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*Men give me credit for some genius. All the genius I have lies in this; when I have a subject in hand, I study it profoundly. Day and night it is before me. My mind becomes pervaded with it. Then the effort that I have made is what people are pleased to call the fruit of genius. It is the fruit of labor and thought.*

- Alexander Hamilton, first Secretary of the Treasury and proponent of the first national bank and the modern monetary system

## Revisiting *American Bank & Trust v. Shaull*: New Forms Established to Protect a Lender's Security Interest in Livestock Being Cared for by a Third Party

By: Robert E. Hayes

In the May 1, 2005 edition of this newsletter, an article titled "Security Interests in Livestock Being Held by a Party Other than the Owner: How to Protect Your Collateral" discussed the implications of a 2004 South Dakota Supreme Court case, *American Bank & Trust v. Shaull*. The Court in *Shaull* grappled with a situation in which a Minnesota cattle owner, who had previously obtained financing from a Minnesota bank, executed an agreement with a South Dakota corporation to feed and care for his cattle in South Dakota. The Minnesota bank had executed a security agreement with the owner for all livestock owned or later acquired, but had not filed financing statements in South Dakota.

Claiming that the livestock were his own, the owner of the South Dakota

corporation sought and obtained financing from his local South Dakota bank. Before approving the sought-after line of credit, the South Dakota bank inspected the cattle, reviewed the corporation's financial statements and tax returns, and even conducted a records search for UCC filings. The records search revealed no filings, as neither the Minnesota owner, nor his bank, had filed the proper financing statements in South Dakota. Finding nothing out of the ordinary, the South Dakota bank extended the loan.

The South Dakota corporation, which had been feeding and caring for the Minnesota owner's cattle, subsequently went bankrupt. In an action to determine the priority of the security interests in the cattle, the South Dakota

*(continued on page 2)*

## Credit Card Litigation Update

By: Roberto A. Lange

The Davenport firm has been involved in defending several cases where credit card issuers have been sued for allegedly failing to include sufficiently clear and conspicuous disclosures required under the Fair Credit Reporting Act ("FCRA") in pre-screen solicitations. This firm also has defended lawsuits that contend that certain credit card solicitations are not "firm offers of credit," and thus

that the credit card issuer violated the FCRA by accessing a consumer credit report prior to sending a "pre-screened" application.

These two theories came together in the class action case of *Perry v. First National Bank, et al.*, a case brought in the Northern District of the District of Illinois.

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## Revisiting *American Bank & Trust v. Shaul* (continued from page 1)

Supreme Court opined that the South Dakota bank's security interest took priority over the herd's true owner and his Minnesota bank. In reaching its holding, the Court reasoned that the owner and his bank were estopped from claiming a valid security interest in the cattle, as they had failed to file UCC-1 statements in the proper state. Further, the South Dakota bank, after conducting a prudent investigation and records search, had no reason to know that the South Dakota corporation was not the true owner of the cattle, nor that the Minnesota bank had a security interest in the livestock.

In response to *Shaul*, the South Dakota Secretary of State's office has created particular forms for lenders to file in order to protect their security interest in their customer's livestock. These new forms allow a lender to more aptly safeguard itself from having its allegedly valid security interest rendered subordinate to the lien of a caretaker's lender. These forms, and instructions for completing them, are found at the South Dakota Secretary of State website: [http://www.sdsos.gov/businesservices/ucc\\_livestock\\_SIS.shtm](http://www.sdsos.gov/businesservices/ucc_livestock_SIS.shtm).

The Caretaker's Authorization form is used if a bank chooses to file a UCC record with an Effective Financing Statement (EFS). The bank should either attach the Caretaker Authorization to the EFS, or have the caretaker sign the EFS that will be filed with the Secretary of State. Effectively, the EFS will notify purchasers of farm products that they need to place the livestock owner's name on sales proceeds checks when they are purchasing livestock described in the EFS.

The new UCC-1 and UCC-3 statements are authorized by South Dakota Codified Laws section 57A-9-505, and were established to be used by anyone in the livestock business. These forms should be utilized to protect the owner's interest in livestock when the livestock are being cared for by a third party. Specifically, the new UCC-1 form and the EFS, as well as the Caretaker's Authorization, should be used whenever the debtor's livestock—the subject of the lender's security interest—will be placed in the possession of a third party for care or

feeding. Executing and filing these forms will result in creating record notice of the security interest, thereby preserving the priority of that interest.

