

APPELLATE COURT CASE NUMBER A04-866

STATE OF MINNESOTA
IN SUPREME COURT

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

Appellant/Creditors,

vs.

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

Respondent/Garnishee,

and

Minnesota Voyageur Houseboats, Inc.,
a Minnesota corporation,

Respondent/Debtor.

RESPONDENT/GARNISHEE'S BRIEF AND APPENDIX

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Statement of Legal Issues

1. Minnesota law allows a bank and a customer to contractually agree to the bank having a right of setoff upon the customer's default. In the present case, by way of a Commercial Promissory Note ("Note"), Wells Fargo and its customer, debtor Minnesota Voyageur Houseboats, Inc., agreed that the remedy of setoff was an option Wells Fargo could enforce upon default. The Note further provides that Wells Fargo could exercise the remedy of setoff without first having to accelerate the debt.

The trial court held that Wells Fargo's setoff was not appropriate because Wells Fargo did not accelerate the debt. The Court of Appeals unanimously reversed.

Apposite Cases: Minnesota Voyageur Houseboats, Inc. v. Las Vegas Marine Supply, Inc., 690 N.W.2d 762 (Minn. Ct. App. 2005).

Nietzel v. Farmers and Merchants State Bank of Breckinridge, 238 N.W.2d 437 (Minn. 1976).

2. Minnesota law provides that a garnishee bank can also have an equitable right of setoff. A garnishee bank can enforce its equitable right of setoff if, among other factors not in contention, the existing indebtedness is due and owing at the time of setoff. A debt is due and owing when the garnishee bank has the *power* to deem the debt due, not when the bank actually *exercises* that power (such as by accelerating the debt). In this case, because of the debtor's default, Wells Fargo had the power to deem the debt due prior to the garnishment summons being served and prior to the setoff. Therefore, the indebtedness was due and owing at the time of setoff.

The trial court held that the debt was not due and owing because Wells Fargo did not accelerate the debt. The Court of Appeals unanimously reversed.

Apposite Cases: First Star Eagan Bank v. Marquette Bank Minneapolis, 466 N.W.2d 8 (Minn. Ct. App. 1991).

Frierson v. United Farm Agency, Inc., 868 F.2d 302 (8th Cir. 1989).

G.E. Supply, a Div. of Gen. Elec. Co. v. Hampton-Tilley Associates, Inc., 866 F. Supp. 431 (E.D. Mo. 1994).

Martens, M.D. v. Hadley Mem'l Hosp., 729 F. Supp. 1391 (D.C. Cir. 1990).

Minnesota Voyager Houseboats, Inc. v. Las Vegas Marine Supply, Inc., 690 N.W.2d 762 (Minn. Ct. App. 2005).

Statement of the Case

Minnesota Voyageur Houseboats, Inc. ("Minnesota Voyageurs") was a customer of Respondent/garnishee bank ("Wells Fargo"). At issue in this case is whether the debt of Minnesota Voyageurs was "due and owing" at the time Wells Fargo exercised its contractual and equitable right of setoff against Minnesota Voyageurs' deposit account.

In August of 1994, Wells Fargo entered into a Commercial Promissory Note ("Note") with Minnesota Voyageurs. The Appellant/creditor Las Vegas Marine Supply, Inc. ("Las Vegas Marine") obtained a foreign judgment against Minnesota Voyageurs in Nevada on January 7, 1997 and caused the judgment to be entered in Minnesota on February 13, 1997. Las Vegas Marine, subsequently, served a garnishment summons on Wells Fargo in August of 1997.

The entry of the judgments and the service of the garnishment summons each independently constituted a default of the Note. Paragraph 1(e) of the Note provides:

1. DEFAULT: Borrower will be in default under this Note in the event that Borrower or any guarantor or any other third party: ***

(e) permits the entry or service of any garnishment, judgment, tax levy, attachment or lien against Borrower, any guarantor, or any of their property or the Collateral; *** (underline added).

Wells Fargo had a number of remedies under the Note because of the defaults, including a right to accelerate the debt and a right of setoff. Paragraph 2 of the Note reads in relevant part:

2. RIGHTS OF LENDER ON DEFAULT: If there is a default under this Note, Lender will be entitled to exercise one or more of the following remedies without notice or demand (except as required by law): ***

(a) to declare the principal amount plus accrued interest under this Note and all other present and future obligations of Borrower immediately due and payable in full; ***

(f) to set-off Borrower's obligations against any amounts due to Borrower including, but not limited to monies, instruments, and deposit accounts maintained with Lender; ***

The last paragraph under Paragraph 2 is significant in that it allows Wells Fargo discretion in electing its contractual remedies upon Minnesota Voyageurs' default. It reads as follows:

Lender's rights are cumulative and **may be exercised together, separately, and in any order**. Lender's remedies under this paragraph are in addition to those available at common law, including, but not limited to, the right of set-off. (bold added).

In addition to this contractual right of setoff, Wells Fargo had an equitable right of setoff under Minnesota common law.

Wells Fargo exercised its right of setoff in the amount of \$40,700 (the amount that was in Minnesota Voyageurs' deposit account) in late August of 1997. Las Vegas Marine contested the setoff and argued that Wells Fargo was required to "accelerate" the debt before it setoff the funds.

