under the security agreement, thereby maintaining UFA as a going concern, while it impairs the status of other creditors by preventing them from exercising valid liens. Allowing Merchants to do so would fly in the face of all Article 9, which is premised on the debtor's ability to exercise rights in the property.

Frierson, 868 F.2d at 304 – 305. This is precisely what the Bank in this case did. It knew of the covenant default, but ignored it. On August 20, 1997, when it received the garnishment, it paid $30,000 of Debtor's checks, and then the next day, took all the rest of the money in the account claiming that it had setoff as a result of the garnishment. The Bank and Minnesota Voyageur then continued their banking relationship as if nothing had ever happened. The Bank never declared a default or accelerated the indebtedness, and it continued to honor Minnesota Voyageur's checks and overdrafts. Six months later, the Bank was paid in full when the Debtor's sole shareholder bought the Debtor's assets at a sheriff's sale and continued the business under a similar name.

A basic premise of garnishment in virtually every jurisdiction is that a creditor has no greater rights against the garnishee than the debtor has. *S.T. McKnight Co. v. Tomkinson,* 209 Minn. 399, 401, 296 N.W. 569, 570 (1941); *Herd v. Ingle,* 713 S.W 2d 887, 888 (Mo. Ct. App. 1986). If a debtor could not have compelled the garnishee to pay over the money, nor can the garnishor. *Id.* In this case, Minnesota Voyageur could and did compel the Bank to pay over the money every time it wrote a check to one of its creditors or an automatic payment was made from its account either before or after August 20. Even on August 20, the date it received the garnishment, the Bank continued to honor checks on this account on which it had the power to setoff. One might wonder, why did the Bank pay all those checks on August 20 (when the garnishment took place and the setoff should have) and on August 21? Since it had the power and was exercising the power, as the Bank asserts, why did it not take all the money? Why did it pick and choose only Las Vegas Marine's garnishment not to pay?

Missouri law and Minnesota law both hold that a bank cannot defeat a garnishment on the grounds that a depositor owes the bank money on a debt not yet due. *Prince v. West End Installation*, 575 S.W.2d 831 (Mo. Ct. App. 1978); *Firstar Eagan Bank*, 466 N.W.2d at 12. Minnesota law requires that the debt be due and owing. *Firstar Eagan Bank*, 466 N.W.2d at 12 *citing* Barkley Clark, *The Law of Bank Deposits, Collections and Credit Cards* §14.06, at 14 – 18 (3d ed. 1990). Barkley Clark clearly states that where default is the basis of maturity, an acceleration clause – so that the bank may take action to accelerate – is necessary. *See* Barley Clark at § 14.05[1] and update §18.05[1].

Minnesota has no corollary to the Missouri proposition, first enunciated by the Eighth Circuit, that a Bank need not accelerate, that it simply must have the power to do so, and that it can then let the debtor proceed along its merry way, still in business, having preserved its banking relationship, and having thwarted its judgment creditor. *See Frierson v. United Farm Agency, Inc.*, 672 F. Supp. 1272, 1274 (W.D. Mo. 1987) *rev'd in part* 868 F.2d 302 (8th Cir. 1989). If this is Missouri law, it is not in accord with the thoughts and writings of acknowledged scholars in the area, such as Barkley Clark, and Minnesota should not follow its strained logic.

4. <u>The Bank's Actions Were Inconsistent With Setoff</u>

A bank will not be allowed to allege a setoff upon receipt of a garnishment and re-lend the same amount to its debtor soon thereafter, or take other similar action such as to honor checks in the amount of the purported setoff. *E.g., Walters v. Bank of America*, 69 P.2d 839

(Cal. 1937). A setoff necessarily requires some interruption in the normal banking relationship *United Seeds, Inc. v. Eagle Green Corp.,* 389 N.W.2d 571 (Neb. 1986).

United Seeds is a Nebraska case factually similar to this one. A month after the judgment in favor of United Seeds was entered against the bank's customer, Eagle Green, the bank broke with its tradition of extending its two loans to Eagle Green and demanded a principal payment. It notified Eagle Green on May 15 of its demand and, since the payment would cause Eagle Green cash flow problems, it agreed to honor overdrafts on the account. The bank then setoff from Eagle Green's account, posting the setoff after the close of its business day at 2:00 p.m., and crediting the payment to the notes the following day. United Seeds garnished the Bank at 3:15 on May 16. Over the ensuing five days, the Bank honored overdrafts, and Eagle Green made deposits to cover the overdrafts. The Bank disclosed that it owed no money to Eagle Green and that there was no account. 389 N.W.2d at 573. The court held that a bank must intend to exercise the right of setoff and must actually do so. 389 N.W.2d at 574 And while it found that the bank's bookkeeping entries evidenced an intent to setoff and a setoff, the court regarded the whole transaction as suspicious and refused to uphold it. As to evidence of intent to setoff the court said:

