Fall 2018

FINANCIAL newsletter

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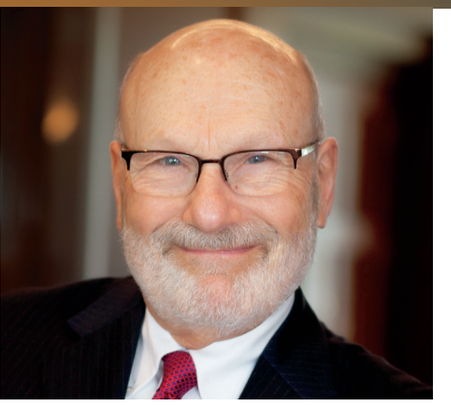

By Peter Stein
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PROTECTING THE BANK FROM FRAUD

SUPREME COURT WEIGHS IN ON TWO FRAUD EXCEPTIONS TO THE BANKRUPTCY DISCHARGE

When an individual files for bankruptcy, the typical result is that the individual's debts to all of its creditors—including its bank creditors—are discharged. As a practical matter, this means that those obligations are essentially uncollectable as personal obligations of the bankrupt debtor. (The creditors may retain lien rights, but that is a subject for another day.) However, under certain circumstances, and provided that the proper hoops are jumped through within the required time deadlines, some or all of the debtor's debts may be excepted from the discharge. When only one or more particular debts are excepted from the discharge, this is called "nondischargeability." The bankruptcy statute specifies the types of debts that are subject to nondischargeability, and the hoops that must be jumped through in order for such debts to be nondischargeable.

There are two statutory provisions regarding non dischargeability that are of particular interest to bankers: these two nondischargeability provisions are generally referred to as the "false financial statement" exception and the "actual fraud" exception.

In two recent bankruptcy decisions of interest to bankers, the Supreme Court has weighed in on each of those two exceptions. In one[1], the Supreme Court

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PROTECTING THE BANK FROM FRAUD

SUPREME COURT WEIGHS IN ON TWO FRAUD EXCEPTIONS TO THE BANKRUPTCY DISCHARGE

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issued what amounted to a warning to bankers to make sure to take certain steps; in the other[2], the Supreme Court appears to broaden the exception, in a way that may well turn out to be helpful to bankers.

False Financial Statements:

If a bank reasonably relies on a borrower's false financial statement in making a loan, and if the borrower then files for bankruptcy, the bank—if it acts quickly and jumps through the right hoops—may be able to get a judgment denying the borrower's discharge of that particular debt. Under the right facts, this can save the bank from a massive loss. (In many instances, this will mean that the borrower is still obligated to the bank, but has been discharged of all of its other debt.)

One of those hoops is that the false financial statement must be in writing. In a recentlyannounced decision, the Supreme Court clarified that the "writing" hoop applies to any statement about the debtor's financial condition, even if the statement is an informal reference, and even if the reference is to a single asset.

Takeaway:

Get it in writing! If the bank is relying on a representation by its customer as to any matter or thing relating to the customer's financial condition, whether as to the making of a loan, the renewal of a loan, or forbearance as to enforcing a loan, find a way to get that representation in writing. If the customer tells you, "My ship is coming in," in any way, and if you are relying on what's on that ship, you need to get the customer to tell you about the ship in writing.

Actual Fraud:

If, in making a loan, a bank reasonably relies on a representation about anything other than the borrower's financial condition, and if the borrower then files for bankruptcy, the bank—again, if it acts quickly and jumps through the right hoops—may be able to obtain a judgment denying the discharge of that particular debt. Until now, many courts have interpreted the "hoops" to include the requirement that a specific misrepresentation must have been made. As we all know, some fraudulent schemes don't necessarily involve the making of a specific misrepresentation to every victim. In a decision that under the right facts could be extremely helpful to banks, the Supreme Court held that this "actual fraud" exception to discharge does not require a specific misrepresentation.

