STATE OF NORTH DAKOTA

ATTORNEY GENERAL'S OPINION 93-F-20

Date issued: November 17, 1993

Requested by: Jeanne L. McLean, Bottineau County State's Attorney

- QUESTION PRESENTED -

Whether a bank may exercise an otherwise valid right of setoff against a judgment debtor's account after having been served with a notice of levy by a county sheriff on behalf of a state judgment creditor.

- ATTORNEY GENERAL'S OPINION -

It is my opinion that a bank may exercise an otherwise valid right of setoff against a judgment debtor's account after having been served with a notice of levy by a county sheriff on behalf of a state judgment creditor, to the same extent as such setoff could have been exercised against the judgment debtor's account in the absence of such levy.

- ANALYSIS -

A bank's right to setoff is regulated by statute. See N.D.C.C. ? 6-03-67. Setoff is typically prohibited unless done pursuant to legal process or at the consent of the depositor. Id. Generally, for a bank to have a right of setoff, the funds to be setoff must be the property of the debtor, the funds must be deposited without restriction and must not be special funds, the existing indebtedness must be due and owing, and there must be mutuality of obligation between the debtor and creditor, as well as between the debt and the funds deposited. See e.g., Spratt v. Security Bank of Buffalo, Wyo., 654 P.2d 130, 136 (Wyo. 1982); Federal Deposit Ins. Corp. v. Pioneer State Bank, 382 A.2d 958 (N.J. Super. Ct. App. Div. 1977).

A bank's right of setoff typically emanates from a depositor's execution of a signature card or other agreement authorizing the bank, as a matter of contract, to charge or setoff against any deposits of the depositor for any debt or obligation owed to the bank. See Biby v. Union Nat'l Bank of Minot, 162 N.W.2d 376; Clairmont v. State Bank of Burleigh County Trust Co., 295 N.W.2d 154 (N.D. 1980).

No North Dakota cases were found which specifically address the issued presented. The general rule is that a bank may exercise a right of setoff at or after the time a sheriff has levied on an account.

The general rule is premised on the principle that a judgment creditor merely steps into the shoes of the judgment debtor and is subject to the claims and defenses that could have been asserted against the judgment debtor by the bank. See Wenneker v. Physicians Multispecialty Group, Inc., 814 S.W.2d 294 (Mo. 1991); Victor Werlhof Aviation Ins. v. Garlick, 771 P.2d 962 (Mont. 1989); Killette v. Raemell's Sewing Apparel, Inc., 377 S.E.2d 73 (N.C. App. 1989); Pittsburgh Nat'l Bank v. United States, 657 F.2d 36 (3d Cir. 1981); Industrial Comm'r v. Five Corners Tavern, Inc., 399 N.E.2d 1005, 1008 (N.Y. 1979). For example, in Killette v. Raemell's Sewing Apparel, Inc., 377 S.E.2d at 74, the court held that the bank could exercise its right of setoff against the deposits of its depositor for any matured debt the depositor owed it and that the right could be exercised at any time including the time when a bank is served with the notice of levy or attachment.

Similarly, in Victor Werlhof Aviation Ins. v. Garlick, 771 P.2d at 963, the court determined that a bank otherwise lawfully entitled to a setoff may exercise the right against the depositor's account at the same time it is presented with a writ of execution seeking to levy upon the account. The court noted that the bank recorded the setoff in its records on the date the writ was presented, executed a response to the sheriff claiming the setoff and furnished an affidavit substantiating the facts of its setoff claim. Id. at 965. The court stated "[a]s to a would-be executing judgment creditor, the setoff is accomplished when the Bank takes positive steps to claim its right, by entering evidence of the setoff in its own records, and then possibly giving other written notice of its action." Id. The court further noted that

> [a] judgment creditor seeking attachment or execution of a judgment debtor's property in the possession of a third party stands in the shoes of the judgment debtor as far as the rights of the third party are concerned. Thus, it is stated in General Elec. Credit Corp. v. Tarr (W.D. Pa. 1978) 457 F.Supp. 935, 938:
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> > The service of attachment execution has the effect of an equitable assignment of the thing attached. It puts the garnishee in the relation to the attaching

> creditor which he had sustained to his former creditor. He may make the same defense to the attachment by evidence of set off or of other equities that he might have made if sued by his original creditor.