To validly execute these new forms, there are important considerations of which to take note. First, the actual signature of the caretaker must be obtained, as this is the only way to acquire the necessary consent to file the financing statement with the caretaker as a party. In addition, it should be noted that in order to avoid the predicament addressed in *Shaul*, the prudent lender should always be conscious of where its customer's livestock are located. Moreover, the lender should be sure to file a financing statement with the Secretary of State's office of the state in which the caretaker is located, as that term is defined in SDCL 57A-9-307, and if different, the state in which the livestock are located.

Due to the recent creation of these forms, the methods for their execution and filing are not concrete. However, it is recommended that banks whose customers will be entrusting livestock to others file a financing statement establishing the caretaker as a "debtor," and the owner and his bank as "secured parties." Moreover, the filing should include language in the description of the collateral highlighting that the "secured party" is actually the owner of the livestock, and the "debtor" is merely the person or entity taking care of the livestock. This method of filing has been accepted by the South Dakota Secretary of State's office. DEHS

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## Credit Card Litigation Update (continued from page 1)

The plaintiff in *Perry*, who was represented by well-known plaintiff class-action attorney Daniel Edelman, claimed that First National Bank (a national bank located in South Dakota) had violated Section 1681m(d) of the FCRA by not notifying pre-screened applicants in a more clear and conspicuous manner of their ability to avoid or opt out of such solicitations. The plaintiff also attempted to amend her Complaint to assert that the sub-prime credit card offering was not a “firm offer of credit” and that the Bank thus had violated the FCRA by accessing her credit information as a part of the pre-screened process. The firm representing the plaintiff had convinced the Seventh Circuit earlier in *Cole v. U.S. Capital*, 389 F.3d 719 (7<sup>th</sup> Cir. 2004), that a lending institution sending a credit card application to “pre-screened” individuals had not made a firm offer of credit, in part because the card was useable only in the purchase of automobiles. The plaintiff’s argument in *Perry v. First National Bank* sought to extend the holding in *Cole* into the sub-prime credit card realm.

The District Court judge in *Perry* granted summary judgment to the defendant, First National Bank, on the original “inconspicuous pre-screened notice” claim and refused to permit the plaintiff to add the additional “no firm offer of credit” claim. A three judge panel of the United States Court of Appeals for the Seventh Circuit upheld the ruling of the District Court in full. First, the Seventh Circuit determined that the Fair and Accurate Credit Transaction Act (“FACTA”), which amended the FCRA, had indeed eliminated private rights of action to enforce FCRA Section 1681m concerning the clear and conspicuous disclosure of opting out of pre-screen solicitations. Thus, despite the plaintiff’s arguments that the Bank had improperly buried the opt out provisions in the terms and conditions and had not referenced the opt out rights in the solicitation letter, the Seventh Circuit determined there to be no private right of action under FCRA Section 1681m for not having a more clear and conspicuous disclosure.

The Seventh Circuit also rejected plaintiff’s argument for extension of the *Cole* decision into the sub-prime credit card market. The Seventh Circuit recognized

that, notwithstanding heavy front end fees and a high interest rate, a solicitation for a sub-prime credit card is a “firm offer of credit.” The Seventh Circuit noted that its decision in *Cole* identified three factors demonstrating that the offer of credit there was a “sham” and not a firm offer: 1) it was unclear that credit approval was guaranteed; 2) the precise rate of credit and other materials terms were not included in the solicitation; and 3) the credit card limit of \$300 was relatively small and could be used only toward a vehicle purchase at particular car dealership. The Seventh Circuit noted that the credit limit involved in the *Perry* case was similarly small, but that the pre-approval status was both disclosed and defined and that the interest rate for the credit card was stated in the Term and Conditions brochure sent with the credit solicitation. Notwithstanding the credit limit of \$300 where, after fees, arguably only \$75 of effective credit existed, the Seventh Circuit recognized that the credit card was useful to establish credit for first time credit card users or those with blemished credit histories. The card also was useable at a variety of businesses and, if the card holder had paid off the card each month, could allow purchases up to \$3,000 in any one year.