Takeaway:

If a borrower goes bankrupt and the bank suspects that it has been the victim of a fraudulent scheme, the bank should investigate—and likely consult with competent counsel—the pros and cons of commencing a legal action in the bankruptcy court to deny the discharge of that debt. As with legal actions involving false financial statements, there are strict deadlines for commencing legal actions alleging "actual fraud" as the basis for denying the discharge of that particular debt. Accordingly, it is important to act quickly. Under the right facts and circumstances, the bank may end up avoiding, or at least mitigating, what might otherwise have been a massive loss. ■

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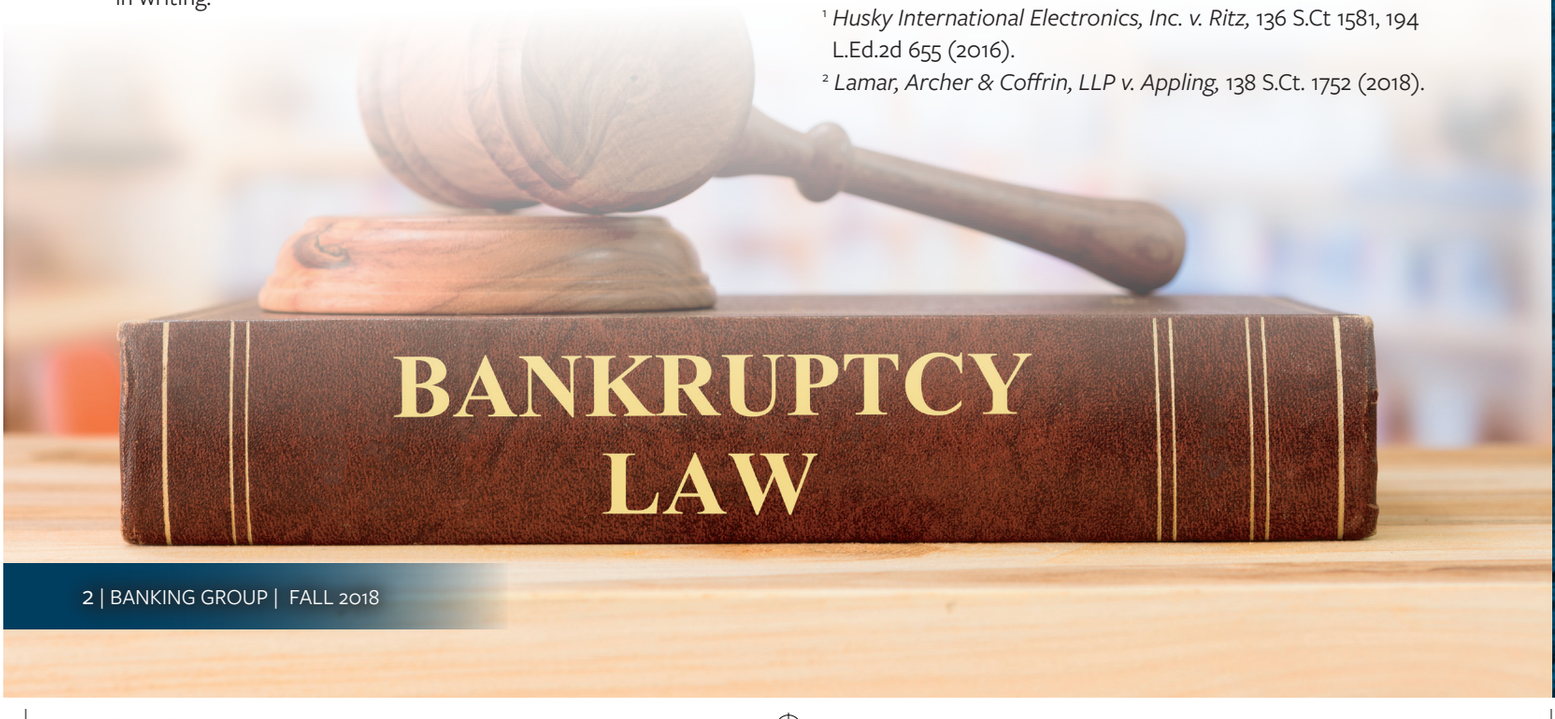
[1] *Husky International Electronics, Inc. v. Ritz,* 136 S.Ct 1581, 194 L.Ed.2d 655 (2016).

[2] *Lamar, Archer & Coffrin, LLP v. Appling,* 138 S.Ct. 1752 (2018).



