

No. 16-1856  
No. 16-1955

---

*IN THE UNITED STATES COURT OF APPEALS  
FOR THE EIGHTH CIRCUIT*

---

In re: Agriprocessors, Inc.

Joseph E. Sarachek, in his capacity as Chapter 7 Trustee

Appellee/Cross Appellant,

v.

Luana Savings Bank

Appellant/Cross-Appellee.

---

APPEAL FROM THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF IOWA

---

BRIEF OF AMICUS CURIAE  
IN SUPPORT OF DEFENDANT-APPELLANT/CROSS-APPELLEE  
LUANA SAVINGS BANK  
IN AFFIRMANCE AND REVERSAL OF THE DISTRICT COURT'S ORDER

---

Robert A. Gamble  
Julie Johnson McLean  
Davis Brown Law Firm  
215 10th Street, Suite 1300  
Des Moines, IA 50309  
Tel. (515) 288-2500

*Counsel for the American Bankers Association  
and Iowa Bankers Association*

Iowa Bankers Association (“IBA”) and the American Bankers Association (“ABA”), as amicus curiae, submit this Brief in support of the positions of Luana Savings Bank (“LSB”) to affirm portions of the Order of The Honorable Chief Judge Linda R. Reade of the U.S. District Court for the Northern District of Iowa (the “District Court”) entered on March 15, 2016 (the “Order”) and reverse other portions of the Order as described below.

Table of Contents

Disclosure Statement of Identity of Amicus Curiae, Interest in Case, and Authority ..... vi

Background ..... 1

Argument..... 5

Brief Point I..... 5  
The District Court was correct in holding that intraday overdrafts caused by LSB’s provisional settlements for checks presented on Agriprocessors’ Account 1430 in excess of funds on deposit are not antecedent debts and that subsequent deposits made before the Midnight Deadline to cover the intraday overdrafts are not voidable preferences under the Bankruptcy Code.

Brief Point II ..... 10  
The District Court correctly held that LSB was entitled to setoff funds in Account 367788 and Account 1430.

Brief Point III ..... 14  
The District Court was incorrect in entering Judgment in favor of the Trustee against LSB in the amount of \$1,556,782.89 on account of voidable preferences and should be reversed.

A. The Conduit Theory. The “true overdrafts” existing after the Midnight Deadline were made for payments between

Agriprocessors and third parties and were made in the ordinary course of the banking transactions provided by LSB as a normal depository service to Agriprocessors, and not as a creditor, and are not recoverable by the Trustee as preferential transfers, as argued by LSB. ....	14
B. <u>LSB’s Security Interest.</u> Since LSB held a perfected security interest in Account 1430 and Account 367788, with priority over the Trustee’s preference claims and avoidance powers, LSB did not receive more than it was entitled to receive if the deposits had not been made and the settlements paid. ....	15
C. <u>LSB’s Right of Setoff.</u> Since LSB had a right to setoff funds deposited by the Debtor in Account 1430 and Account 367788, with priority over the Trustee’s preference claims and avoidance powers, LSB did not receive more than it was entitled to receive if the deposits had not been made and the settlements paid. ....	20
D. <u>Ordinary Course of Business.</u> The “true overdrafts” allowed by LSB occurred in the ordinary course of business and therefore the subsequent deposits are not avoidable by the Trustee.....	21
Conclusion .....	22

Table of Authorities

Cases

<i>In re AppOnline.com, Inc.</i> , 296 B.R. 602, 619 (Bankr. E.D.N.Y. 2003).....	9, 24
<i>In re Catamount Dyers, Inc.</i> , 50 B.R. 788 (D. Vt. 1985) .....	20
<i>In re Cumberland Molded Prods., LLC</i> , 431 B.R. 718, 723-724 (B.A.P. 6th Cir. 2010) .....	19
<i>In re Frigitemp Corp.</i> , 34 B.R. 1000, 1016, 1020-1023 (S.D.N.Y. 1983) .....	7, 23, 25
<i>In re Wingspread Corp.</i> , 107 B.R. 456,460 (Bankr. S.D.N.Y. 1989) .....	16
<i>Andrew v. Dundee Sav. Bank</i> , 216 Iowa 240, 249 N.W. 154, 155 (Iowa 1933) .....	11
<i>Barton v. Chem. Bank</i> , 577 F.2d 1329, 1334 (5th Cir. 1978) .....	16

<i>Barnhill v. Johnson</i> , 503 U.S. 393, 399-401 (1992) .....	6
<i>Berger v. Cas' Feed Store, Inc.</i> , 543 N.W.2d 597 (Iowa 1996) .....	11
<i>Farmers Co-Op Elevator, Inc., Duncombe v. State Bank</i> , 236 N.W.2d 674 (Iowa 1975) .....	11
<i>First Nat. Bank of Clinton v. Julian</i> , 383 F.2d 329 (8th Cir. 1967) .....	12, 13
<i>General Electric Credit Corp. v. Nadulli &amp; Sons, Inc.</i> , 836 F.2d 184, 192 (3d Cir. 1988) .....	19
<i>Ky. Highlands Inv. Corp. v. Bank of Corbin, Inc.</i> , 217 S.W.3d 851, 856 (Ky. Ct. App. 2006) .....	17, 18, 26
<i>Laws v. United Mo. Bank of Kansas City, N.A.</i> , 98 F.3d 1047, 1050, 1051 (8th Cir. 1996) .....	6, 7, 23
<i>Lockhart v. Garden City Bank &amp; Trust Co.</i> , 116 F.2d 658 (2nd Cir. 1940) .....	19

