

# Pratt's Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT®

JUNE 2018

**EDITOR'S NOTE: A SUPREME RULING ... AND MUCH MORE!**

Steven A. Meyerowitz

**U.S. SUPREME COURT CLARIFIES SCOPE OF SECURITIES  
SAFE HARBOR**

Stuart I. Gordon and Matthew V. Spero

**CYBERSECURITY AND POTENTIAL HEALTHCARE BANKRUPTCY:  
THE CONTINUING INTERSECTION OF DATA AND DISASTER**

Leslie A. Berkoff and Stephen Breidenbach

**NINTH CIRCUIT HOLDS THAT JOINT PLAN COVERING MULTIPLE  
DEBTORS MUST BE APPROVED BY ONLY ONE IMPAIRED CLASS  
PER PLAN, NOT ONE IMPAIRED CLASS PER DEBTOR**

Paul M. Basta, Alan W. Kornberg, and Brian S. Hermann

**NEW YORK BANKRUPTCY COURTS GRAPPLE WITH TERRITORIAL  
LIMITS OF U.S. BANKRUPTCY CODE**

Rick Antonoff, Michael B. Schaedle, Bryan J. Hall, and Matthew E. Kaslow

**P.O.D. ACCOUNTS RESTRICTING BANK'S RIGHT OF SETOFF**

Sara McNamara and James A. Sheriff

**IRS PROVIDES SAFE HARBOR VALUATION METHODS FOR  
TAX-FREE REORGANIZATIONS**

John K. Sweet, L. Wayne Pressgrove, Jr., Abraham N.M. Shashy, Jr.,  
Jonathan Talansky, Robert Beard, and John G. Green, Jr.

**THE NEW TAX CUTS AND JOBS ACT—IMPLICATIONS FOR  
LOAN MARKETS**

Eschi Rahimi-Laridjani and Andrew R. Walker



LexisNexis

# Pratt's Journal of Bankruptcy Law

---

VOLUME 14

NUMBER 4

JUNE 2018

---

<b>Editor's Note: A Supreme Ruling . . . and Much More!</b> Steven A. Meyerowitz	155
<b>U.S. Supreme Court Clarifies Scope of Securities Safe Harbor</b> Stuart I. Gordon and Matthew V. Spero	158
<b>Cybersecurity and Potential Healthcare Bankruptcy: The Continuing Intersection of Data and Disaster</b> Leslie A. Berkoff and Stephen Breidenbach	163
<b>Ninth Circuit Holds That Joint Plan Covering Multiple Debtors Must Be Approved by Only One Impaired Class Per Plan, Not One Impaired Class Per Debtor</b> Paul M. Basta, Alan W. Kornberg, and Brian S. Hermann	181
<b>New York Bankruptcy Courts Grapple with Territorial Limits of U.S. Bankruptcy Code</b> Rick Antonoff, Michael B. Schaedle, Bryan J. Hall, and Matthew E. Kaslow	185
<b>P.O.D. Accounts Restricting Bank's Right of Setoff</b> Sara McNamara and James A. Sheriff	192
<b>IRS Provides Safe Harbor Valuation Methods for Tax-Free Reorganizations</b> John K. Sweet, L. Wayne Pressgrove, Jr., Abraham N.M. Shashy, Jr., Jonathan Talansky, Robert Beard, and John G. Green, Jr.	196
<b>The New Tax Cuts and Jobs Act—Implications for Loan Markets</b> Eschi Rahimi-Laridjani and Andrew R. Walker	199

**QUESTIONS ABOUT THIS PUBLICATION?**

---

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:

Kent K. B. Hanson, J.D., at ..... 415-908-3207

Email: ..... kent.hanson@lexisnexis.com

Outside the United States and Canada, please call ..... (973) 820-2000

For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at ..... (800) 833-9844

Outside the United States and Canada, please call ..... (518) 487-3385

Fax Number ..... (800) 828-8341

Customer Service Website ..... <http://www.lexisnexis.com/custserv/>

For information on other Matthew Bender publications, please call

Your account manager or ..... (800) 223-1940

Outside the United States and Canada, please call ..... (937) 247-0293

---

Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)

ISBN: 978-0-7698-7988-8 (eBook)

ISSN: 1931-6992

Cite this publication as:

[author name], [*article title*], [vol. no.] PRATT’S JOURNAL OF BANKRUPTCY LAW [page number] ([year])

**Example:** Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the “Rescue and Recovery” Culture for Business Recovery*, 10 PRATT’S JOURNAL OF BANKRUPTCY LAW 349 (2014)

This publication is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis and the Knowledge Burst logo are registered trademarks of Reed Elsevier Properties Inc., used under license. A.S. Pratt is a registered trademark of Reed Elsevier Properties SA, used under license.

Copyright © 2018 Reed Elsevier Properties SA, used under license by Matthew Bender & Company, Inc. All Rights Reserved.