AG LENDING 2018
RECORD BREAKING ATTENDANCE

Attorney Michael Dove conducting an Ag Lending Round table at the ICMB Annual meeting in August

Attorneys Pete Stein and Abby Pettit hosting a booth at the SBA Conference September 6

Full house at the Ag Lending Conference September 6

Kaitlin Pals presenting at Ag Lending

SAVE THE DATE
FOR AG LENDING 2019

THURSDAY, SEPTEMBER 5, 2019

WELCOME TO THE FUTURE:
ELECTRONIC AND REMOTE NOTARIZATION IN THE DIGITAL AGE

By Dean Zimmerli
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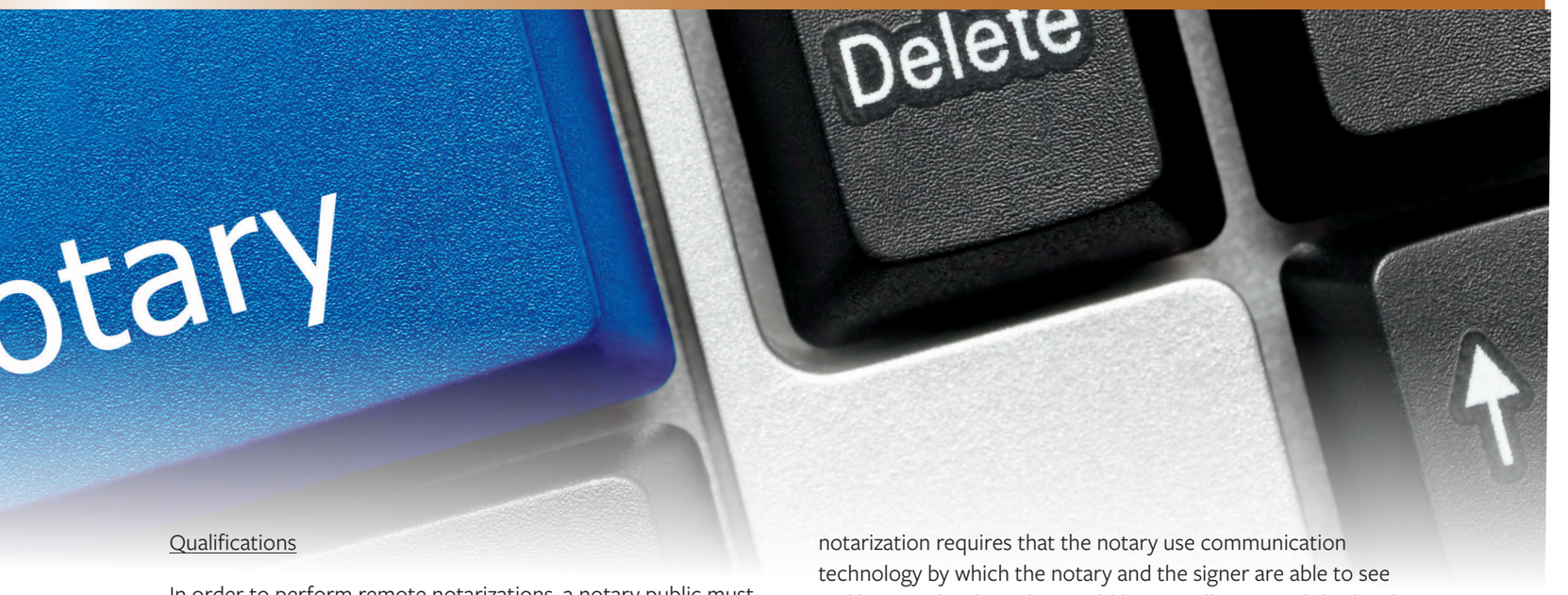
Almost every area of finance and business has dramatically changed as a result of the digital revolution. Notarization has not been among them. If a document needed a notarized signature, it required an in-person meeting with a notary public present where the notary watches the person sign the document and then stamps the document with a rubber stamp. This is not much different than the process followed for decades. But thanks to the adoption of the Revised Uniform Law on Notarial Acts ("Revised Act") adopted in Minnesota during the 2018 Legislative session, this process will finally enter the digital age in earnest. For the first time in Minnesota, the Revised Act will allow for remote online notarization beginning January 1, 2019.