### Statutes

11 U.S.C. § 101(5)(A).....	6
11 U.S.C. § 544.....	19
11 U.S.C. § 547(b) .....	1, 27
11 U.S.C. § 553(a) .....	10, 14, 26
Iowa Code Chapter 524 .....	1
Iowa Code § 524.801(1) .....	12
Iowa Code § 524.801(1)(1) .....	10
Iowa Code § 535.17(4) .....	16
Iowa Code § 544 .....	19
Iowa Code § 554.4104(1)(j) .....	5
Iowa Code § 554.4201 .....	23
Iowa Code § 554.4301 .....	5, 23
Iowa Code § 554.4301(1) .....	6
Iowa Code § 554.4302(1)(a) .....	6
Iowa Code § 554.9104 .....	17, 19
Iowa Code § 554.9104(1)(a) .....	17, 18
Iowa Code § 554.9109 .....	17
Iowa Code § 554.9109(1)(a) .....	17
Iowa Code § 554.9203(1) .....	17
Iowa Code § 554.9203(2) .....	17
Iowa Code § 554.9304 .....	27
Iowa Code § 554.9314 .....	18, 19
Iowa Code § 554.9314(1) .....	18
Iowa Code § 554.9327(1) - (3) .....	19

Iowa Code § 554.9340(1) .....	11, 15, 20
Iowa Code Ann. § 554.9104 (West 2001) .....	17, 18
Iowa Code Ann. § 554.9340 (West 2001) .....	15
Packers and Stockyard Act of 1921, 7 U.S.C. § 181 .....	1

Other Authorities

OCC Inter. Ltr. 1082, June 2007, 2007 WL 5393636 (May 17, 2007) .....	21, 22, 24, 25, 27
Expedited Funds Availability Act, 12 U.S.C. §§ 4001-4010 .....	9
Federal Reserve Regulations, 12 C.F.R. §§ 229.31-32 .....	9
Iowa Superintendent of Banking, <i>One-Time Overdraft Fees</i> , Superintendent Guidance SG-2014-01 (January 7, 2014) (available at <a href="http://idob.state.ia.us/bank/docs/bulletin/guidance/SG-2014-01%20One-Time%20Overdraft%20fees.pdf">idob.state.ia.us/bank/docs/bulletin/guidance/SG-2014-01%20One-Time%20Overdraft%20fees.pdf</a> ).....	21, 24, 25, 27
Barkley Clark and Barbara Clark, <i>The Law of Bank Deposits</i> , <i>Collection &amp; Credit Cards</i> , § 5.01(2) .....	7, 8

Disclosure Statement of Identity of Amicus Curiae,  
Interest in Case, and Authority

The ABA is the principal national trade association of the financial services industry in the United States. Founded in 1875, the ABA is the voice for the nation's \$13 trillion banking industry and its million employees. ABA members are located in each of the fifty States and the District of Columbia and include financial institutions of all sizes and types, both large and small. The ABA, whose members hold a substantial majority of domestic assets of the banking industry of the United States and are leaders in all forms of commercial and consumer financial services, often appears as *amicus curiae* in litigation that affects the banking industry. Pursuant to Federal Rule of Appellate Procedure 26.1, the ABA is not a subsidiary of any corporation; no publicly-held corporation holds 10% or more of its membership or ownership interests; and the ABA does not control, is not controlled by, and is not under common control with, any publicly-owned corporation.

IBA was initially formed in 1887 for the purpose of enhancing banks in Iowa by providing leadership, advocacy, information and education to its members, their commercial and consumer customers, and the public. IBA is an Iowa nonprofit corporation organized under Iowa Code Chapter 504. The current membership of IBA consists of approximately 345 state and national banks and

savings associations operating in Iowa. There is no parent corporation of IBA, nor does any publicly-held corporation own 10% or more of its stock.

The ABA and IBA have interests in this case because the issues involve matters of great importance to their respective members and to the entire banking industry in the United States.

Banks nationwide have adopted procedures pursuant to which banks make provisional settlement for checks drawn on customer accounts and presented for payment. Generally, when a bank receives a check drawn upon its customer's account, it has the following options prior to midnight on the bank's next banking day following the banking day on which it receives the check (the "Midnight Deadline"): (a) accept and make final settlement for the check; (b) make provisional settlement and, if sufficient funds are not deposited prior to the Midnight Deadline, return the check for insufficient funds or send notice of dishonor or nonpayment; or (c) permit the Midnight Deadline to expire and assume liability for the check, all as provided by the Uniform Commercial Code ("UCC") and as a part of the ordinary bank deposit and collection process.

If this Court should hold that a provisional settlement resulting in an intraday overdraft creates a short-term debt and that a subsequent wire transfer or other deposit received prior to the bank's Midnight Deadline is a payment of that debt, such that the payment results in a voidable preference, the results would be

catastrophic for LSB and for the banking industry nationwide for the reasons described in this Brief.

Whether a deposit to cover a “true overdraft” after the Midnight Deadline creates a voidable preference under the Bankruptcy Code, the applicability of defenses to the Trustee’s preference claim, and the priority of a bank’s rights of setoff and its security interest in funds deposited to cover the “true overdraft” over the Trustee’s preference claim, are also of vital interest to Iowa banks and the banking industry.

This Brief is filed upon the authority of the Executive Committee of the ABA and the President of IBA, and no counsel for either LSB or the Trustee authored this Brief, in whole or in part, nor has either party or counsel for either party contributed money that was intended to fund the preparation or submission of this Brief. No person other than ABA and IBA contributed money that was intended to fund the preparation and submission of this Brief.



## BACKGROUND

A. Bankruptcy. Agriprocessors, Inc. (“Agriprocessors” or “Debtor”) owned and operated a kosher meatpacking and food processing facility in Postville, Iowa. In May 2008, U.S. Immigration and Customs Enforcement conducted a raid at the Agriprocessors facility and arrested nearly 400 of its employees for immigration violations.

On November 4, 2008, Agriprocessors voluntarily filed a Chapter 11 bankruptcy petition in the United States Bankruptcy Court for the Eastern District of New York. On December 15, 2008, the case was transferred to the Bankruptcy Court for the Northern District of Iowa (the “Bankruptcy Court”). On October 8, 2009, the case was converted to a Chapter 7 bankruptcy case and the United States Trustee for the region appointed Joseph E. Sarachek (the “Trustee”), as the Trustee in the Chapter 7 case. On November 3, 2010, the Trustee filed an adversary action against LSB seeking to set aside preferential transfers under 11 U.S.C. section 547(b).