No copyright is claimed by LexisNexis, Matthew Bender & Company, Inc., or Reed Elsevier Properties SA, in the text of statutes, regulations, and excerpts from court opinions quoted within this work. Permission to copy material may be licensed for a fee from the Copyright Clearance Center, 222 Rosewood Drive, Danvers, Mass. 01923, telephone (978) 750-8400.

*An A.S. Pratt® Publication*

Editorial Office  
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862  
[www.lexisnexis.com](http://www.lexisnexis.com)

MATTHEW  BENDER

# *Editor-in-Chief, Editor & Board of Editors*

---

**EDITOR-IN-CHIEF**

**STEVEN A. MEYEROWITZ**

*President, Meyerowitz Communications Inc.*

**EDITOR**

**VICTORIA PRUSSEN SPEARS**

*Senior Vice President, Meyerowitz Communications Inc.*

**BOARD OF EDITORS**

**SCOTT L. BAENA**

*Bilzin Sumberg Baena Price & Axelrod LLP*

**LESLIE A. BERKOFF**

*Moritt Hock & Hamroff LLP*

**TED A. BERKOWITZ**

*Farrell Fritz, P.C.*

**ANDREW P. BROZMAN**

*Clifford Chance US LLP*

**MICHAEL L. COOK**

*Schulte Roth & Zabel LLP*

**MARK G. DOUGLAS**

*Jones Day*

**MARK J. FRIEDMAN**

*DLA Piper*

**STUART I. GORDON**

*Rivkin Radler LLP*

**PATRICK E. MEARS**

*Barnes & Thornburg LLP*

**DERYCK A. PALMER**

*Pillsbury Winthrop Shaw Pittman LLP*

PRATT'S JOURNAL OF BANKRUPTCY LAW is published eight times a year by Matthew Bender & Company, Inc. Copyright 2018 Reed Elsevier Properties SA., used under license by Matthew Bender & Company, Inc. All rights reserved. No part of this journal may be reproduced in any form—by microfilm, xerography, or otherwise—or incorporated into any information retrieval system without the written permission of the copyright owner. For permission to photocopy or use material electronically from *Pratt's Journal of Bankruptcy Law*, please access [www.copyright.com](http://www.copyright.com) or contact the Copyright Clearance Center, Inc. (CCC), 222 Rosewood Drive, Danvers, MA 01923, 978-750-8400. CCC is a not-for-profit organization that provides licenses and registration for a variety of users. For subscription information and customer service, call 1-800-833-9844.

Direct any editorial inquires and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway, No. 18R, Floral Park, NY 11005, [smeyerowitz@meyerowitzcommunications.com](mailto:smeyerowitz@meyerowitzcommunications.com), 646.539.8300. Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher. POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, Attn: Customer Service, 9443 Springboro Pike, Miamisburg, OH 45342-9907.

# P.O.D. Accounts Restricting Bank's Right of Setoff

*By Sara McNamara and James A. Sheriff*

*"Payable on death" accounts are an increasingly common estate planning tool used by many individuals to avoid the hassle and expense of probate. The authors of this article discuss the issue of whether a bank has a right to setoff against these accounts if a deceased account holder owed the bank money.*

Banks generally have a right of setoff against funds they maintain on deposit in a customer's account that can be used to satisfy any obligations owed to the bank by that customer. This setoff right might come from common law or from a contractual provision in a deposit account agreement or other contract. There are few limits on a bank's right of setoff other than "mutuality of obligation," the result being that lenders are comfortable when individual debtors have accounts with substantial balances at the bank. While some banks may try to take a pledge and security interest in the deposit account, that is often not the case.

## **PAYABLE ON DEATH ACCOUNTS**

However, as evidenced by the cases described below, and by legislation enacted in Oklahoma and Texas, there is one type of deposit account that can pose a major issue for a bank seeking repayment of a loan following the death of a customer. "Payable on death" accounts, commonly known as "P.O.D. Accounts," are an increasingly common estate planning tool used by many individuals to avoid the hassle and expense of probate. Most state laws permit the designation of a deposit account as a P.O.D. Account. When a P.O.D. Account owner dies, the funds in the account transfer without probate to the P.O.D. beneficiary. A P.O.D. beneficiary designation is absolute; even if a will or living trust of the decedent gives the decedent's assets to a different beneficiary.<sup>1</sup> The funds in the P.O.D. Account go to the beneficiary named on

---

\* Sara McNamara is an associate in Reinhart Boerner Van Deuren s.c.'s Banking/Bankruptcy Practice providing clients with general legal counsel in relation to corporate governance, capital formation, mergers and acquisitions, asset sales and purchases, and finance transactions, as well as bankruptcy proceedings, receiverships, and workouts. James A. Sheriff is a shareholder in the firm's Financial Institutions and Banking and Finance groups representing banking organizations of all sizes on a wide variety of matters. The authors may be reached at [smcnamara@reinhartlaw.com](mailto:smcnamara@reinhartlaw.com) and [jsheff@reinhartlaw.com](mailto:jsheff@reinhartlaw.com), respectively.