For notarizations performed in-person, the Revised Act makes only minor changes. Notaries performing notarial acts in person will still identify the person signing by a driver's license or other form of identification, witness the signature, and sign, date, and stamp the document as in the past. However, notaries performing a remote notarization—performing a notarial act when the notary and the person signing are not in the same physical location—must follow special rules set out in the Revised Act. This article will detail the process of performing remote online notarization, which is set forth at Minnesota Statutes §§ 358.645–358.646.



Qualifications

In order to perform remote notarizations, a notary public must be properly qualified. Naturally, the person must actually be appointed and commissioned as a notary public. The notary must then apply to the Minnesota Secretary of State's office for remote online notarization registration and certify that the notary intends to use "communication technology" to perform notarial acts. The registration to perform remote notarization will remain in place so long as the notary commission remains valid, unless terminated sooner. A registration to perform remote online notarization may be revoked or terminated if the notary fails to comply with the provisions governing remote notarization.

Procedure

In some respects, the procedure for performing a remote online notarization follows the traditional process. The notary must verify the identity of the individual signing the document, witness the signature, and then apply their notary stamp to the document (electronically). The Revised Act contemplates that remote online notarization will deal primarily with electronic signatures, rather than wet ink signatures. This facilitates the ability of the signer and the notary to both work from the same document even though located in different places.

As with traditional notarization, the location of the notary governs. A notary physically present in Minnesota may notarize documents remotely even when the signer is located in another state (or another country in limited circumstances). The reverse is not true; a Minnesota notary may not notarize documents pursuant to their Minnesota commission if the notary is located in another state, even if the remote signer is located in Minnesota.

Use of Communication Technology

The first requirement for remote online notarization is that the notary must still witness the "signature;" thus, remote online notarization requires that the notary use communication technology by which the notary and the signer are able to see and hear each other. This would be typically accomplished with a webcam or similar device. During the entire process, both parties should be able to see and hear each other in real time. The notary must take reasonable steps to ensure this connection is secure.

Identity Verification

As noted above, one of the biggest differences in remote online notarization is in the identity verification procedures—the steps the notary should take to ensure the person before them signing the document is who they say they are. Under the Revised Act, a notary who has "personal knowledge of the person creating the electronic signature" need not take additional steps for verification. In other words, if the signer is a friend, colleague, family member, or other person whom the notary already knows, additional verification is unnecessary.

However, when the notary does not have "personal knowledge" of the signer, then the notary must complete a two-step identify verification procedure. First, the notary must review, through webcam or other device, a driver's license, passport, or other government-issued identification document; the notary should of course compare the picture and description on the ID to ensure it appears to match the individual on the other end of the video feed who will be signing. The driver's license or other document relied on must also be "validated"; in other words, the notary needs to take steps to ensure the document itself is authentic. The Revised Act requires that the notary use "one or more automated software or hardware processes that scan the credential, including its format features, data, bar codes, or other security elements" to ensure the document is valid and matches the signer's claimed identity. Third-party software may be available to use the webcam feed as a scanning device to conduct this verification.

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WELCOME TO THE FUTURE: ELECTRONIC AND REMOTE NOTARIZATION IN THE DIGITAL AGE

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After the identification document is verified, the notary must use "knowledge-based authentication" to verify the signer's identity. This involves asking the signer a series of questions that the signer must answer correctly to prove their identity. Specifically, the notary must ask "five or more questions with a minimum of five possible answer choices per question." The questions should be drawn from information contained in a credit report or similar third-party report. Thus, questions about addresses associated with the signer, banks with whom the signer may have a loan, or similar inquiries would be likely questions to ask. The signer must answer all questions within a two minute period and must answer at least 80% of the questions correctly (4/5). If the signer does not answer enough questions correctly, the notary may offer a second attempt; during this second attempt, no more than three of the questions from the first attempt may be asked. Assuming that the identification document checks out, and the signer answers the questions correctly, the notary can move forward with the execution of documents.

Electronic Signature and Electronic Notarization

In almost all remote notarization situations, the signer will then "sign" the document electronically. This means to attach or associate an electronic symbol, sound, or process to the document in manner that evidences the signing of a record. In many cases there is special software that allows this, or the signer may simply add a typed "/s/ John Doe" in a signature block, or even check a box.