B. Debtor’s Bank Accounts at LSB. LSB is a state bank organized and existing under Iowa Code Chapter 524, with its principal place of business in Luana, Iowa. Agriprocessors maintained three accounts with LSB. Account number 401102 (“Account 401102”) was opened in 1999 and maintained pursuant to the Packers and Stockyard Act of 1921, 7 U.S.C. § 181. Account number 1430

(“Account 1430”), opened in early 2000, was Agriprocessors’ primary checking account with LSB, and was used for daily transactions. Account number 367788 (“Account 367788”) was opened in July 2008 with a zero balance after Agriprocessors closed Account 401102.

Account 367788 was originally opened to replace Account 401102, but through the course of conduct and an informal agreement (the “Informal Agreement”) between Agriprocessors and LSB, Account 367788 became a cushion account to cover negative balances in Account 1430. Agriprocessors and LSB operated Account 1430 and Account 367788 under the Informal Agreement with the understanding that LSB would make provisional settlement on all checks drawn on Account 1430 (LSB’s “pay all policy”) up to the total of funds in Account 1430 and Account 367788 (the “netting” of the two accounts). If the provisional settlements exceeded the available funds at the time of presentment, then the provisional settlements created an “intraday overdraft”. At LSB’s request, on August 1, 2008, Agriprocessors deposited \$1,150,000 into Account 367788. On August 7, 2008, LSB placed a hold on Account 367788. Two weeks later, at LSB’s request, Agriprocessors deposited an additional \$250,000 in Account 367788. Prior to and during the ninety-day preference period that ran from August 6, 2008 to November 4, 2008, Agriprocessors regularly incurred intraday overdrafts in Account 1430.

Prior to July 2008, Agriprocessors switched its primary business checking account from Citizen's Bank to LSB. After that time and throughout the preference period, the volume of checks written on Account 1430 and the related intraday overdrafts in Account 1430 increased significantly. The increase was due in part to LSB's pay all policy, by which LSB gave provisional settlement for all checks presented, whether or not the provisional settlement would create an intraday overdraft at the time of presentment. On the morning of each banking day, LSB's President, David Schultz, would review reports to determine which customer accounts were in an overdraft position, including Agriprocessor's Account 1430. Generally, if Account 1430 showed an intraday overdraft, then after Schultz's review, a LSB representative would contact Agriprocessors to determine whether a covering deposit would be forthcoming before the Midnight Deadline. If Agriprocessors indicated that covering funds were available, LSB would wait to determine whether to honor the checks. Usually, Agriprocessors would wire in covering funds and LSB would then honor most of the checks written on Account 1430. App. 1562-1563.

Even after Agriprocessors wired in covering funds, however, the account balance in Account 1430 always remained below zero during the preference period. Under the Informal Agreement between LSB and Agriprocessors, in order to determine whether the covering funds wired into Account 1430 by

Agriprocessors were sufficient to avoid a “true overdraft”, LSB considered both the funds in Account 1430 and the funds in Account 367788 to be available. LSB would net the account balances of Account 1430 and Account 367788, which carried a balance of \$1.4 million, with the covering funds. If those amounts combined yielded a zero or positive balance, LSB would not consider Account 1430 overdrawn and would allow final payment on the checks. There were, however, 9 days during the preference period in which the covering funds were not sufficient, even considering the funds in Account 367788, to bring Account 1430 to a positive or zero balance. On those days, LSB paid the checks creating “true overdrafts” in Account 1430. Within one (1) banking day after each “true overdraft”, funds were deposited to cover the overdraft and Agriprocessors and LSB then continued to operate the accounts under the pay-all policy and the Informal Agreement. App. 989.

On October 24, 2008, LSB learned that no covering funds were coming from Agriprocessors to eliminate the intraday overdrafts on Account 1430. LSB immediately transferred the \$1.4 million from Account 367788 into Account 1430 to cover the negative balance. On November 4, 2008, Agriprocessors filed its Chapter 11 petition.

## ARGUMENT

### Brief Point I

The District Court was correct in holding that intraday overdrafts caused by LSB's provisional settlements for checks presented on Account 1430 in excess of funds on deposit are not antecedent debts and that subsequent deposits made before the Midnight Deadline to cover the intraday overdrafts are not voidable preferences under the Bankruptcy Code.

Intraday overdrafts are a function of the UCC and the two-day check clearinghouse process, and occur because of the deferred posting procedure under Iowa Code section 554.4301. The deferred posting procedure generally authorizes a bank to provisionally settle a check presented to it, but then gives the bank the option to revoke the settlement prior to the bank's Midnight Deadline if there are insufficient collected funds in the account to cover the check. Iowa Code § 554.4301. Iowa Code section 554.4104(1)(j) defines the Midnight Deadline as "midnight on [a bank's] next banking day following the banking day on which it receives the relevant item...".

If a covering deposit is not made prior to the Midnight Deadline, the bank may: (a) accept and make final settlement for the check; (b) revoke the provisional settlement prior to the Midnight Deadline and return the check for insufficient funds or send notice of dishonor or nonpayment; or (c) permit the Midnight Deadline to expire and assume liability for the check, all as provided by the UCC

and as a part of the ordinary bank deposit and collection process. Iowa Code §554.4301(1); 554.4302(1)(a).

The Trustee takes the position that a provisional settlement is an advance that creates an antecedent debt within the meaning of 11 U.S.C. section 101(5)(A) (the “Bankruptcy Code”), and that a subsequent deposit to cover the advance is the payment of the antecedent debt that creates a voidable preference. The District Court, in affirming the Bankruptcy Court, correctly held that intraday overdrafts do not constitute antecedent debt. App. 1575-1578.