Here the Bank could have asserted its right of setoff against any claim of Garlick to his checking account at the time of the presentation of the writ of execution. The judgment creditor, Victor Werloff Aviation Insurance, had no greater right against the Bank than did Garlick at that time. Therefore, the writ did not take precedence over the right of setoff. We hold the setoff here could be asserted by the Bank at the time it was presented with the execution writ.

Id.

Likewise, the court in Industrial Comm'r v. Five Corners Tavern, Inc., 393 N.E.2d at 1008, determined that a depository bank's statutory right of setoff is not extinguished by service of a state tax compliance agent's statutory levy. The court noted that

> [t]o hold, as the courts below did, that this right terminates upon levy by service of execution not only contravenes legislative intent, but, also, ignores the realities of everyday practice regarding executions generally, and would work to nullify a garnishee's right to setoff after issuance of execution the very benefit which section 151 of the Debtor and Creditor Law bestows. This is so because, in most instances, the garnishee bank's first effective notice of the issuance of execution occurs only upon service. . . . Thus, to limit the availability of section 151 to garnishees only to that time at which a copy of the execution is served would work to deprive a garnishee of its opportunity to assert its right of set-off . . .

Id.

However, there are two major exceptions to the general rule. The first exception is that a bank may not assert its right of setoff after the attaching of a federal tax lien or delivery of a notice of levy for federal taxes. See Texas Commerce Bank - Fort Worth, N.A. v. United States, 896 F.2d 152 (5th Cir. 1990). See also United

States v. Cache Valley Bank, 866 F.2d 1242 (10th Cir. 1989); State Bank of Fraser v. United States, 861 F.2d 954 (6th Cir. 1988); United States v. Bell Credit Union, 860 F.2d 365 (10th Cir. 1988). The second exception is that a bank may not assert its right of setoff in bankruptcy proceedings without court approval once the petition is filed because to do so would be a violation of the automatic stay provision. See U.S.C. ? 362(a)(7). See also In re Voight, 24 B.R. 983 (Bankr. N.D. Tex. 1982); In re Mealey, 16 B.R. 800 (Bankr. E.D. Pa. 1982).

When faced with this issue in 1986, former Attorney General Nicholas J. Spaeth opined, based primarily on former N.D.C.C. ? 41-04-28.1 (which required a financial institution to provide immediate notice to its depositor when a setoff action was taken) that a financial institution must take affirmative steps to exercise its right of setoff and, consequently, limited the bank's ability to exercise that right. However, N.D.C.C. ? 41-04-28.1 was repealed in 1991. See 1991 N.D. Sess. Laws ch. 448. Because this requirement no longer exists, there is little substantive support for the proposition that North Dakota would depart from the majority rule.

Based on the foregoing, it is my opinion that a state judgment creditor levying against funds held by a bank stands in the shoes of the judgment debtor with respect to any rights to the deposited funds. If the bank had an otherwise valid claim or defense of setoff against the judgment debtor, the bank similarly can assert such a claim of defense or setoff against the levy of the judgment creditor. It is my further opinion that the bank can raise the claim of setoff against the levy of the judgment creditor at any time it could have raised the claim of setoff against the judgment debtor. Consequently, a bank may claim an otherwise valid setoff at or after the time it is served with a notice of levy by a judgment creditor, to the same extent such setoff could have been raised against the judgment debtor's account in the absence of such levy.

To the extent that the April 30, 1986, letter from Attorney General Nicholas J. Spaeth to Barnes County State's Attorney Carol S. Nelson is inconsistent with this opinion, it is so modified.

- EFFECT -

This opinion is issued pursuant to N.D.C.C. ? 54-12-01. It governs the actions of public officials until such time as the question presented is decided by the courts.

ATTORNEY GENERAL'S OPINION 93-20
November 17, 1993

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