After the electronic signature is provided, the notary may then complete their "remote online notarial certificate" which is the acknowledgement or verification that contains the usual information associated with a notarial certificate. The certificate must include the notary's electronic signature, electronic seal, title, commission number, and commission expiration date and any other information otherwise required. The certificate must indicate the time and place of the notarization—this should be the location of the notary, not necessarily the signer. The certificate must also indicate that the person signing appeared before the notary remotely and online. The notary must use software or other process to attach the electronic signature and electronic seal to the certificate in a manner that "is capable of independent verification and renders any subsequent change or modification to the electronic document evident." In other words, some software must be used to ensure the document cannot be altered after the fact.

The notary's electronic seal that must be included is similar to the rubber stamp typically used in traditional notarizations. The notary must keep the electronic seal secure to prevent unauthorized access and use. This may be accomplished by using third-party software and password protections.

Electronic Journal and the Record of the Notarization

Although notaries are encouraged to keep a journal of traditional notarial acts, the law does not require it. However, for remote online notarizations, the notary must keep a secure electronic journal of all remote online notarization acts performed by the notary. This journal must include the following information: (1) the date and time of the notarization; (2) the type of notarial act (e.g., an acknowledgement of a record or attestation of a signature); (3) the type, title, or description of the electronic document or proceeding; (4) the printed name and address of each signer; (5) evidence of the identity of the signer; and (6) the fee (up to a statutory maximum of $25) charged for the notarization.

In addition to the electronic journal, the notary must "create an audio and video copy of the performance of the notarial act." Thus, the notary's actions in filling out the notarial certificate and affixing their electronic seal must be recorded. It may be good practice to keep an audio and video record of the entire exchange, including the identity verification procedures.

Both the journal and recordings must be kept for a period of ten years from the date of the transaction. The notary's employer or a third party may serve as a repository for these records, provided that either is able to ensure the integrity and security of the data, and maintain a backup of the data.

Other Considerations:

A notary performing online notarizations has an affirmative duty to make a report to law enforcement and the commissioner of commerce if their electronic seal or electronic journal is stolen or vandalized. As a practical matter, this means that if the notary has reason to believe their account has been hacked or compromised, they should report it immediately.

There is no doubt that remote online notarization is a complicated process when compared to traditional notarization, but it may open up opportunities or ease other burdens when dealing with individuals located out of state or otherwise. However, as the use becomes more widespread, it is likely that third-party vendors will create software and processes that will facilitate and streamline the process. It appears that with the adoption of the Revised Act, Minnesota is poised to bring the archaic process of notarization into the digital age. ■

Gislason & Hunter LLP

Employment Law Conference

Thursday, October 25, 2018

Courtyard Marriott
907 Raintree Road
Mankato, MN 56001

11:30 – Lunch Buffet

Noon – 3:30 Conference

Topics to include:

- **Sexual Harassment – Updates on polices, training and program implementation**
- **Social Media in the Workplace**
- **The Nuts & Bolts of Employment Law (FMLA, hiring, firing, policy development etc)**
- **Case Law Update to include Health Law issues important to Human Resources**

Registration

Name _____

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$50.00 includes, lunch, break, seminar and access to materials
RSVP: jdonner@gislason.com

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THE DEBTOR TRANSFERRED HIS WHAT, TO WHOM? NOW WHAT?

THE MINNESOTA FRAUDULENT TRANSFERS ACT

By Jennifer G. Lurken
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Picture this, you are a creditor pursuing a debtor. You file your lawsuit, successfully argue your case to the judge and obtain a judgment. While attempting to enforce the judgment, you find out the debtor transferred a large asset, such as a second home or large piece of equipment, to the debtor's family member.

It is not uncommon for a debtor, who is concerned about losing equipment or other property, to transfer the property to another person in an attempt to place the property out of the creditor's reach. In an attempt to protect creditors from such behavior, Minnesota adopted the Minnesota Uniform Fraudulent Transfer Act ("MUFTA"). While the first version of the Uniform Fraudulent Transfers Act came into existence in 1918, the law of fraudulent transfer law has been around for over 400 years. One of the landmark cases in fraudulent transfer law is the Twyne's Case from 1601. The Twyne's Case established the precedent that good faith and valuable consideration are required to prevent a fraudulent transfer.