LSB had the right to revoke the provisional settlement for a check if funds were not deposited in Account 1430 prior to the Midnight Deadline. No transfer of funds occurred until the settlement became final, whether by payment of the check by LSB, payment from funds deposited in Account 1430 to cover the check, or by allowing the Midnight Deadline to expire without revocation of the provisional settlement. A check is not transferred on the date of the payee’s receipt of the check, but on the date the check is finally honored or dishonored upon presentment by the payor bank. *Barnhill v. Johnson*, 503 U.S. 393, 399-401 (1992). The District Court recognized the applicable rule that the point for determining whether a debt arises from the provisional settlement of a check is the Midnight Deadline, and that “... a careful reading of *Laws* [*Laws v. United Mo. Bank of Kansas City, N.A.*, 98 F.3d 1047 (8<sup>th</sup> Cir. 1996)] indicates that a debt only arises when the Bank

decides to honor the check by allowing the midnight deadline to expire, thereby relinquishing its right to dishonor the check and avoid the provisional overdraft becoming a true overdraft.” App. 1574. The District Court further correctly found at page 18 of the Order that: “reading the U.C.C. and *Barnhill* together, the court finds that there is support for concluding that intraday overdrafts do not give rise to antecedent debt.” The District Court cited multiple cases finding that intraday overdrafts do not give rise to antecedent debt. App. 1575-1578.

Other courts have held that a provisional settlement does not create a debt for preference purposes, *In re Frigitemp Corp.*, 34 B.R. 1000 (S.D.N.Y. 1983), and recognize that the bank is acting as the customer’s agent until a provisional settlement becomes final. *Laws*, 98 F.3d at 1050. *See also* Barkley Clark and Barbara Clark, *The Law of Bank Deposits, Collections & Credit Cards*, § 5.01(2).

The District Court holding is entirely consistent with the Eighth Circuit Court ruling in *Laws* and the cases and policy described therein. The *Laws* decision dealt with whether or not the settlement of checks drawn on the debtor’s account against uncollected funds that were covered by deposits from third-party checks received prior to the Midnight Deadline create an antecedent debt, the payment of which is a voidable preference under the Bankruptcy Code. This case involves whether a voidable preference results from the provisional settlement for checks presented for payment on Agriprocessors Account 1430 that were covered

by deposits received prior to the Midnight Deadline, an issue slightly different, but similar to that in *Laws*.

This Court should adopt the legal conclusions and policy considerations relating to intraday overdrafts set forth in *Laws*, *Frigitemp*, and *In re AppOnline.com, Inc.*, 296 B.R. 602 (Bankr. E.D.N.Y. 2003). The court stated in *AppOnline.com*:

If the concept of provisional settlement as between the bank and its customer were eliminated, stop payment orders, garnishments and set-offs would all be ineffective if they arrived at the payor bank after forward settlement has been made with its presenting bank but before the payor bank has determined whether or not to honor the check, and the concept of the midnight deadline would, in effect, cease to exist.

296 B.R. at 619.

A ruling for the Trustee that the provisional settlement for checks drawn by Agriprocessors on its account at LSB is an advance by LSB and the subsequent deposit by Agriprocessors is a repayment of that advance, would make meaningless the UCC provisions that permit provisional settlements that may be revoked prior to a bank's Midnight Deadline. As a result, banks nationwide would be required to determine in real time, on a second by second basis, whether a customer's account contains sufficient collected funds to cover a check at the precise instant the check is presented. A bank that elects to give provisional settlement for a presented check would run the risk that subsequent same day deposits or next day deposits that cover the provisional settlement may be subject



to a preference claim by a bankruptcy trustee in the event of a bankruptcy filing by the customer sometime in the next 90 days following the covering deposit.

In addition, the result could substantially impair a bank's ability to comply with the Expedited Funds Availability Act, 12 U.S.C. sections 4001-4010, and Federal Reserve Regulation CC, specifically 12 C.F.R. sections 229.31-.32 thereof, which set forth various times by which a check must be returned. The Midnight Deadline under the UCC has not been preempted by Regulation CC and continues to set the time frame for all banks to determine whether or not to honor a check drawn by a customer and provisionally debited from the customer's account. *See AppOnline.com*, 296 B.R. at 619, at n. 5, and cited authorities. A ruling in favor of the Trustee would force banks to be far more restrictive in permitting intraday overdrafts, checks would be dishonored that could be covered by same day or next day deposits in the ordinary course of the business of their customers, and customers would be uncertain that the use of checks would continue to be a reliable method of payment.

In determining whether a deposit covering an intraday overdraft creates a voidable preference, the Court should also consider that LSB had a right of setoff that applied to Account 1430 and Account 367788 and a perfected security interest in Account 1430 and Account 367788. *See* Brief Points II, III.B. and III.C. *infra*.

## Brief Point II

The District Court correctly held that LSB was entitled to setoff funds in Account 1430 and Account 367788.

The District Court correctly stated:

The Bankruptcy Code does not create any general federal right of setoff. However, it does protect any other setoff rights the creditor may have so long as the setoff meets the additional requirements of 11 U.S.C. § 553(a). In order for its setoff to be proper, the Bank must demonstrate that: (1) it owed the Debtor a debt which arose prior to the commencement of the bankruptcy case; (2) Debtor owed a debt to LSB which arose prior to the commencement of the bankruptcy case; and (3) the debts were mutual.

App. 1605.

LSB had a contractual right to setoff funds in Account 1430 against debts of Agriprocessors to LSB. The Account 1430 deposit account agreement (LSB Exhibit B) provides in part:

SETOFF - We may (without prior notice and when permitted by law) set off the funds in this account against any due and payable debt you owe us now or in the future, by any of you having the right of withdrawal, to the extent of such persons' or legal entity's right to withdraw."

App. 874. The account agreement for Account 367788 has the identical provision.

App. 877.

In addition, LSB has the statutory power of setoff against deposit accounts under Iowa Code section 524.801(1)(l) which provides a state bank the power:

To set off a customer's account against any of the customer's debts or liabilities owed the state bank pursuant to an agreement entered into between the customer and the state bank.

There is no requirement in the Iowa Banking Act that the agreement be in writing or that the agreement have any particular form. Iowa Code Chapter 524.

LSB also has the statutory right of setoff against Account 367788 under Article 3 of the UCC. Iowa Code section 554.9340(1) provides:

Except as otherwise provided in subsection 3, a bank with which a deposit account is maintained may exercise any right of recoupment or setoff against a secured party that holds a security interest in the deposit account.