The parties stipulated to the relevant facts and filed cross-motions for summary judgment. The issue presented to the district court was limited to whether the indebtedness of Minnesota Voyageurs was due and owing at the time Wells Fargo setoff the funds.

An indebtedness is due and owing when the garnishee bank has the *power* to deem the debt due- such as when a default occurs- and not when the garnishee bank actually *exercises* that power. The district court, however, held that Las Vegas Marine was entitled to the proceeds of the deposit account because Wells Fargo did not “accelerate” the indebtedness. Summary judgment was granted in favor of Las Vegas Marine. (App. 05-09).

The Minnesota Court of Appeals reversed and correctly held that Wells Fargo had both a contractual and equitable right of setoff and that Wells Fargo was not required to accelerate the debt before exercising its right of setoff. (App. 01-04).

This Court granted Las Vegas Marine’s Petition for Review by Order dated March 15, 2005. (Resp’t App. 01).

Statement of the Facts

Prior to a recitation of the facts, it is important to point out one significant factual error set forth in Las Vegas Marine's Brief. After quoting certain remedies Wells Fargo had under the Note upon Minnesota Voyageurs' default, Las Vegas Marine states that the "remedy of acceleration, option '(a)' was not automatic, but needed to be exercised by the Bank." Appellant's Brief at p. 2. No citation to the Note or the record was provided to support this statement because there exists no requirement that Wells Fargo "needed" to accelerate the debt.

Wells Fargo and Las Vegas Marine stipulated to a set of facts¹ that was presented to the district court with their summary judgment motions. Attached as an exhibit to the Stipulation of Facts is a copy of the Note at issue. (App. 29-30). In addition, comments relevant to this appeal were presented to the district court during oral arguments on the summary judgment motions. Each set of information will be presented in turn.

I. Stipulation of facts.

The Stipulation of Facts reads in its entirety as follows:

¹ The Stipulation of Fact and exhibits referenced therein are attached to Appellant's Appendix at pp. 10-86.

This Stipulation of Fact (sic) is made by Creditors ("Las Vegas Marine") and Garnishee now known as Wells Fargo Bank (the "Bank"). The parties stipulate and agree as follows:

1. Las Vegas Marine obtained a judgment against the Debtor, Minnesota Voyageur Houseboats, Inc. ("Minnesota Voyageurs"), in Nevada on January 7, 1997. A true and correct copy of the judgment entered in Nevada is attached as Exhibit 1.

2. Las Vegas Marine caused the judgment to be entered in this Court in Minnesota on February 13, 1997. Exhibit 1.

3. The Court notified Las Vegas Marine and Minnesota Voyageurs of the entry of the judgment in Minnesota. Exhibit 1.

4. 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?" Mr. Sutherland testified that he would have known about the Las Vegas Marine judgment against Minnesota Voyageurs no later than August 6, 1997. A true and correct copy of the notes and the deposition testimony surrounding them is attached as Exhibit 2.

5. Minnesota Voyageurs executed a promissory note in the amount of \$530,160.00 in favor of the Bank on August 24, 1994 (the "Term Loan"), a true and correct copy of which is attached as Exhibit 3.

6. Minnesota Voyageurs granted the Bank a security interest in certain of its assets to secure the Term Loan. A true and correct copy of the Security Agreement evidencing the security interest and dated August 24, 1994, is attached as Exhibit 4.

7. The Bank filed financing statements with the Minnesota Secretary of State on August 26, 1994 and August 29, 1994. True and correct copies of the financing statements are attached as Exhibits 5 and 6.

8. The Term Note required the Debtor 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.

9. A true and correct copy of the Loan Accounting System Note Transcript Statement for the Term Loan is attached as Exhibit 7. Exhibit 7 reflects the payments made by Minnesota Voyageurs to the Bank from 1994 through 1998 when the note was paid in full.

10. Minnesota Voyageurs 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. A true and correct copy of the Agreement and Assignment of Note is attached as Exhibit 8. The parties disagree on the relevance of this Exhibit.

11. A true and correct copy of the Loan Accounting System Note Transcript Statement for the IRRRB Loan is attached as Exhibit 9. Exhibit 9 reflects the payments

made by Minnesota Voyageurs to the Bank from 1994 through 1998 when the note was paid off. The parties disagree on the relevance of this Exhibit.

12. As of August 20, 1997, Minnesota Voyageurs had made its July 1 and August 1 payments on the Term Loan.

13. On August 20, 1997, Las Vegas Marine garnished the Bank. A true and correct copy of the documents by which Las Vegas Marine garnished the Bank is attached as Exhibit 10.

14. A true and correct copy of the records of the checking account of Minnesota Voyageurs at the Bank for the months of January 1997 through November 1997 is attached as Exhibit 11.

15. On August 19, 1997, the daily balance in Minnesota Voyageurs' checking account at the Bank was \$71,093.17.

16. On August 20, 1997, the daily balance in the Minnesota Voyageurs' checking account at the Bank was \$40,703.28.

17. On August 21, 1997, the daily balance in the Minnesota Voyageurs' checking account at the Bank was \$4,317.89.

18. The Bank on August 21, 1997 took \$40,700.00 from the Minnesota Voyageur checking account in the form of a cashier's check. A true and correct copy of the cashier's check is attached as Exhibit 12.