The current MUFTA describes three different situations where a transfer by a debtor is voidable as to a creditor, meaning the transfer is undone and the property returns to the debtor. The first situation is if the debtor made the transfer with actual intent to hinder, delay, or defraud any creditor. Minn. Stat § 513.44(a)(1). Frequently it is difficult to prove a debtor's intent. Thankfully, MUTFA lays out factors or "badges of fraud" to consider when determining intent. These factors include: whether the transfer

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THE DEBTOR TRANSFERRED HIS WHAT, TO WHOM? NOW WHAT?
THE MINNESOTA FRAUDULENT TRANSFERS ACT

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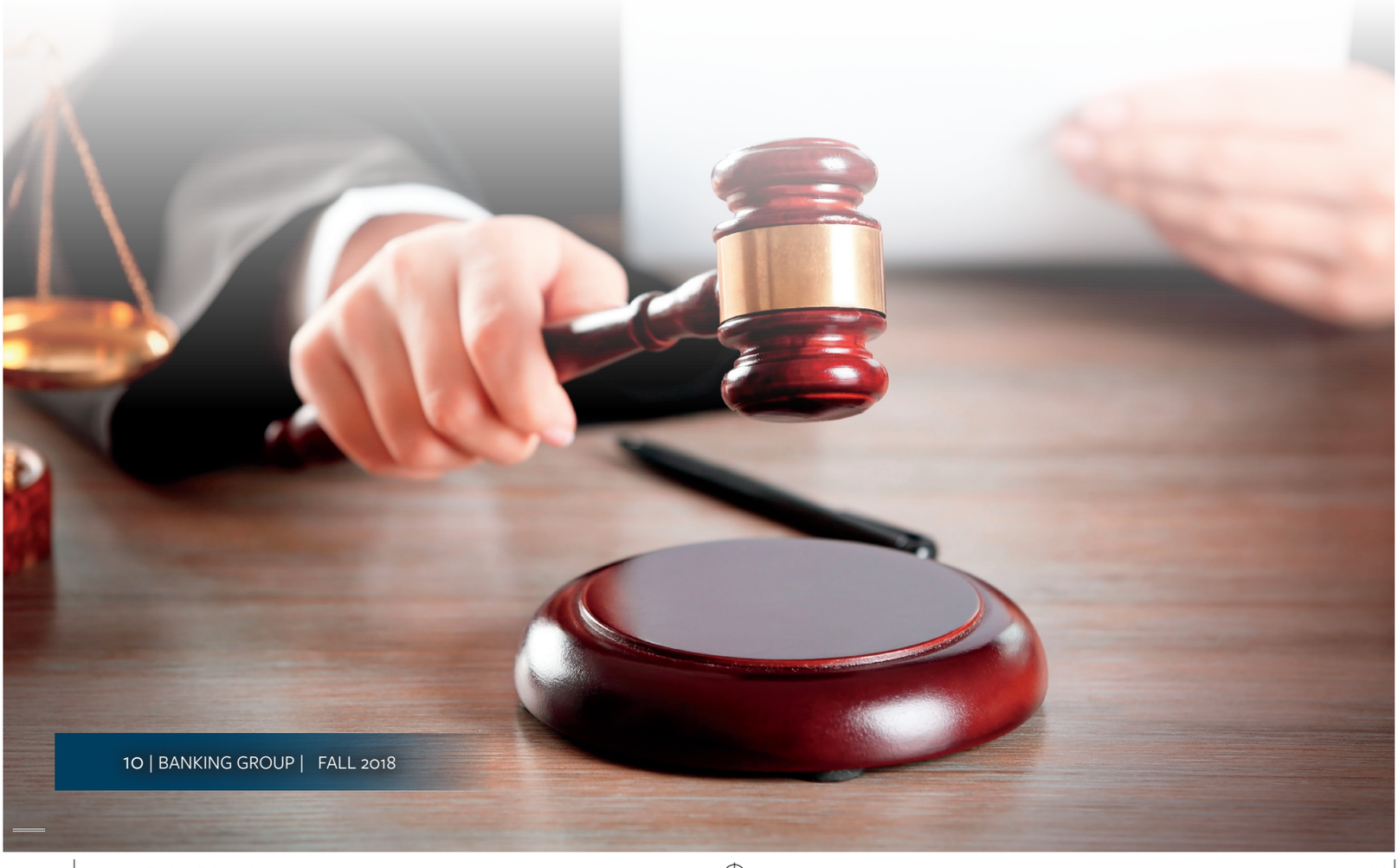
was made to an "insider", whether the debtor retained possession or control of the property after the transfer, whether the transfer was concealed, whether the debtor had been sued or threatened with suit before the transfer, whether the debtor was insolvent, and whether the value received by the debtor was reasonably equivalent to the value of the asset transferred. Minn. Stat § 513.44(b). A common example of this would be a debtor who transfers her second home into her child's name without receiving anything in return, but continues to use the second home in the same manner as she did before the transfer.