In addition to LSB's statutory rights of setoff, it is also well settled under Iowa case law that a bank may setoff a general deposit against a mature debt of a depositor. *See, e.g., Berger v. Cas' Feed Store, Inc.*, 543 N.W.2d 597 (Iowa 1996); *Farmers Co-Op Elevator, Inc., Duncombe v. State Bank*, 236 N.W.2d 674 (Iowa 1975); *Andrew v. Dundee Sav. Bank*, 216 Iowa 240, 249 N.W. 154, 155 (Iowa 1933) (Iowa Supreme Court held that the requirement of mutuality is not requisite under the equitable doctrine of setoff).

The only issue relating to setoff under the Bankruptcy Code is the third element of mutuality. The Trustee argues that, as to Account 367788, the obligations of LSB and Agriprocessors were not mutual because LSB had a hold on the account limiting Agriprocessors' access to the account.

The Informal Agreement between the parties is an agreement within the meaning of Iowa Code section 524.801(1) permitting LSB to setoff the funds in Account 367788. The Informal Agreement was either in addition to or modified Account 367788 deposit account agreement by recognizing that Account 367788 would be held as a cushion for the amount of checks written against Account 1430. Under the Informal Agreement, Account 367788 essentially provided a fund to cover advances made by LSB to pay checks drawn on Account 1430 and recognizing that, in the event funds deposited in Account 1430 were insufficient to cover checks drawn on that account, LSB could setoff Account 367788 and apply the proceeds to checks drawn against Account 1430.

In *First Nat. Bank of Clinton v. Julian*, 383 F.2d 329 (8th Cir. 1967), the Eighth Circuit held, in a case involving an account created to provide a reserve for payment of floor plan loans, that the oral understanding of the bank and its customer permitted the bank to setoff funds in the reserve account and that the funds were not subject to turn over to the bankruptcy trustee. The fact that the customer could not draw on the reserve account without bank approval did not prevent the bank's setoff of the account. In *Julian*, the Eighth Circuit stated:

However, as a matter of law, the account was a general checking account created for the purpose of securing the Bank against losses of some kind. The only restriction on the account was that Woody could not draw checks on it without the approval of the Bank. There was no agreement that the account was to be kept separate and isolated from the other checking accounts in the Bank. That is, the Bank did not

and was not under any obligation to hold this money separate and apart from its other funds and to refrain from using the funds in its business. This type of reserve account constitutes a general deposit for a special purpose which creates a general deposit that the Bank may use in its regular business operations, the Bank becoming a debtor in the amount of the deposit.

*Id.* at 337.

In this case, while Account 367788 was subject to a hold, Agriprocessors had virtually unrestricted access to the funds by writing checks on Account 1430.

As the District Court correctly found:

While Debtor did not have the ability to directly draw on the funds in the 367788 Account, there is no evidence in the record that the Bank was legally bound to hold the funds in the Account 367788 separate and apart from Debtor's other funds. This conclusion is further bolstered by the court's finding above that Debtor in fact enjoyed access to the funds in the 367788 Account.

App. 1611. The District Court further noted that any finding that the setoff was improper "would lead to the somewhat absurd result that the Bank would not be able to utilize the funds in the 367788 Account for their understood purpose."

App. 1611, n. 9. The District Court was correct in its rejection of the Trustee's argument that a narrow reading of the mutuality requirement was required since it "would so completely rob the parties of their own expectations for the use of the funds." *Id.*

The District Court affirmed the Bankruptcy Court's finding that the parties intended that Account 367788 be held by LSB to satisfy checks drawn by

Agriprocessors on Account 1430. The District Court, having reviewed the record as a whole, agreed with the Bankruptcy Court's reasoned finding that "the parties not only reached an informal netting agreement but took actual steps to effectuate it." App. 1596, citing the Bankruptcy Court. The Informal Agreement provided that Account 367788 would be held as a cushion for checks drawn against Account 1430. App. 1594-1596. The course of conduct of the parties and the testimony referenced by the Court bears that out.

The result of the Informal Agreement and LSB's pay all policy was that Agriprocessors had virtually unrestricted access to and the ability to use the funds in Account 367788 by simply writing checks on Account 1430 up to the total amount in Account 1430 and Account 367788. Accordingly, the requirement for mutuality under Bankruptcy Code Section 553(a) was satisfied, and the Order as it relates to the right of LSB to setoff the funds in Account 367788 should be affirmed.

### Brief Point III

The District Court was incorrect in entering Judgment in favor of the Trustee against LSB in the amount of \$1,556,782.89 on account of voidable preferences and should be reversed.

A. The Conduit Theory. The "true overdrafts" existing after the Midnight Deadline were made for payments between Agriprocessors and third parties and were made in the ordinary course of the banking transactions provided by LSB as a normal depository service to Agriprocessors, and not as a creditor, and are not recoverable by the Trustee as preferential transfers, as argued by LSB.

For the reasons set forth in the Brief filed by LSB, the “true overdrafts” allowed by LSB did not create antecedent debts and subsequent deposits by Agriprocessors to cover the “true overdrafts” are not payments of antecedent debts that may be voidable by the Trustee as preferences.

If the Court should conclude that the covering deposits made within one day after the Midnight Deadline to cover “true overdrafts” are payments on account of antecedent debts within the meaning of the Bankruptcy Code, the deposits made by Agriprocessors to cover the overdrafts are nevertheless subject to LSB’s setoff rights and LSB’s security interest in Account 1430,<sup>1</sup> each of which are prior and superior to the preference claims of the Trustee. *See* Brief Points III.B. and III.C., *infra*.

B. LSB’s Security Interest. Since LSB held a perfected security interest in Account 1430 and Account 367788, with priority over the Trustee’s preference claims and avoidance powers, LSB did not receive more than it was entitled to receive if the deposits had not been made and the settlements paid.