<sup>1</sup> Wis. Stat. § 705.04(3).

the P.O.D. Account, and not to the decedent's estate, unless the decedent's estate is designated as the P.O.D. beneficiary.

### **DOES A BANK HAVE A RIGHT TO SETOFF?**

What if the deceased account holder owed the bank money? While a bank may think that its right of setoff applies before the money in the account is paid to the P.O.D beneficiary, in Wisconsin, that thought would be incorrect. Any money in the P.O.D. account is transferred by right to the beneficiary immediately upon the death of the account holder, eliminating any right the bank had to setoff, since there is no longer the required "mutuality of obligation" between the parties. For example, consider a situation where Holder A has a P.O.D. account that contains \$250,000 and also has \$100,000 outstanding on a personal unsecured loan from the same bank. When Holder A dies, the bank loses all right of setoff and the \$250,000 immediately becomes the property of the P.O.D. beneficiary. The bank then is stuck with only one option; it must go after Holder A's estate for the money due under the loan. If there is no estate, the bank could lose completely.

This situation is not just theoretical. In 2010, the Wisconsin Supreme Court held that P.O.D. Accounts passed to the named beneficiary upon the decedent's death, free of estate tax. In this case, a P.O.D. beneficiary received almost \$4,000,000 upon the death of the P.O.D. Account holder, and, as intended, the money bypassed the estate. The estate sued the beneficiary for reimbursement of federal and estate taxes generated by the P.O.D. account, but the Court found that obligation to pay the estate taxes fell solely on the estate. In other words, the decedent's estate was required to pay all estate tax due upon the decedent's death, including estate tax attributable to the P.O.D. Accounts.<sup>2</sup>

### **THE LAW IN SOME OTHER STATES**

As you can imagine, P.O.D Accounts are increasingly being used by estate planners to increase the money that goes to their client's beneficiaries and reduce the difficulties and costs of probate. Although an unintended consequence, this planning strategy is leaving creditors vulnerable and exposed, as they likely expected to be repaid from the funds on deposit. Some states, such as Texas, Ohio, and Oklahoma, have taken measures to protect lenders in these types of situations as more fully described below. We expect that other states would be responsive to state financial institution lobbies requesting changes to

---

<sup>2</sup> *Estate of Sheppard ex rel. McMorrow v. Schleis*, 2010 WI 32, 324 Wis. 2d 41, 782 N.W.2d 85.

their deposit account laws to protect depository institutions that allow their customer's to open and designate P.O.D. Accounts.

At the request of the state bankers' association, Texas enacted a statute that allows banks to setoff against a P.O.D. Account the amount due under a loan, prior to the payout of any account balance to the P.O.D beneficiary.<sup>3</sup> Additionally, Oklahoma enacted a statute that requires any party with a secured interest in a P.O.D Account to be paid off before the money goes to the beneficiary.<sup>4</sup>

Although not a legislative change, the Ohio Supreme Court previously held that a bank had a right to exercise setoff before paying the P.O.D. beneficiary when the owner of a P.O.D Certificate of Deposit pledged such Certificate as collateral for a loan. The court reasoned that the beneficiary's interest was only as great as the account holder's interest. Since the account holder's interest was subject to the bank's rights to collateral, the beneficiary's interest was also subject to that right.<sup>5</sup>

## WISCONSIN LAW

Unfortunately, Wisconsin has yet to provide any assistance to lenders on this issue. Chapter 705 of the Wisconsin Statutes, which includes coverage of P.O.D. Accounts and "how they work," makes no concessions. Ideally, Wisconsin would consider a statute similar to Texas and Oklahoma that assures that bank lenders can protect their interests before a P.O.D. beneficiary can take his or her stake of the account funds at the time of death.

## CONCLUSION

Banks need to be vigilant and consider how P.O.D. Accounts will affect its security in, or repayment of, their loans. While almost all deposit account agreements contain provisions on a bank's right of setoff, few have included provisions that contemplate the issues identified in this article. Further, banks rarely require binding pledges or grants of security interests for their deposit customers. However, some of the larger money-center banks are already hedging against this risk in their agreements. For example, a large, well-known bank has a provision in its agreement that states:

[W]e are authorized to exercise our right of setoff or security interest

---

<sup>3</sup> Tex. Est. Code, § 113.210.

<sup>4</sup> Okla. Stat. tit. 6, § 901.

<sup>5</sup> *Jamison v. Soc'y Nat'l. Bank*, 66 Ohio St. 3d 201, 611 N.E.2d 307, 309 (Ohio 1993).



rights against the funds credited to your balance after your death. We have these rights even if a "payable on death" payee has rights to the account.

However, without judicial guidance, it is unclear whether such a provision in an account agreement can trump the provisions of existing state law. Even so, this is a provision that every bank should consider including in its deposit account agreements. As estate planners increase their use of P.O.D. Accounts as a strategic tool, banks may be left with a false sense of security and uncollectible loans.