The second situation is if the debtor made the transfer without receiving reasonably equivalent value in exchange for the transfer and the debtor either: (i) was engaged or was about to engage in a business or transaction for which the remaining assets of the debtor were unreasonably small in relation to the business; or (ii) intended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor's ability to pay as they became due. Minn. Stat § 513.44(a)(2) & 513.45(a).

More simply put, if the debtor did not receive reasonably equivalent value for the transfer and was insolvent, then the transfer may be voided. An example of this would be a farmer transferring a combine to his son for little to nothing, but the farmer cannot pay his bills as they come due.

The third situation is if the debtor made the transfer to an "insider" for a past debt, when the debtor was insolvent, and the "insider" had reasonable cause to believe that the debtor was insolvent. This commonly occurs when the debtor repays a debt to a close friend or relative but does not repay his other creditors.

In each of these situations, the fight will be between the creditor, attempting to receive the payment, and the transferee, in possession of property previously owned by the debtor. The creditor should obtain as much information and detail about the transfer at issue to determine whether it would fit under any of the above situations. ■



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METRO BANKING CONFERENCE

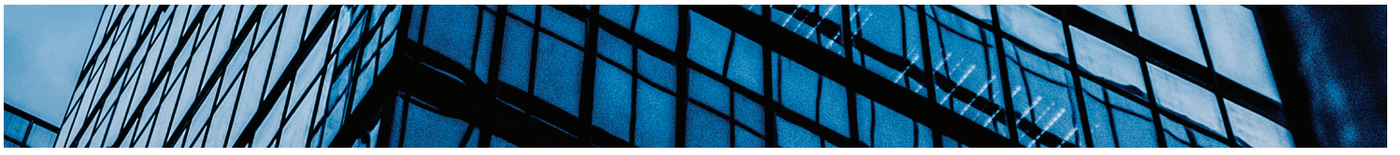
You and your colleagues are invited to a complimentary seminar

Tuesday, November 13, 2018

DoubleTree Hotel Conference Center | 1500 Park Place, Minneapolis MN

11:30 a.m. Lunch | 12:00 – 3:30 p.m. Seminar

Please RSVP to: jdonner@gislason.com



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What Happens When Your Client Dies
SBA – What's New
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This is a complimentary seminar but all participants must register by

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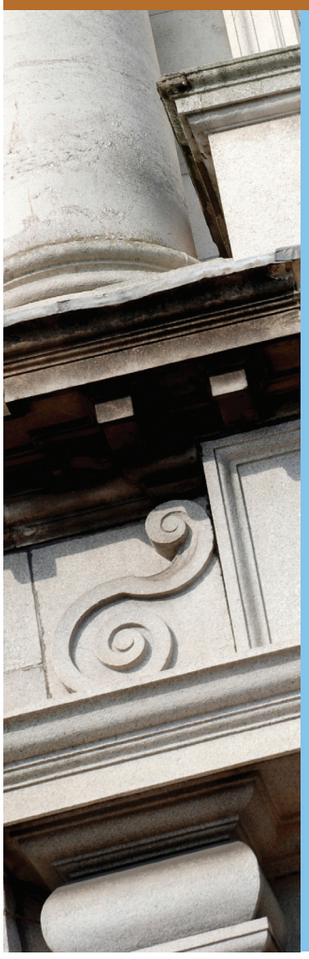

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Banking Services

Gislason & Hunter represents numerous financial institutions and has a thorough familiarity with financial economic conditions, as well as an ever-evolving regulatory environment. We have extensive experience in the following banking areas:

- Management & shareholder issues
- Transfer of bank assets
- Bank litigation
- Business planning
- Real estate
- Property foreclosures and repossessions
- Loan and workout agreements
- Collateralizing and securing all forms of loans
- Loan and credit agreements
- Subordination and participation agreements

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