19. The Bank on August 22, 1997 applied the \$40,700 to the Term Loan. Exhibit 12 contains the documentation the Bank generated to reflect this transaction.

20. The Bank disclosed to Las Vegas Marine, pursuant to its garnishment disclosure and answers to interrogatories, that it offset the \$40,700 and applied it to the Term Loan when Las Vegas Marine garnished it. True and correct copies of the garnishment disclosure and response to interrogatories are attached as Exhibit 13.

21. At his deposition on October 6, 1997, the president of the Bank, Keith Sutherland, testified that prior to the garnishment, Minnesota Voyageurs had made its August 1 payment and that Minnesota Voyageurs made a payment on or about September 1, 1997. True and correct copies of the testimony is (sic) attached as Exhibit 14.

22. Mr. Sutherland also testified that the Minnesota Voyageurs' loan was still listed as a performing loan at the Bank, and that the Bank had not notified Minnesota Voyageurs that the entire Term Loan was due and owing. True and correct copies of the testimony are attached as Exhibit 15.

II. Relevant paragraphs of the Note.

Paragraph 1(e) of the Note provides circumstances under which Minnesota Voyageurs would be in default:

1. **DEFAULT:** Borrower will be in default under this Note in the event that Borrower or any guarantor or any other third party: ***

(e) permits the entry or service of any garnishment, judgment, tax levy, attachment or lien against Borrower, any guarantor, or any of their property or the Collateral; ***

Note at Para. 1(e). (App. 29-30).

The Note further sets forth a number of options that Wells Fargo could take if it deemed a default under the Note occurred:

2. RIGHTS OF LENDER ON DEFAULT: If there is a default under this Note, Lender will be entitled to exercise one or more of the following remedies without notice or demand (except as required by law): ***

(a) to declare the principal amount plus accrued interest under this Note and all other present and future obligations of Borrower immediately due and payable in full; ***

(f) to set-off Borrower's obligations against any amounts due to Borrower including, but not limited to monies, instruments, and deposit accounts maintained with Lender; ***

Id. at Para. 2. (App. 30).

One of the most significant provisions pertaining to Wells Fargo's rights upon default is the final paragraph of Paragraph 2 and Las Vegas Marine never mentions in its Brief. It reads as follows:

Lender's rights are cumulative and may be exercised together, separately, and in any order. Lender's remedies under this paragraph are in addition to those available at common law, including, but not limited to, the right of set-off.

Id. (App. 30).

In basic terms, subsection (a) provides Wells Fargo with the option to accelerate the amount due under the Note and subsection (f) allows Wells Fargo to setoff any amounts due. Wells Fargo chose the latter option. As the final paragraph of Paragraph 2 makes clear, the remedies are options and not requirements or prerequisites to initiate further remedies.

III. Transcript of oral arguments

A transcript of the oral arguments on the motions for summary judgment was prepared. Numerous comments relevant to the issue on appeal were made by Las Vegas Marine's attorney. For example, the attorney for Las Vegas Marine identified the issue for the Court to decide as follows:

But the one requirement of setoff that is at the crux here is was the debtor's debt owing?

Tr. p. 5, l. 3-5. (App. 91).

Additionally, Las Vegas Marine's attorney acknowledged that events of default under the Note occurred:

Now, in this case, default clearly occurred back in January of 1997 when judgment was entered in favor of my clients against Minnesota Voyageurs in Nevada. Another event of default, I suppose, occurred in February when the judgment was docketed here in Duluth.

And yet another event of default occurred on August 21st, the day after we garnished, when we served the garnishment payments on the debtor. Because the loan agreement or the security agreement is clear that the default occurs when the garnishment is served on the debtor, not on some bank, but on

the debtor. That was on the 21st, the day after this garnishment.

Tr. p. 5, l. 23- p. 6, l. 11. (App. 91-92).

Finally, Las Vegas Marine's attorney correctly identified the consequence suffered by a bank's relationship with a customer if a garnishee bank was required to accelerate a debt:

And if the bank had accelerated, it would have had to have changed its relationship with its customer. Indeed, it would have been - taken all its customer's money. And its customer would have had to go get a new - find a new lender.

Tr. p. 7, l. 7-11. (App. 93).

Argument

The issue in this case is whether the debt was due and owing at the time Wells Fargo setoff the funds. An analysis and review of relevant authorities- including the authorities upon which Las Vegas Marine primarily relies- reveals that the debt was, in fact, due and owing at the time of setoff.

I. Standard of review.

When reviewing a decision on a motion for summary judgment, the reviewing court is to determine whether any genuine issues of material fact exist and whether the moving party is entitled to judgment as a matter of law. Wartnick v. Moss & Barnett, 490 N.W.2d 108, 112 (Minn. 1992). When summary judgment is granted based on the application of law to undisputed facts, the result is a legal conclusion, which the appellate courts review de novo. Lefto v. Hoggsbreath Enters., Inc., 581 N.W.2d 855, 856 (Minn. 1998).

