Case Note: Stopping Payment on Bank Checks

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the borrower failed to qualify for the original loan product but other loan products are available, the borrower could request a new GFE. This appears similar to a "counter-offer" procedure under Federal Reserve Board Regulation B.

B. Borrower Fails to Lock-In the Interest Rate

If the borrower qualifies for the loan but fails to lock-in the interest rate on which the GFE was based within the specified time period, the loan originator can provide the borrower with an amended GFE at the time the borrower does lock in the rate, if it is different from the original quoted rate. In this situation, the amended GFE must identify those categories of charges that have changed as a result of the interest rate and could not include any increases in cost categories that are not dependent on the interest rate.

XXI. Revision of HUD-1/1A and Appendix A Instructions to Reflect Revised GFE

The Proposal’s changes to the GFE are also incorporated into the HUD-1 and HUD-1A. However, the HUD-1 has not been revised so that the listing of settlement charges is comparable to the revised GFE format that consolidates certain charges into major settlement cost categories. HUD took this approach because it believes the HUD-1 is well accepted as a listing of settlement charges by industry and consumers alike, and HUD is reluctant to change the form unnecessarily. HUD has proposed minor revisions to the HUD-1 instructions to assist borrowers in comparing the new GFE to the current HUD-1 format. Note that the HUD-1A may not be used where there is a lender payment to the borrower based on the transaction, including any payments based on a higher rate.

XXII. Clarification on Volume Discounts

The Proposal clarifies that any discounts negotiated among settlement service providers, packagers, or any other entities for settlement services do not violate RESPA section 8’s prohibition on unearned fees, so long as the entire discounted price is charged to the borrower and reported as part of the total charge as appropriate. This rule (which is a clarification of a rule many thought applied already) does not apply to volume discounts paid for services in connection with a GMP. In a GMP, the safe harbor exemption applies to exchanges of things of value, regardless of whether any of the discount is passed through to the borrower.

XXIII. Other Parts of the Rule

HUD also announced that it will finalize the 1997 RESPA section 6 transfer of servicing proposed rule. In the meantime, the statutory language of RESPA section 6 (which was amended in 1990 to relax some of the disclosure requirements in the servicing transfer disclosure), may be provided in conjunction with the GFE.

HUD also announced in the preamble to the Proposal that, separate from this rulemaking, the Secretary of HUD is increasing the resources devoted to enforcing and regulating RESPA.

[Appendices to this article follow on pages 22-25.]

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The 1990 revisions to the uniform text of Uniform Commercial Code Article 3 include two new provisions dealing with “stopping payment” on a cashier’s check, or on other bank check (e.g., a teller’s check, certified check, or the similar “official” checks issued by some banks). See sections 3-312 (allowing a customer to claim a refund for a lost, destroyed, or stolen bank check) and 3-411 (governing a bank’s liability for wrongful dishonor of a bank check); see also section 3-104 (definitions of various types of bank checks).

Banks have generally welcomed the straightforward system of liability rules at section 3-411, which is consistent with the rest of Article 3 and rejects alternative cases like Hotel Riviera v. First Nat. Bank and Trust Co. of Oklahoma City. But bankers have sometimes expressed concern over section 3-312, recognizing the risk that it could require the bank to refund a cashier’s check that is later presented for payment by a party entitled to enforce the instrument.

These issues were recently brought into focus by Estate of Swidrow v. Kochkowski,1 intriguingly arising in a state that has not adopted the 1990 Article 3 revisions and therefore does not have sections 3-312 and 3-411. This case sheds light on some of the risks that bankers have feared, both under prior law and the 1990 revisions. The facts are simplified below in order to focus on the legal issues.

In Swidrow there was a joint bank account in the names of an uncle and his niece. The niece withdrew most of the funds and was issued two bank checks. Later the uncle arrived at the bank, claimed that the bank checks were never “endorsed, cashed…or delivered to any person,” and demanded a refund. He also claimed that “[i]n no other person except [the uncle] is entitled to the…check.”