> However, the bank's willingness to honor Eagle Green's overdrafts does not indicate that the bank was feeling particularly insecure about Eagle Green's ability to repay its outstanding notes. It is questionable why the bank suddenly refused to grant extensions on its depositor's notes as it had 22 times in the past, yet essentially loaned the depositor a similar amount by honoring the depositor's overdrafts.. . . . the agreement to honor Eagle Green's overdrafts was, in effect, an agreement to allow Eagle Green the full use of its deposits while circumventing the garnishment statutes. Such an agreement is inconsistent with an intent to exercise the right of setoff, and will not be upheld.

(Id.)

The case before the Court is no different. From the Bank's honoring of more than $30,000 in checks on the day of the garnishment (App. 64), and more on the following days, to the failure to accelerate the indebtedness, to the failure to perform the setoff until the day following the garnishment, (App. 70), to the lack of any interruption of the banking relationship with Minnesota Voyageur, to the testimony of the Bank president in deposition, every fact points to a concerted effort to keep Minnesota Voyageur's judgment creditor, Las Vegas Marine, from being paid.

The testimony of the Bank president soon after the garnishment is especially disingenuous. Although the 1997 payment on the IRRRB Note was due September 30, and made the day of the garnishment, August 20, when asked, the Bank president testified merely, "I believe they paid their 1997 payment prior to us completing the Interrogatories, OK?" (App. 121.) While not untrue, his testimony gave no suspicion of the odd timing of the payment. His statement as to the September 1 Term Note payment was untrue since Minnesota Voyageur had made all of its 1997 payments, even the September one, by August 18, 1997. The Bank president testified, however:

> Q. When you offset on that account on or about August 20, 1997, had Minnesota Voyageur Houseboats made its August 1st payment on that loan?
>
> A. Yes.
>
> Q. So the next payment was due September 1st?
>
> A. Yes.
>
> Q. Did it make a payment on or about September 1st?
>
> A. Yes.

(App. 82.) And although every banker in Minnesota must be aware of this Court's 1972 decision that held that absent special circumstances a bank does not have a fiduciary duty to its customers, *Klein v. First Edina Nat'l Bank*, 293 Minn. 418, 196 N.W.2d 619 (1972), the Bank president and Bank counsel insisted that the Bank had a fiduciary duty to its customer, an "independent party", not to divulge any information about him and his collateral, despite that he was a third party guarantor who had pledged "liquid" collateral and who, as it turned out, was the president and sole shareholder of Minnesota Voyageur. (App. 74, 118 – 119.)

The Bank was oversecured and had no worry about being repaid by Minnesota Voyageur. The Bank valued the hard collateral at $750,000, and it also held certificates of deposit in the amount of $450,565.37. All this for a loan on which less than $400,000 was owing. The Bank knew about Las Vegas Marine's judgment, at least as of August 6, 1997 when it appears on the Bank president's notes of a conversation he had with someone about various Minnesota Voyageur financial issues. (App. 23.) The actions of the Bank suggest that its motive in asserting a setoff was to frustrate the attempts of Las Vegas Marine to be paid on its judgment.

CONCLUSION

A bank must carefully determine if it has a right of setoff when its customer is current on its installment payments. It must be careful because acceleration of the indebtedness, an action that must be taken if the debtor is to owe anything for the setoff to occur, will cause a fundamental change in the Bank's relationship with its customer. The bank cannot re-lend the money, or simply honor checks on an overdrawn account. If a technical default is to be the basis for acceleration, the bank must be prepared to fulfill its role as secured creditor so that other creditors are not damaged.

The Bank did not bother to accelerate in this case. It kept the money, kept the customer's creditor from getting the money, and kept its smooth banking relationship with its customer as well The Bank acted inequitably and should not be able to use the equitable remedy of setoff to shield its conduct.

We respectfully request that the Court reverse the decision of the Court of Appeals and reinstate the judgment of the Trial Court granting summary judgment to Appellant Las Vegas Marine.

Dated: April 14, 2005

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CERTIFICATATION OF COMPLIANCE

I hereby certify that this brief conforms to the requirements of Minnesota Rules of Civil Appellate Procedure 132.01 Subdivision 1 and 3 for a brief produced with a proportional font. The length of this brief is 18 pages and 5,748 words. This brief was prepared using WORD 2000.

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2) (with amendments effective July 1, 2007).