II. Setoff is an appropriate remedy in garnishment proceedings.

The remedy of setoff and its relationship to garnishment proceedings have a long history in Minnesota jurisprudence. As early as 1910, the Minnesota Supreme Court held that the equitable right of setoff is applicable in garnishment proceedings in all cases where the plaintiff presents no superior rights. Wunderlich v. Merchants Nat'l Bank, 124 N.W. 223, 223-24 (Minn. 1910). It is a general rule that when a depositor is indebted to a bank,

and the debts are mutual- that is, between the same parties and in the same right- the bank may apply the deposit, or such portion thereof as may be necessary, to the payment of the debt by the depositor. Nietzel v. Farmers and Merchants State Bank of Breckinridge, 238 N.W.2d 437, 440 (Minn. 1976).

III. A garnishee bank can have a contractual right of setoff. The Note at issue provides that Wells Fargo could exercise the right of setoff upon Minnesota Voyageurs' default and further states that the right of setoff could be exercised without first accelerating the debt. Was the Court of Appeals correct in holding that Wells Fargo was not required to accelerate the debt before exercising its right of setoff?

A bank and a borrower can contractually agree for the bank to have a right of setoff- in addition to the bank's equitable right of setoff- upon the borrower's default. Minnesota Voyager Houseboats, Inc. v. Las Vegas Marine Supply, Inc., 690 N.W.2d 762, 766 (Minn. Ct. App. 2005); Nietzel, 238 N.W.2d at 440.

A. *It is not disputed that a default occurred.*

The terms of the Note explain that the borrower will be in default if the borrower permits the entry or service of a garnishment or judgment. The Note reads:

1. DEFAULT: Borrower will be in default under this Note in the event that Borrower or any guarantor or any other third party: ***

(e) permits the entry or service of any garnishment, judgment, tax levy, attachment or lien against Borrower, any guarantor, or any of their property or the Collateral; ***

Note at Para. 1(e). (App. 29-30).

Judgment was entered in Nevada against Minnesota Voyageurs on January 7, 1997 and then in Minnesota on February 13, 1997. It is not disputed that the entry of judgments each constituted a default under the Note. It is also not disputed that service of the garnishment on Minnesota Voyageurs was another event of default. In fact, Las Vegas Marine's attorney represented to the trial court that each of these events constituted a default:

Now, in this case, default clearly occurred back in January of 1997 when judgment was entered in favor of my clients against Minnesota Voyageurs in Nevada. Another event of default, I suppose, occurred in February when the judgment was docketed here in Duluth.

And yet another event of default occurred on August 21st, the day after we garnished, when we served the garnishment payments on the debtor. Because the loan agreement or the security agreement is clear that the default occurs when the garnishment is served on the debtor, not on some bank, but on the debtor. That was on the 21st, the day after this garnishment.

Tr. p. 5, l. 23- p. 6, l. 11. (App. 91-92).

Las Vegas Marine argues that Wells Fargo may have setoff the funds shortly before Minnesota Voyageurs received the garnishment summons (an event constituting default) and, therefore, the setoff occurred prior to a default. This argument fails to take into account that, by Las Vegas Marine's own admission, the entry of judgments both triggered a default. If Las Vegas Marine is now arguing that an event of default did not occur prior to the setoff, this argument belies the facts and the representations made to the district court.

B. Due to Minnesota Voyageurs' default, Wells Fargo was entitled to exercise the remedies set forth in the Note, including the right of setoff.

The Note sets forth a number of remedies Wells Fargo could exercise in the event of Minnesota Voyageurs' default, including the right of setoff and the right to accelerate the debt:

2. RIGHTS OF LENDER ON DEFAULT: If there is a default under this Note, Lender will be entitled to exercise one or more of the following remedies without notice or demand (except as required by law): ***

(a) to declare the principal amount plus accrued interest under this Note and all other present and future obligations of Borrower immediately due and payable in full; ***

(f) to set-off Borrower's obligations against any amounts due to Borrower including, but not limited to monies, instruments, and deposit accounts maintained with Lender; ***

Note at Para. 2. (App. 30).

The Note further provides Wells Fargo with the right to determine which remedy (or remedies) it thought prudent to exercise. The Note states at the end of Paragraph 2:

Lender's rights are cumulative and **may be exercised together, separately, and in any order.** Lender's remedies under this paragraph are in addition to those available at common law, including, but not limited to, the right of set-off.

Id. (App. 30) (bold added).

It is this last paragraph that the Court of Appeals found most significant because it entitled Wells Fargo to exercise the right of setoff without first having to accelerate the debt.

See, Minnesota Voyager Houseboats, 690 N.W.2d at 767. Las Vegas Marine does not even

address this paragraph. It is never explained how its position (acceleration is required) comports with the express language of the Note that allows the remedies to be taken “together, separately, and in any order.” Acceleration of the debt is only one option Wells Fargo was entitled to exercise. Wells Fargo, instead, elected the option to setoff the funds as allowed under subsection (f) of Paragraph 2 of the Note.

Las Vegas Marine cites the case of Larson v. Vermillion State Bank to support its argument that the debt was not due and owing. Larson, however, does not address setoff and, therefore, does not provide guidance on the central issue in this case- was the debt due and owing at the time of setoff? See, Larson v. Vermillion State Bank, 567 N.W.2d 721 (Minn. Ct. App. 1997). While for the most part irrelevant, Larson does provide instructive language regarding a bank’s right to enforce the express terms of a note:

This court cannot limit the bank’s ability to enforce its rights under the demand note without interposing new terms into the parties’ agreement. The note unambiguously conferred on the bank the right to demand payment from the Larsons at any time it deemed necessary or desirable. **The bank did not breach the agreement simply by taking action expressly permitted by the agreement’s terms.** To impose an additional requirement of good faith would force the bank to surrender its entitlement to payment on demand, in exchange for the right to payment on a demand supported by good faith judgment. The parties did not bargain for such a term, and we decline to read one into the contract.