One of the three members of the Seventh Circuit panel in *Perry* dissented and wrote specially to advocate extension of the *Cole* decision to sub-prime credit cards. With the decision of the Seventh Circuit being by a two to one vote, the plaintiffs have petitioned for rehearing of the case en banc before all of the judges of the Seventh Circuit. The Seventh Circuit has not yet ruled on the request for rehearing en banc. If the Seventh Circuit opinion stands, as we expect it will, the precedent will control all cases throughout the Seventh Circuit and should be persuasive to other federal circuit courts. The *Perry* case thus held that Section 1681m of the FCRA, in light of FACTA, does not extend a private right of action, and sub-prime credit card offerings do constitute “firm offers of credit” such that credit bureau information may be accessed prior to sending solicitations to prospective cardholders. DEHS

## U.S. Supreme Court Sets Broad Parameters for Retaliation Claims: Don't Turn a Bad Discrimination Case into a Good Retaliation Case

In *Burlington Northern v. White*, 126 S.Ct. 2405 (June 22, 2006), the US Supreme Court significantly expanded the parameters of the types of conduct that can constitute retaliation against an employee under the Federal anti-discrimination laws. The retaliation protection extends to an employee who has filed or participated in an investigation into an allegation of discrimination, including an allegation of harassment/hostile work environment. The Court

concluded that any conduct that is materially adverse to a reasonable employee and would dissuade others from filing a charge of discrimination is sufficient to constitute actionable retaliation. The Court also recognized that conduct that causes harm outside of the workplace may be considered retaliatory. The Court held that context matters - the significance of any claimed act of retaliation will depend upon the circumstances of each case. While recognizing that petty slights or mi-

nor annoyances will not create sufficient deterrence, the Court stated that if the conduct is harmful to the point that the actions could dissuade a reasonable worker from making a claim, a jury will be permitted to decide if the conduct was retaliatory. Employers must carefully monitor post-allegation treatment of employees so as to avoid turning a bad case of discrimination into a good case of retaliation. DEHS

## Reminder: Importance of Employee Handbooks and Annual Review

Entities with employees in South Dakota, regardless of size, are governed by the South Dakota Human Relations Act which prohibits discrimination in the workplace. Various Federal anti-discrimination and leave laws may also apply, depending upon the size of your workforce. Therefore, it is recommended, at a minimum, that all entities have a policy addressing discrimination, including workplace harassment. With the continued technological advancements and resulting changes in the workplace, an electronic communications policy should also be considered. These and other policies should be reviewed annually to ensure compliance with the law and to afford corporations the greatest protection against claims by employees. We have a number of experienced employment lawyers who can help you with this task as well as assist you with any employment-related questions you may have. Please feel free to contact Sue Simons (357-1263) or Jean Bender (357-1224) for assistance with compliance in the area of employment law. DEHS

## Reminder: Employees are Protected Against Discrimination, Including Termination, Based "Solely" on the Filing of Bankruptcy

The Bankruptcy Code, 11 U.S.C. §525(b) provides that "[n]o private employer may terminate the employment of, or discriminate with respect to employment against, an individual who is or has been a debtor under this title, a debtor or bankrupt under the Bankruptcy Act, or an individual associated with such a debtor or bankrupt, solely because such debtor or bankrupt - (1) is or has been a debtor under this title or a debtor or bankrupt under the Bankruptcy Act; (2) has been insolvent before the commencement of a case under this title or during the case but before the grant or denial of a discharge; or (3) has not paid a debt that is dischargeable in a case under this title or that was discharged under the Bankruptcy Act."

Despite being enacted in 1984, there remains very little case law addressing this provision. The historical notes following the statute state that the "prohibition extends only to discrimination or other action based solely on the basis of the bankruptcy . . . . It does not prohibit consideration of other factors, such as the future financial responsibility or ability, and does not prohibit impositions of requirements such as net capital rules, if not applied non-discriminatorily." Despite the language and historical notes, at least one court has liberally construed the term "solely" to mean that the bankruptcy "played a significant role" or "but for" the filing of the bankruptcy, the action would not have been taken. Others have concluded that "solely"

means exactly what it says; the bankruptcy or discharge of debt is the *sole reason* for the actions taken against the individual. There is also a split of judicial authority on whether the act extends to hiring decisions or is limited to treatment post-hire. Remedies for violations have included reinstatement, back pay and in one case, compensatory damages for emotional distress.

In light of the above, any employment decision where bankruptcy is a part of the factual background, it is best to consult with legal counsel to review whether 11 U.S.C. §525(b) applies. DEHS

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## IRS Extends Amendment Deadline for Deferred Compensation Plans

By: Jean Hagerty Bender and Robert L. Thomas

On October 4, 2006, the IRS announced that it is further extending the transition period for nonqualified deferred compensation (“NQDC”) arrangements to come into compliance with the requirements of Internal Revenue Code Section 409A, which was added by the 2004 American Jobs Creation Act. Under the proposed regulations published almost a year ago, plans were to be amended to come into compliance with Code Section 409A no later than December 31, 2006. In order to allow sufficient time for taxpayers to analyze the final regulations and come into compliance, the effective date for the regulations is expected to be January 1, 2008. Therefore, the IRS has provided additional transition relief through December 31, 2007.