LSB had a perfected security interest in both Account 1430, with respect to true overdrafts, and Account 367788, with respect to coverage of negative balances in Account 1430. Agriprocessors’ Controller, Toby Bensasson, verified by direct testimony in open court that under the Informal Agreement, Account 367788

---

<sup>1</sup> Comment 3 to Iowa Code § 554.9340(1) makes clear that a bank may hold a right of setoff and a security interest in the same account and that, by holding a security interest, the bank does not impair any right of setoff it would otherwise be entitled to exercise. Iowa Code Ann. § 554.9340 (West 2001).

provided a cushion for checks drawn on Account 1430 (App. 1595). As such, the Informal Agreement is not required to be in writing to satisfy the Iowa Statute of Frauds applicable to credit agreements. *See* Iowa Code § 535.17(4) (“a credit agreement which is not in writing . . . is enforceable if the party against whom enforcement is sought admits in court that . . . the agreement was made.”). The Informal Agreement is a sufficient agreement under the UCC to create a security interest in favor of LSB covering Account 1430. *See Barton v. Chem. Bank*, 577 F.2d 1329, 1334 (5th Cir. 1978) (“Although the Georgia statute enacting the Uniform Commercial Code explicitly provides that a written security agreement is required for enforcing a security interest when the secured party lacks possession of the collateral, Ga. Code Ann. § 109A-9-203(1)(b), no similar requirement for enforcing a security interest is imposed when the secured party possesses the collateral, *id.* § 109A-9-203(1)(a). The Official Comments indicate that the omission of a provision for a written security interest when the creditor possesses the collateral was intended to allow oral security agreements.”); *In re Wingspread Corp.*, 107 B.R. 456, 460 (Bankr. S.D.N.Y. 1989) (where the collateral is in the possession of the secured party, the security agreement may be oral or may be implied from circumstances including course of dealing or usage of trade or course of performance).



In addition, as the depository bank with possession of both accounts, LSB had an automatic perfected security interest in both accounts. *See Ky. Highlands Inv. v. Bank of Corbin, Inc.*, 217 S.W.3d 851, 856 (Ky. Ct. App. 2006) (“Under the revised portions of the UCC, depository banks receive an automatic perfected interest in the accounts of their customers.”).

The UCC applies to “a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract.” Iowa Code § 554.9109(1)(a). While a security interest is ordinarily created by the execution of a security agreement, a written security agreement is not required under Iowa Code section 554.9109 in order that the UCC apply. All that is required is that there be a transaction, regardless of form, that creates a security interest by contract.

Under Iowa Code section 554.9203(1), “a security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral.” A security interest is enforceable against the debtor and third parties with respect to the collateral only if:

(a) value has been given; (b) the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and (c) one of the following conditions is met: ... (4) the *collateral is deposit accounts ... and the secured party has control* under ...section 554.9104 ....

Iowa Code § 554.9203(2) (emphasis added). A secured party has control of a deposit account if “the secured party is the bank with which the deposit account is

maintained.” Iowa Code § 554.9104(1)(a). Further, UCC Comment 2 of Iowa Code section 554.9104 explains the concept that “control” of a deposit account may substitute for an authenticated security agreement as an element of attachment. Iowa Code Ann. § 554.9104 (West 2001).

In this case, first, as to intraday overdrafts, value was given by LSB by providing provisional settlement for checks drawn on Account 1430 up to the total amount in Account 1430 and Account 367788. As to “true overdrafts”, value was given by LSB’s payment of the checks or assumption of any obligation for the checks held beyond the Midnight Deadline for which there were insufficient collected funds in Account 1430. Second, Agriprocessors had rights in the funds that constituted the collateral since the deposits in Account 1430 and Account 367788 created a debt owed by LSB to Agriprocessors, and Agriprocessors had the power to transfer rights in the accounts to LSB. Third, LSB as the bank where the deposit accounts were maintained, had control of Account 1430 and Account 367788 as provided in Iowa Code section 554.9104(1)(a). Furthermore, under Iowa Code section 554.9314(1) LSB’s security interest in both deposit accounts was also perfected by control. *See* Iowa Code §554.9314(1) (“A security interest in . . . deposit accounts . . . may be perfected by control of the collateral . . .”).

Therefore, LSB had a perfected security interest in Account 1430 and Account 367788 that had priority over any conflicting security interests in the same deposit account. *See Ky. Highlands*, 217 S.W.3d at 855.

Iowa Code section 554.9327(1) - (3) provides as follows:

(1) A security interest held by a secured party having control of the deposit account under section 554.9104 has priority over a conflicting security interest held by a secured party that does not have control. (2) Except as otherwise provided in subsections (3) and (4), security interests perfected by control under section 554.9314 rank according to priority in time of obtaining control. (3) Except as otherwise provided in subsection 4, a security interest held by the bank with which the deposit account is maintained has priority over a conflicting security interest held by another secured party.

UCC Comment 3 of Iowa Code section 554.9104, provides:

Under subsection (a)(1), the bank with which the deposit account is maintained has control. The effect of this provision is to afford the bank automatic perfection. No other form of public notice is necessary; all actual and potential creditors of the debtor are always on notice that the bank with which the debtor's deposit account is maintained may assert a claim against the deposit account.

Iowa Code Ann. § 554.9104 (West 2001).

A perfected security interest accounts is prior and superior to a Trustee's status as a hypothetical judgment lienholder under 11 U.S.C. Code section 544. *In re Cumberland Molded Prod., LLC*, 431 B.R. 718, 723-724 (B.A.P. 6th Cir. 2010) (bank's security interest in debtor's checking account and funds which was properly perfected prior to the petition date was superior and Chapter 7 trustee may not avoid the bank's security interest nor prevail over the bank's superior interest);

*see also General Electric Credit Corp. v. Nardulli & Sons, Inc.*, 836 F.2d 184, 192 (3d Cir. 1988) (a trustee's status as a hypothetical judgment lien holder "inures upon commencement of the case"); *Lockhart v. Garden City Bank & Trust Co.*, 116 F.2d 658 (2d Cir. 1940) (trustee's rights are determined at the time of bankruptcy and liens valid at that time remain valid as against the trustee); *In re Catamount Dyers, Inc.*, 50 B.R. 788 (D. Vt. 1985) (holding that the rights of perfected lienholders were superior to those of the trustee as a hypothetical lienholder). Accordingly, because LSB security interest in both accounts is prior and superior to the Trustee's interest as a hypothetical judgment lienholder.