Id. at 723 (citations omitted) (bold added).

In the present case, the terms of the Note- and, thus, the terms of Wells Fargo’s rights upon default- were contractually agreed upon between Wells Fargo and Minnesota

Voyageurs. Wells Fargo should be able to take action that was expressly permitted by the terms of the Note. The Note- like every other commercial or individual note or loan- reflects the risks the bank agrees to take and the remedies the borrower agrees to grant to the bank upon default in exchange for the loan of money. With respect to a judgment creditor such as Las Vegas Marine, their rights are subordinate to a bank's rights for the reason that a judgment creditor's rights do not arise contractually. As such, Las Vegas Marine is not in the position to argue that Wells Fargo should not be able to seek a remedy that was agreed upon between Wells Fargo and Minnesota Voyageurs just because it does not like the outcome.

IV. A garnishee bank can enforce its equitable right of setoff if the indebtedness is due and owing at the time of setoff. A debt is due and owing when the garnishee bank has the "power" to deem the debt due, not when the bank actually "exercises" that power. Because Minnesota Voyageurs defaulted on the Note- giving Wells Fargo the power to deem the debt due- prior to the garnishment summons being served and prior to the setoff, the debt was due and owing when Wells Fargo setoff the funds. Was the Court of Appeals correct in holding that acceleration of the debt was not required to make the debt due and owing?

A. Minnesota law provides that the equitable remedy of setoff can be enforced if, among other prerequisites not in dispute, the existing indebtedness is due and owing at the time of setoff.

The parties agree that the prerequisites to exercise the equitable right of setoff are generally: (1) mutuality of obligation must exist; (2) the funds used for the setoff must be the property of the debtor; (3) the funds against which the setoff is exercised must be a general deposit as opposed to a special deposit; and (4) the existing indebtedness must be due and

owing at the time of setoff. First Star Eagan Bank v. Marquette Bank Minneapolis, 466 N.W.2d 8, 12 (Minn. Ct. App. 1991).

In this case, prerequisites 1-3 are not at issue. The only question before the trial court and the Court of Appeals was whether or not Minnesota Voyageurs' debt was due and owing at the time Wells Fargo setoff funds from Minnesota Voyageurs' general account and applied it to the Note.

B. A debt is due and owing when the garnishee bank has the "power" to deem the debt due, not when the bank actually "exercises" that power.

Prior to the present case, there existed no Minnesota caselaw directly on point regarding when a debt becomes due and owing for setoff purposes. One of the leading cases on this issue is Frierson v. United Farm Agency which is an Eighth Circuit Court of Appeals case arising out of Missouri. See, Frierson v. United Farm Agency, Inc., 868 F.2d 302 (8th Cir. 1989). Frierson held that:

For setoff purposes, Missouri law considers a debt due when the bank has the *power* to deem the debt due, not when the bank actually *exercises* that power. Under Missouri law, a bank need not take steps to effect a setoff prior to garnishment, but only must show that a default existed. As the Missouri court stated in *Herd*, "[i]f the note was due, then the bank had the right to a set-off (sic) even if at the time of the garnishment they did not know that conditions existed making it due."

Id. at 304 (citations omitted) (italics included in original text).

In reaching its decision that acceleration was not required to make the debt due and owing, the Minnesota Court of Appeals found the reasoning of Frierson and its Missouri

precedent compelling. Minnesota Voyageur Houseboats, Inc., 690 N.W.2d at 767. A review of the facts and analysis of Frierson shows why the Minnesota Court of Appeals correctly characterized Frierson as compelling and why the Minnesota Supreme Court should find the same.

A creditor obtained a judgment against the debtor in California on June 3, 1985. Frierson, 868 F.2d at 303. Garnishment summons were served by the creditor on the garnishee bank (“Merchants”) on May 20, 1987. Id. The debtor and Merchants brought motions to quash the garnishment on the basis that Merchants had a perfected security interest and it had a contractual and common law right to setoff. Id.

The district court denied the motions and one of the basis for denial was that Merchants could not exercise its common law or contractual setoff rights because it never declared the loan in default and, thus, the debt had not matured when the garnishment summons was served. Id.

The Eighth Circuit Court of Appeals reversed this portion of the district court’s decision in an opinion that divided the case into two parts. The first part- the part relevant to the present case- involved Merchants’ common law and contractual right to setoff funds that were being held by Merchants. The second part pertains to Merchants setting off funds under the UCC at institutions other than Merchants. The present case does not involve funds from other institutions and, therefore, the second part of Frierson is distinguishable.

In reaching its holding under the first part, the Eighth Circuit Court of Appeals framed the issue as follows:

Merely recognizing that the debt must be due, however, does not help us decide this case. The important issue is when, exactly, is a debt “due” for purposes of quashing a garnishment? ²

Id. at 304.