A NQDC plan is any plan that provides for the deferral of compensation other than tax qualified retirement plans (such as a 401(k) Plan) or any bona fide vacation leave, sick leave, compensatory time, disability pay or death benefit plans. Therefore, NQDC plans include stock appreciation rights plans (SARs), phantom stock arrangements, and other similar employer equity participation arrangements. Under Code Section 409A, all amounts deferred under a nonqualified deferred compensation (“NQDC”) plan are currently includable in gross income to the extent not subject to a substantial risk of forfeiture, unless the plan: (1) meets the distribution, acceleration of benefits and election requirements under Code Section 409A; and (2) is operated in accordance with those requirements.

If an NQDC plan is not in compliance with Code Section 409A rules at any time during a tax year, all amounts deferred under the plan for that tax year and all preceding tax years will be included in the participant’s gross income for that year to the extent not subject to a substantial risk of forfeiture and not previously included in gross income. The amount included in income is also subject to: (1) interest at the underpayment rate plus one percentage point on the amount that should have been included in income for the first tax year when deferred or, if later, the first taxable year in which such deferred compen-

sation was not subject to a substantial risk of forfeiture; and (2) additional income tax equal to 20% of the compensation required to be included in gross income.

In general, the IRS has now extended transitional relief through December 31, 2007 if the plan is operated in good faith compliance and is amended to reflect the final regulations by December 31, 2007. A plan is deemed to be operated in good faith compliance if operated in accordance with published guidance, including the proposed regulations. A plan will not be deemed to be operated in good faith compliance if discretion provided under the terms of the plan is exercised in a manner that causes the plan to fail to meet the requirements of Section 409A.

The transition relief also allows NQDC plans to provide for new payment elections, with respect to both time and form of payment, through December 31, 2007. The preamble to the proposed regulations permitted such changes in 2006 if the payments were not otherwise payable in 2006 and the election would not cause the payment to be made in 2006. This rule is extended to apply to elections and amendments made in 2007, with a comparable restriction on changes that would affect the timing of a payment relative to 2007 (i.e., an election in 2007 cannot defer an amount otherwise payable in 2007 or accelerate an amount not payable into 2007). DEHS

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Davenport, Evans, Hurwitz & Smith, LLP was founded in 1939. Since that time, the firm has grown steadily and is now one of the largest firms in South Dakota. For more than fifty years, the firm has assisted clients in banking and financial services matters. The firm acts as counsel to many South Dakota banks, financial institutions, and holding companies. Davenport, Evans also regularly acts as counsel to businesses who contract with banks, including various servicing and marketing firms.

The firm handles all aspects of banking law, from entity formation, acquisitions, and branching to operational issues involving lending, compliance, creditors' rights, payment processing (check, ACH, wire transfer), general commercial law, and trust administration. The firm represents banks in all phases of state and federal banking regulation and deals extensively with state and federal banking regulators. The firm understands that keeping up with new regulatory developments is a major challenge for banks today and helps its clients respond to that challenge effectively and efficiently.

South Dakota has become a major center for financial services, with approximately a half dozen credit card processing centers located in the Sioux Falls area alone. The firm has served as counsel to many of these entities and has particular experience and expertise in the areas of credit card and stored value card issuance, compliance, and receivables securitization.

The firm also represents its bank clients in bankruptcy matters and complex mediations, foreclosures, and commercial litigation on a regular basis. Davenport, Evans often acts as counsel to lenders in loan workouts and bankruptcy cases filed in South Dakota. The firm's banking and financial services lawyers, together with the firm's strong litigation practitioners, also handle commercial litigation such as bank shareholder disputes, complex lender liability cases, bank-marketer disputes, federal compliance cases, employment disputes and many other litigation cases. Our employment law attorneys assist clients with personnel issues and discrimination claims while our benefits lawyers develop both qualified and non-qualified benefit and retirement plans.

Numerous out-of-state and nationwide lenders also retain the firm for review of loan documents, compliance with state and federal law, and assistance in completing major real estate and commercial loans. The firm also assists out of state individuals and entities in the formation and operation of trust companies.

If you have any questions or desire assistance on any matter, please feel free to contact us at your convenience.

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