Though as noted New York does not have section 3-312, the bank followed a somewhat similar

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been pointed out that if something like the Bankruptcy Reform Act is enacted, debtors may use Chapter 13 more frequently in order to force the creditor to "take back" collateral (or alternatively accept cram-down) with respect to loans on which the debtor owes more than the collateral is worth. This case is an example of how it is done. But even under current law there are limits as to how far the debtor can go. The White court refused to allow the plan to set how much the creditor would realize on the collateral if it was returned, or how it would be resold, although the method of sale will affect the sales price and the size of the creditor's unsecured claim for a deficiency.

In 're Adkins' is similarly interesting. In this Chapter 13 case, the secured creditor obtained relief from the automatic stay to permit foreclosure on collateral after the debtor had defaulted on the plan. The plan provided that the creditor would be paid a certain amount as a secured creditor. The creditor sought to have its deficiency claim treated as secured, and the court agreed. The court relied on 'In re Nolan', the claim could not be recharacterized as unsecured after confirmation of a plan that treated it as secured.

IV. Cramming the Interest Rate

The Seventh Circuit U.S. Court of Appeals concluded that a debtor cannot cram-down a subprime lender's interest rate as part of a Chapter 13 plan, at least on the facts of that case. The proposed Bankruptcy Reform Act would not have restricted the debtor's ability under Chapter 13 to cram-down an interest rate. It is therefore significant that the Seventh Circuit, on these facts, allowed the creditor's 21 percent interest rate to stand unless one of the parties could present persuasive evidence to show that the creditor's current rate for similar loans is higher or lower than the contract rate. Judge Rovner dissented.

V. Ride-Through

A "ride-through" is when a Chapter 7 debtor forces a secured creditor, over the creditor's objection, to allow the debtor to keep the collateral and maintain payments, without reaffirming the debt. Four Circuits allow a Chapter 7 debtor to ride-through; five Circuits do not allow the practice. This leaves Third and Eighth Circuits out of the fray.

In 2002, the Bankruptcy Court for the District of Delaware concluded that the ride-through was not permitted in that district.

If something like the Bankruptcy Reform Act is enacted, ride-through against creditor objection will be prevented. The debtor will have to make one of the three statutory choices provided at Bankruptcy Code section 521 (redeem, reaffirm, or surrender), or possibly ride-through with the creditor's permission. The interpretation issues under section 521 on which the Courts have so obviously disagreed would be, on the whole, made moot and this issue would finally be resolved in favor of the current statutory alternatives.

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procedure and required the uncle to sign a letter of indemnity agreeing to indemnify the bank for any resulting loss. It then paid out the joint account funds again, this time to the uncle, and stopped payment on the check to the niece. The bank subsequently found itself in the middle of a dispute between the niece (as representative of her grandmother's estate) and the uncle, each claiming ownership of the funds from the joint account, and the niece also claiming wrongful refusal to pay the bank check. Without sections 3-312 and 3-411 to guide it, the court's analysis was muddled, for example holding that the bank had a duty to give notice to the other joint account holders before allowing a withdrawal by one of the joint tenants, because it was "aware" of "competing claims," and indicating that the bank's belief it had a claim against the niece was not a basis for stopping payment of the bank check. An official bank check is deemed accepted, and therefore too late to stop payment on, when the bank issues the check. And: "Conclusory allegations of 'judges of fraud' are not sufficient to defeat the bank's obligation to pay." All of these holdings are questionable if not outright erroneous, under any version of Article 3, but more clearly so under the 1990 revisions.

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4. Id., at *4. See also Miller and Eisen, supra note 1.

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one thing is clear: Future financial writers and historians will have to understand the events described at this program, if they are to accurately understand and portray the financial developments of the Twenty-First Century.

As media stories of corporate scandals continue to proliferate, it is fitting that experts from the banking, financial, regulatory, and legal professions as well as financial writers and scholars gathered at Oklahoma City University School of Law for a program to study a similar crisis that shook the foundation of America's banking industry twenty years ago: the failure of Penn Square Bank of Oklahoma City.