The Eighth Circuit Court of Appeals recognized that, under Missouri law, a bank has the right to setoff a borrower’s deposit account against debts owed by that borrower. Id. Before a bank can exercise its setoff rights, however, the borrower’s debt must be due and owing. Id. In the case of garnishment proceedings, the borrower’s debt must be due on the date the garnishment is served. Id. at 303-304.³

The Eighth Circuit Court of Appeals went on to hold that Merchants was not required to *declare* a default for the debt to be considered due and owing at the time of the garnishment. Id. at 304. Instead, Merchants’ right of setoff accrued no later than thirty days after registration of the California judgment in Missouri on January 9, 1987 (the loan

² Las Vegas Marine’s attorney stated the issue in the instant case as: “[B]ut the one requirement of setoff that is at the crux here is was the debtor’s debt owing?” Tr. p. 5, l. 3-5. (App. 91). The issue in the present case and the issue in Frierson are essentially identical. Therefore, the Minnesota Court of Appeals was correct in deciding that Wells Fargo did not raise a “new” issue for the first time on appeal simply by citing to Frierson. See, Minnesota Voyageur Houseboats, Inc., 690 N.W.2d at 767, n. 1.

³ These rules of Missouri law are similar, if not identical, to the law in Minnesota except that, under Minnesota law, the debt must be due and owing at the time of setoff as opposed to the time of service of the garnishment. See, First Star Eagan Bank, 466 N.W.2d at 12. This difference does not affect the outcome of the present case.

agreement provided for default on the debtor's failure to discharge any judgment within thirty days). Id. On this basis, the Eighth Circuit Court of Appeals held that the district court was "clearly incorrect" in holding that the debt was not due and owing when the bank received the garnishment summons on May 20, 1987. Id.

In a subsequent case, a federal district court in Missouri elaborated on the Frierson decision and held that the right of setoff accrues when the cure period has passed after the entry of judgment in the foreign state as opposed to entry of judgment in the forum state. G.E. Supply, a Div. of Gen. Elec. Co. v. Hampton-Tilley Associates, Inc., 866 F. Supp. 431, 433 (E.D. Mo. 1994).

Other jurisdictions have followed the rationale and holding of Frierson. The district court in the District of Columbia held that a debt is due and owing when the garnishee bank has the power to deem the debt due, not when the bank actually exercises that power. See, Martens, M.D. v. Hadley Mem'l Hosp., 729 F. Supp. 1391, 1396 (D.C. Cir. 1990). A circuit court of Virginia concluded, based upon a number of cases, that:

[t]he right of set-off continues even after a writ of attachment or garnishment is served, and whether or not the bank has formally 'called' the default. Indeed, as Federal Reserve Bank implies, it is the debt, not the default, which creates the lien giving rise to the right of set-off. Accordingly, the judgment creditor's argument that the bank's right of set-off was lost because of the absence of a default notice is rejected.

Smith v. Akers, 1990 WL 751321 (Va. Cir. Ct. 1990) (unpublished) (copy attached at Resp't App. 02-06).

C. Minnesota Voyageurs defaulted on the Note- giving Wells Fargo the power to deem the debt due- prior to the garnishment summons being served and prior to the setoff. Therefore, the debt was due and owing when Wells Fargo exercised its right of setoff.

Applying these holdings to the instant case, Minnesota Voyageurs' debt was due and owing the date judgment was entered in Nevada (unlike Frierson, no cure period is provided for in the Note). It is not disputed that the entry of the Nevada judgment constituted a default. Tr. p. 5, l. 23- p. 6, l. 11. (App. 91-92). Because of the default, Wells Fargo had the power to deem the debt due and owing. Wells Fargo did not have to declare a default- and accelerate the debt- for the debt to be considered due and owing at the time of the setoff. Therefore, when Wells Fargo setoff the funds on August 21, 1997, the debt was due and owing and all the prerequisites of the equitable remedy of setoff had been met.

Las Vegas Marine argues that the debt was not due and owing because Minnesota Voyageurs' payments on the Note were current at the time of setoff. This argument is irrelevant because, under Frierson, the focal question is "when did Wells Fargo have the *power* to deem the debt due and owing?" As indicated above, because of the default, Wells Fargo had the power to deem the debt due and owing when the judgment was entered in Nevada.

This conclusion and the analysis in Frierson makes practical sense. A garnishee bank is a secured creditor and it should not be required to accelerate a debt of a customer to protect its interests. Requiring that a debt be accelerated (and, thus, potentially ending a banking relationship) would be tantamount to allowing an unsecured creditor to dictate to a secured

creditor what actions must be taken to protect its secured status. In simple terms, Las Vegas Marine's analysis puts a garnishee bank between a rock and a hard place: A garnishee bank either has to forfeit the amount sought by the judgment creditor or accelerate a debt which could irrevocably terminate the bank's relationship with the customer and put the customer in a dire financial situation. Las Vegas Marine acknowledged this problem when its attorney addressed the court at the summary judgment hearing:

And if the bank had accelerated, it would have had to have changed its relationship with its customer. Indeed, it would have been - taken all its customer's money. And its customer would have had to go get a new - find a new lender.

Tr. p. 7, l. 7-11. (App. 93).

The Frierson decision recognizes one of the fundamental principles of commercial lending- a secured creditor has superior rights to an unsecured creditor and the rights and actions of a secured creditor cannot be dictated by an unsecured creditor.