C. LSB's Right of Setoff. Since LSB had a right to setoff funds deposited by the Debtor in Account 1430 and Account 367788, with priority over the Trustee's preference claims and avoidance powers, LSB did not receive more than it was entitled to receive if the deposits had not been made and the settlements paid.

As noted in Brief Point II *infra*, LSB had a right of setoff against both Account 1430 and Account 367788. The right of setoff applied at all times during the preference period. Iowa Code section 554.9340(1) states the general rule and provides that a bank may effectively exercise rights of setoff against any secured party that holds a security interest in the deposit account. Within one (1) banking day following each "true overdraft", deposits were received by LSB to cover the overdrafts. App. 989. LSB then setoff the deposits in Account 1430 to cover the amount of the "true overdrafts". LSB and Agriprocessors then continued to operate Account 1430 and Account 367788 under the Informal Agreement and the

pay all policy, until October 24, 2008, when LSB was advised that no funds would be received from Agriprocessors to cover the overdrafts and LSB setoff the funds in Account 367788.

D. Ordinary Course of Business. The “true overdrafts” allowed by LSB occurred in the ordinary course of business and therefore the subsequent deposits are not avoidable by the Trustee.

Banks nationwide commonly permit overdrafts in the ordinary course of business settling items on behalf of customers where there are insufficient funds in the accounts to cover such items or by permitting the Midnight Deadline to expire. Subsequent deposits to the accounts are then applied to cure the negative balances in customers’ accounts. The practice by banks to honor items when there are insufficient funds in depositors’ accounts and recover the resulting overdraft amounts as part of banks’ routine maintenance of accounts and to charge fees from the depositors’ accounts for doing so, was approved by the Comptroller of the Currency (“OCC”) in Interpretive Letter No. 1082, 2007 WL 5393636 (May 17, 2007) (“OCC Letter 1082”) and by the Iowa Superintendent of Banking, *One-Time Overdraft Fees*, Superintendent Guidance, SG-2014-01 (January 7, 2014) (“Iowa Supt. SG-2014-01”).

At page 3 of OCC Letter 1082, the OCC stated:

Your letter describes how overdrafts are created and the process by which the Bank clears and recovers overdraft amounts. The process by which a bank honors overdraft items is typically part of the Bank’s administration of a depositor’s account. Creating and recovering

overdrafts have long been recognized as elements of the discretionary deposit account services that banks provide. Where a customer creates debits on his or her account for amounts in excess of the funds available in that account, a bank may elect to honor the overdraft and then recover the overdraft amount as part of its posting of items and clearing of the depositor's account. These activities are part of or incidental to the business of receiving deposits.

A bank's authority to provide products or services to its customers necessarily encompasses the ability to charge a fee for the product or service. This ability to charge a fee for the bank's services is expressly reaffirmed in 12 C.F.R. § 7.4002(a)...

OCC Letter 1082, 2007WL 5393636, at 3.

Accordingly, the portion of the Order granting judgment in favor of the Trustee in the amount of \$1,556,782.89 should be reversed.

### Conclusion

The issues presented in this matter are of great importance to Iowa banks and the banking industry generally in the conduct of their account relationships and, particularly, relationships with customers who are experiencing financial difficulties.

1. Provisional Settlement. The District Court was correct in holding that provisional settlement for checks presented prior to LSB's Midnight Deadline does not create a debt owed by Agriprocessors to LSB for bankruptcy preference purposes. App. 1572. Banks have historically provided provisional settlement for checks drawn by their depositors with the understanding that banks will have until the Midnight Deadline to pay checks, revoke the provisional settlement and return

the checks indicating insufficient funds, or allow the Midnight Deadline to expire and the provisional settlement to become final and assume the obligations for the checks. Iowa Code § 554.4301. To the extent funds are received in accounts prior to the Midnight Deadline, checks may be paid and the provisional settlement becomes final.

Similarly, under Iowa Code section 554.4201, banks have historically acted as an agent in the collection process by giving provisional settlement for checks drawn upon uncollected funds with the understanding that banks will have until the checks are dishonored before debts are created for bankruptcy preference purposes. *See Laws*, 98 F.3d at 1051.

Without the ability to make a provisional settlement that may be revoked or made final prior to a bank's Midnight Deadline, banks would be required to verify on an immediate basis that collected funds are available to cover each check at the precise second presented or run the risk that a provisional settlement for that check may result in a voidable preference, notwithstanding a covering deposit subsequently made that day or the next banking day. As a result, customers and creditors would be unable to use checks as a reliable method of payment, and the free flow of funds would be materially and adversely affected. That practice could create such a burden on banks that the entire presentation and collection process would become unworkable. *See Frigitemp*, 34 B.R. at 1016. In addition, stop

payment orders, garnishments and setoffs would be ineffective if they arrived after a check is presented and either settled or returned. *See AppOnline.com*, 296 BR at 619.

According to LSB's call reports, the equity capital of LSB was \$73,463,000 as of March 31, 2016. The amount of damages sought by the Trustee relating to the overdrafts and alleged preferential transfers ranges from \$51,911,381.81 to \$61,435,427.34. At the lowest level asserted by the Trustee, such a judgment would consume a substantial portion of the capital of LSB, which could result in the closure of LSB. The same could be true of hundreds of banks nationwide when trustees in pending bankruptcy cases file preference claims to recover the amount of intraday overdrafts in the debtors' accounts.

2. Overdrafts. Banks commonly permit overdrafts by settling items on behalf of customers where there are insufficient funds in the accounts to cover such items or by permitting the Midnight Deadline to expire. Subsequent deposits to the accounts are then applied to cure the negative balances in customers' accounts. The practice by banks to honor items when there are insufficient funds in depositors' accounts and recover the resulting overdraft amounts as part of banks' routine maintenance of accounts and to charge fees from the depositors' accounts for doing so, was approved by the OCC in OCC Letter 1082 and by the Iowa Superintendent of Banking in Iowa Supt. SG-2014-01.