Like some of today's corporate scandals, the closing of Penn Square Bank suggested unsound policies and documentation issues that were systematic. Yet, today as in 1982, the real story goes well beyond the headlines and other superficial media reports. In the aftermath of Penn Square Bank, many other banks and most of the nation's thrifts failed or otherwise disappeared, leading to a federal deposit insurance crisis and a nationwide credit crunch. The results included a massive bailout of the Federal Savings and Loan Corporation (FSLIC) by taxpayers, and ultimately the essential demise of our 200 year tradition of independent community banking and direct consumer lending.

"Penn Square Bank—20 Years Later" explored the events leading up to the bank's closure, its causes and effects, and how the regulatory and financial system has changed in its aftermath. The Conference on Consumer Finance Law wishes to thank all of those who contributed to the program or its written materials, with a special thanks to: financial writer Phillip L. Zwieg, who first raised questions about Penn Square Bank in the American Banker and late wrote the national best-seller on the crisis, *Belly Up: The Collapse of the Penn Square Bank*; attorney Marion C. Bauman, who represented Penn Square Bank in the 1980s and recounted the perspectives of bank insiders; Bob Brucken, deputy regional counsel for the Federal Deposit Insurance Corporation, Dallas, Texas; noted financial industry economist Edward J. Kane, Boston College, Chestnut Hill, Mass.; Susanne Trimbath, an economist at the Milken Institute, Santa Monica, California; and Washington, D.C. banking lawyer Robert Ledig.

The written program materials are available for separate sale from the Conference on Consumer Finance Law CLE office, (405) 634-1445, at a price of $195.00 postpaid. Selected portions of these materials will be revised and published as articles in a forthcoming symposium in the *Oklahoma City University Law Review*.

1. Conference on Consumer Finance Law Executive Director Alvin C. Harrell introduced the program and provided a chronological overview of important events relating to the banking and deposit insurance crises of the 1980s.

2. Marion C. Bauman represented Penn Square Bank with respect to corporate and regulatory matters, and he provided a perspective of the relevant events from the bank's viewpoint.

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The Swidov court granted summary judgment for the niece against the bank, and for the bank against the uncle, holding that the bank was liable to the niece for the amount of the check, but could recover from the uncle under the letter of indemnity. Under the 1990 revisions to Article 3 the result would likely be the same, but the analysis would be easier: The equivalent to the uncle's letter of indemnity would be a "declaration of loss" under section

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The future of the uniform law process will answer this question. The open, meritocratic, and relatively nonpolitical nature of the uniform law process, its focus on consistent core principles that describe rather than prescribe admirable human behavior, and an emphasis on the UCC goals of simplicity, clarity, and uniformity, create a unique avenue for the rational resolution of legislative challenges. It is not a perfect system, or a clean and simple process; and it is a process that must function in the context of human society, with all of its ills. But, if the essence of the uniform law process can be preserved, and extended to new areas of law on the periphery of existing uniform laws, the uniform law process offers the promise of achieving the full potential of American legal, political and economic systems in the Twenty-First Century. The next few years may well determine whether this potential can be reached.

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3-312; it would be clear under section 3-312 that he was not entitled to file such a declaratory action unless he was willing to swear that the check was lost, stolen, or destroyed, and the entire lawsuit involving the bank might have been avoided. (The uncle could proceed directly to resolve any claim against the niece.) If the bank stopped payment on its check after being advised by the uncle of possible fraud on the part of the niece, her claim against the bank would be governed by section 3-411. This would avoid much of the Steward court’s confusing analysis as to when payment can be stopped on a bank check, e.g., suggesting that “badges of fraud” are not a sufficient basis for a bank to withhold payment. If the niece’s ownership claim was valid, she could recover the amount of the check plus interest, but not her expenses assuming the bank had reasonable grounds to assert its defense. The court’s unhelpful discussion of whether the bank had a duty to give prior notice of the withdrawal to the other joint tenants could also have been avoided.

The analytical problems caused by the lack of the 1990 revisions in Steward illustrate how much those revisions have contributed in terms of clarifying the law applicable to these kinds of day-to-day disputes. The next time a bank gets caught in the midst of one of these family conflicts, everyone should have an easier time under the 1990 revisions, at least in states other than New York.