D. Las Vegas Marine's reliance upon the second part of the Frierson decision is misplaced.

Las Vegas Marine quotes language from the second part of the Frierson decision to support its position. Reliance upon this part of the decision is misplaced. The second part of Frierson deals with Merchants' rights under the UCC over the debtor's deposits at banks other than Merchants. Frierson, 868 F.2d at 304-305. It was over these other accounts that the Eighth Circuit Court of Appeals held that Merchants could not refuse to exercise its rights under the security agreement, thereby maintaining the debtor as a going concern, while

impairing the status of other creditors by preventing them from exercising valid liens. Id. at 305. This situation is not present in the instant case because Wells Fargo is not seeking to exercise rights over Minnesota Voyageurs' deposits at other banks.

Furthermore, it is agreed that the UCC has no place in the common law right of setoff under Minnesota law. See, Appellant's Brief at p. 9; Firststar Eagan Bank, 466 N.W.2d at 11 (stating that Article 9 of the UCC does not apply to a right of setoff).

In any event, the second part of Frierson is not beneficial to Las Vegas Marine. The Eighth Circuit Court of Appeals held that the funds which Merchants did not have the right to setoff (and were subject to garnishment by the judgment creditor) were still subject to Merchant's security interest. Frierson at 305.

Finally, Las Vegas Marine's reading of Frierson has been rejected by other courts. For example, in a case involving the right to collateral in a garnishment proceeding where the judgment creditor contended that the secured party must declare a default of the loan before the judgment creditor exercises control over the collateral, the Ohio Court of Appeals commented:

Thus, as appellee notes, *Frierson* does not stand for the proposition that a security interest loses its priority if the loan is not declared in default prior to the completion of the garnishment proceedings. Instead, it merely stands for the proposition that although the collateral can be transferred, it is still subject to the security interest.

Rhodes v. Boardman Computers, Inc., 1996 WL 704343 (Ohio Ct. App. 1996) (unpublished)

(copy attached at Resp't App. 07-11).

These holdings (while not directly relevant to the issues in the present case) exemplify the rights of a secured creditor (ex. garnishee bank) versus those of a judgment creditor. By the nature and purpose of a secured creditor, a judgment creditor is junior to the interests of the secured creditor. Therefore, even if Wells Fargo had accelerated the debt, the funds obtained by Las Vegas Marine would remain subject to Wells Fargo's security interest and could be traced and recaptured by Wells Fargo.

E. The writings of Barkley Clark do not stand for the propositions for which Las Vegas Marine claims. In fact, his writings support Wells Fargo's position.

Las Vegas Marine relies heavily upon the writings of Barkley Clark. A review of Mr. Clark's treatise, however, reveals that his understanding of the law of setoff is consistent with Frierson and the position of Wells Fargo.

In a section entitled "Setoff vs. Garnishment," Mr. Clark criticizes a case arising out of Kentucky in which it was held that a bank cannot debit a customer's account with a setoff after being served with a garnishment notice. Barkley Clark, The Law of Bank Deposits, Collections and Credit Cards ¶ 18.17 (2004) (copy attached at Resp't App. 15-18). Mr. Clark writes:

If the Kentucky court had reviewed the decision from other jurisdictions, it would have found that exercise of setoff almost always prevails over the garnishment, even if it is not "exercised" until after the bank receives the garnishment notice.

Id.

In his citation of legal authority for this comment, Mr. Clark cites the Frierson case. Therefore, Mr. Clark actually supports Wells Fargo's position.

The portions of Mr. Clark's treatise that Las Vegas Marine cite do not stand for the proposition that Las Vegas Marine claims. First, Las Vegas Marine contends that a bank must be careful not to exercise setoff until the maturity date arrives if the debt contains a specific maturity date rather than being payable on demand. Appellant's Brief at p. 7-8 (quoting Barkley Clark at § 14.05[1] and update at ¶ 18.05). This section, however, does not address a bank's rights upon default (which is the circumstance in the present case). Barkley Clark at ¶ 18.05 (2004) (Resp't App. 12). In fact, default is never discussed in this section. Id.

Second, with respect to the comment that a promissory note should contain an acceleration clause, a review of this entire section reveals that it is essentially a checklist that banks should use as a guide when creating a promissory note. Appellant's Brief at p. 8 (quoting Barkley Clark at § 14.05[1] and update at ¶ 18.05); Barkley Clark at ¶ 18.05[1] (Resp't App. 13-14). Mr. Clark lists a number of items a security agreement should contain that constitute a default and then recommends that an acceleration clause be included. Barkley Clark at ¶ 18.05[1]. This section does not stand for the proposition that a bank must first accelerate a debt before exercising its right of setoff. Id.

In short, Mr. Clark's treatise is supportive of Wells Fargo's position and does not state what Las Vegas Marine has asserted it states.

V. **Las Vegas Marine raises a “new” issue on appeal by arguing that Wells Fargo waived its right to setoff. This is not a proper argument on appeal because it was not presented to the district court nor was it ruled upon by the district court.**

Las Vegas Marine claims that Wells Fargo waived its right of setoff. The Minnesota Court of Appeals held that this argument was raised for the first time on appeal and, therefore, was not properly before the court. Minnesota Voyager Houseboats, Inc., 690 N.W.2d at 765. A review of the record establishes that the Minnesota Court of Appeals’ determination was correct.