A ruling that overdrafts create antecedent debts for bankruptcy preference purposes, and that subsequent deposits for such overdrafts are recoverable as voidable preferences by bankruptcy trustees could have a substantial adverse effect on the banking industry.

Banks will be forced to reconsider providing the traditional service of permitting overdrafts to be paid by subsequent deposits and charging fees for such service, a practice recognized by the UCC and expressly approved in OCC Letter 1082 and in Iowa Supt. SG-2014-01. If deposits to cover overdrafts are recoverable in bankruptcy, then the routine practice of permitting overdrafts may be deemed an unsafe and unsound banking practice that would subject banks to regulatory criticism or sanctions. As a result, checks that would otherwise be used to pay trade creditors and employees of depositors will be returned for insufficient funds, and many customers who are experiencing financial difficulties will be forced to file bankruptcy sooner than they would otherwise file. The result would be more bankruptcy filings rather than fewer. *See Frigitemp*, 34 B.R. at 1020-1023. In addition, banks may be required to revise overdraft protection programs now made available as a convenience to customers.

If funds deposited to cover overdrafts are subject to preference actions in the event of a subsequent bankruptcy by the customer, then trustees in bankruptcy

actions nationwide will file preference claims that could have a substantial adverse impact on bank capital.

3. Setoff. The right of banks to set off deposit liabilities against sums due banks from customers has been a historic remedy available to banks, both by reason of statute and by common law, as well as an equitable remedy. Since the Informal Agreement provided Agriprocessors with unrestricted use of the funds in Account 367788 and the mutuality requirement of Section 553(a) of the Bankruptcy Code was satisfied, the right of LSB to setoff funds in Agriprocessors' accounts should be recognized. LSB's right of setoff applies as well to sums deposited in Account 1430 to cover "true overdrafts". On the nine (9) occasions when LSB permitted overdrafts, the funds subsequently deposited on the next banking day following the Midnight Deadline to cover the overdrafts were properly setoff to reverse the negative balance in Account 1430. *See* Brief Points II and III.C. *supra*.

4. Security Interest. LSB had an automatic perfected security interest in Account 367788 and Account 1430. *See Ky. Highlands*, 217 S.W.3d at 856. The District Court found that there was an Informal Agreement under which funds in Account 367788 were used to provide assurance of the payment of checks drawn on Account 1430. That Informal Agreement is sufficient to create a security interest in favor of LSB. The perfection and priority of the security interest in

deposit accounts is governed by Iowa Code section 554.9304 and such interest is superior to the claims and powers of the Trustee.

The Court should consider the long-standing practice of banks to provide overdraft protection services for their commercial and consumer customers in the ordinary course of their banking operations and the adverse impact a ruling in favor of the Trustee would have nationwide. Overdraft protection programs are recognized as a normal banking practice in OCC Letter 1082 and in Iowa Supt. SG-2014-01 and are not recoverable as preferential transfers under Bankruptcy Code 547(b). Further, given the perfected security interests and setoff rights of banks with respect to their customers' deposit accounts, the subsequent deposits do not enable banks to receive more than what they are otherwise entitled. Finally, the practice of Agriprocessors and LSB, in this case, to receive incoming wire transfers from Agriprocessors to cover overdrafts is protected from recovery by the Trustee as the transfers occurred in the ordinary course of business or financial affairs of the parties and, in addition, made according to ordinary business terms in the banking industry.

The ABA and IBA appreciate the opportunity to present this Brief before the Court.

Dated this 21st day of July, 2016.

/s/Julie Johnson McLean

Robert A. Gamble

Julie Johnson McLean (AT#0005185)

Davis Brown Law Firm

215 10th Street, Suite 1300

Des Moines, IA 50309

Telephone: (515) 288-2500

Facsimile: (515) 243-0654

Email: [beaugamble@davisbrownlaw.com](mailto:beaugamble@davisbrownlaw.com)

[juliemclean@davisbrownlaw.com](mailto:juliemclean@davisbrownlaw.com)

CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

Certificate of Compliance with Type-Volume Limitation,  
Typeface Requirements, and Type Style Requirements

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because:

this brief contains 6,613 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because:

this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in Times New Roman in font size 14.

3. This brief has been scanned for viruses and the brief is virus-free.

DATED this 21st day of July, 2016.

/s/Julie Johnson McLean

Robert A. Gamble  
Julie Johnson McLean (AT#0005185)  
Davis Brown Law Firm  
215 10th Street, Suite 1300  
Des Moines, IA 50309  
Telephone: (515) 288-2500  
Facsimile: (515) 243-0654  
Email:  
[beaugamble@davisbrownlaw.com](mailto:beaugamble@davisbrownlaw.com)  
[juliemclean@davisbrownlaw.com](mailto:juliemclean@davisbrownlaw.com)  
ATTORNEYS FOR AMERICAN  
BANKERS ASSOCIATION AND  
IOWA BANKERS ASSOCIATION

CERTIFICATE OF SERVICE

On the 21st day of July, 2016, the undersigned served copies of the foregoing Amicus Curiae Brief to which this Certificate is attached via CM/ECF, which will send notification of such filing to the following counsel who have appeared in this case:

Dale L. Putnam  
801 Commerce Drive, Suite 1  
P.O. Box 70  
Decorah, IA 52101  
ATTORNEY FOR DEFENDANT-APPELLEE/CROSS-APPELLANT  
LUANA SAVINGS BANK

Paula L. Roby  
Dan Childers  
Nicholas J. Kilburg  
Elderkin & Pirnie, P.L.C.  
316 2nd Street, SE, Suite 124  
P.O. Box 1968  
Cedar Rapids, IA 52406-1968  
ATTORNEYS FOR PLAINTIFF-APPELLANT/CROSS-APPELLEE  
JOSEPH E. SARACHEK, CHAPTER 7 TRUSTEE

/s/Julie Johnson McLean  
Julie Johnson McLean