First and foremost, Minnesota Voyageurs admits that it is a new issue. In its Brief, Las Vegas Marine recites the identical language as that of its Brief to the Minnesota Court of Appeals:

if we are to consider this new argument (Frierson), then we must consider whether the Bank waived default 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.

Appellant’s Brief at p. 12.

Second, Las Vegas Marine argued to the district court that the only issue to be addressed is whether or not the debt was due and owing at the time of setoff. Tr. p. 5, l. 3-5. (App. 91). The Minnesota Court of Appeals understood that the parties agreed that this was the only issue for the district court to decide and correctly declined to consider it for the first time on appeal. Minnesota Voyager Houseboats, Inc., 690 N.W.2d at 765.

Finally, for an issue to be properly before an appellate court, the issue must not only have been presented to the district court, it must also have been ruled upon by the district

court. See, Thiele v. Stich, 425 N.W.2d 580, 582 (Minn. 1988) (clarifying that the court of appeals will not consider the applicability of the statute of limitations, even though the question was raised below, if it was not passed on by the trial court). The district court did not address the waiver issue (because it was not submitted for adjudication) in its Order and accompanying Memorandum. See, Summ. J. Order (App. 05-07). The district court found that there should have been an acceleration of the debt owed to the bank before it was entitled to exercise the right of setoff. Id. Nowhere in the district court's order is it even suggested that Wells Fargo waived its right to setoff. Id. In fact, the district court cited the cases it considered in making its determination and, notably, the one case mentioned by Las Vegas Marine which vaguely addresses the issue of waiver- United Seeds, Inc. v. Eagle Green Corp., 389 N.W.2d 571 (Neb. 1986)- was not cited by the district court.

Even though the issue of waiver is not properly before this Court, it is important to note that a waiver theory is not as clear cut as Las Vegas Marine suggests. In a case similar to this one, the North Carolina Court of Appeals held that a bank did not waive its right of setoff by honoring some of the debtor's checks after the note became due. Killette v. Raemell's Sewing Apparel, Inc., 377 S.E.2d 73, 74 (N.C. Ct. App. 1989). In reaching this holding, the North Carolina court stated that:

[T]he law does not discourage leniency to one's debtors and, in our opinion the mere honoring of a depositor's checks after its note is due manifests only an intention by the bank to accommodate the depositor at that time; it does not indicate an intent to continue doing so in the future. If such indulgences were held to be a permanent waiver of the right of setoff it could

only encourage banks to immediately offset their matured notes against the checking account balances of their depositor-debtors, a practice bound to embarrass if not ruin many hard pressed debtors.

Id. at 74-75.

This reasoning recognizes the real-world consequences that would befall a debtor if a bank was required to immediately accelerate the debt or lose its right to setoff. While not controlling, it is persuasive and reflects why Las Vegas Marine's position should not become the law of Minnesota.

Conclusion

The Minnesota Court of Appeals correctly held that Wells Fargo was not required to accelerate Minnesota Voyageurs' debt before exercising its right of setoff. The Note provides that setoff is a remedy that Wells Fargo could exercise without having to exercise any other remedy, including acceleration of the debt.

In addition to its contractual right of setoff, Wells Fargo had an equitable right of setoff. The Frierson case out of the Eighth Circuit Court of Appeals is very similar to the present case and held that a debt is due and owing when a garnishee bank has the power to deem the debt due and owing, and not when it actually exercises that power. Therefore, acceleration of the debt is not required. Because of the similarities between Frierson and the present case, the Minnesota Court of Appeals correctly determined that the holding in Frierson is compelling.

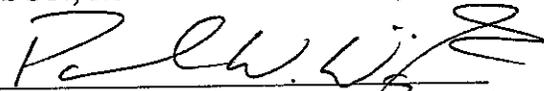
Wells Fargo has not raised a "new" issue on appeal simply because it cites a case not cited at the district court level. The issue on appeal has remained the same as it was at the district court level- was Minnesota Voyageurs' debt due and owing at the time Wells Fargo exercised its right of setoff? Frierson directly addresses this issue. Therefore, it was appropriate for the Minnesota Court of Appeal to rely on Frierson.

Finally, Las Vegas Marine has tried to raise a "new" issue on appeal- the issue of waiver. Because the district court did not rule on a waiver theory (or even address it), it was not properly before the Court of Appeals and it is not properly before the Minnesota Supreme Court.

Therefore, based upon the foregoing, Wells Fargo respectfully requests that the Minnesota Supreme Court affirm the decision of the Court of Appeals.

Dated: May 12, 2005

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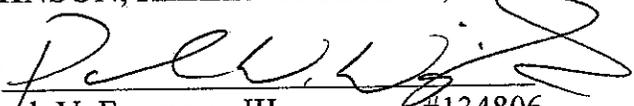
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Certificate of Compliance

Pursuant to Rule 132.01 subd. 3, the undersigned hereby certifies, as counsel for Appellant/Garnishee Northern National Bank, now known as Wells Fargo Bank, that this brief complies with the type-volume limitation as there are 8,823 number of words of proportional space type in this brief. The word processing software used is WordPerfect 12.

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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).