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2014 UCC Articles 3 and 4 Update--Promissory Notes, Checks, Deposits and Payments

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By Alvin C. Harrell

I. Introduction

As in previous years, this article notes selected case law developments relating primarily to Uniform Commercial Code (UCC) Articles 3 and 4. Despite the relatively settled state of the law, and an exceptionally clear and user-friendly statute, cases continue to proliferate. Perhaps a reason is that UCC Articles 3 and 4 essentially relate to the creation and use of private money, and there will always be fights over money. Given the large volume of this litigation, one can only guess at the legal and economic consequences should policy-makers create new uncertainties by miscalculating the effects of new initiatives in this area of law.

II. Scope of Article 3

A. Common Law Not Displaced

UCC section 1-103(b) provides that the UCC is supplemented by general principles of law and equity, except as these principles are displaced by UCC provisions. This raises a question as to when or whether such displacement occurs. In Koss Corp. v. American Express Co., example, the corporate executive paid her American Express credit card bill and other personal expenses by sending corporate wire transfers to herself and issuing corporate checks to American Express. American Express recovered the fraud but did not report it to the corporate employer for more than a year. The corporate employer then sued American Express, asserting common law claims based on negligence, conversion, breach of fiduciary duty, and aiding and abetting fraud. American Express argued that the UCC displaced the common law claims, and there could be no conversion claim because a check is not property. In addition, American Express argued that there was no duty to report, and therefore no basis for negligence. The trial court agreed and dismissed all of the claims; on appeal, reversal of the negligence claim was affirmed (because there is no duty to report suspicious activities to a customer) but the court of appeals reversed dismissal of the conversion, breach of fiduciary duty, and aiding and abetting claims. The court of appeals held that these common law claims were not displaced by UCC Article 4A (see sections 4A-202 – 4A-204) because they did not arise out of a wire transfer. The conversion claims based on


5. Id. See also UCC 1-102 cmt. and 4A-506.
negotiation and payment of the fraudulent checks were authorized by UCC section 3-420. The trial court’s conclusion that a check is not property was clearly erroneous. The case was remanded for consideration of the conversion and other remaining common law claims.

3. Conversion and Forged Indorsements

Brown v. Pub. Ins. Adjusters of N.Y., Ltd. illustrates a somewhat common problem. An insurance company issued a claims draft in partial payment of a fire insurance claim. As is customary, the draft was payable to the insured and the mortgagee, requiring both to indorse. Both indorsements were forged and the check was deposited into the deposit account of a repair contractor. Upon discovery, the insured sued, among others, the insurance adjuster who received the draft from the insurance company and apparently delivered it to the repair contractor. The adjuster’s motion for summary judgment was denied in part, because the insured alleged that the adjuster was negligent in delivering the draft to the repair contractor and that this contributed to the unauthorized indorsements. The court concluded that this stated a cause of action under UCC section 3-406 and raised material issues of fact for a jury trial. Section 3-406 allows a prejudice against assertion that a signature is unauthorized, on the basis of negligence. However, it is not clear that it is the basis for a general negligence claim, as suggested in this case. On the other hand, it is also not clear that Article 3 applied at all, given that the adjuster had no claim to interest on the instrument. In Regions Bank v. Maroone Chevrolet, LLC, a car rental company borrowed money from a bank to finance its purchase of vehicles from a dealer, and deposited the loan proceeds checks (payable to both the dealer and the rental company) in the rental company’s deposit account without the dealer payee’s indorsement. When the dealer failed to receive payment for the vehicles sold to the car rental company, the dealer sued the depositary and payor banks for conversion (for paying the loan proceeds checks without a required indorsement, pursuant to UCC section 3-420). The trial court held for the dealer, concluding that the banks breached the duty of ordinary care. Note that ordinary care is not stated to be a factor in a conversion action in UCC section 3-420, though perhaps it could be relevant under the general law of conversion. The trial court’s decision was reversed on appeal on other grounds. The appellate court noted that a depositary or payor bank is not liable to a payee for conversion under UCC section 3-420 unless the payee received delivery of the instrument (i.e., a person cannot sue for conversion of property the person has not received). The appellate court noted that delivery to an agent is sufficient. However, in this case the car rental company was deemed not to have been an agent of the dealer because the dealer was unaware of the transactions and did not authorize them. Thus, the dealer did not receive possession of the checks and could not sue for conversion. However, the court affirmed the dealer’s basic right to payment from the car rental company, for the sales of vehicles as to which the dealer did not receive payment.

III. Form of Instruments – Negotiability

A. Full Settlement Language

Recently some mortgage loan borrowers have attempted to pay off their loans by adding “paid in full” language to their monthly payment checks, or by submitting purported loan payoffs using non-negotiable drafts (e.g., with notations such as “EFT only: For Discharge of Debt” or “Not for Deposit”). The courts have recognized that these provisions are not effective, and consistently hold that the language has no impact except (in some cases) to render the instrument non-negotiable.

B. Certificate of Deposit

Many bank certificates of deposit are denoted as nontransferable in order to avoid the reserve requirements for transaction accounts in Federal Reserve Board Regulation D. Swift v. Norwest Bank-Omaha West held that such a certificate of deposit is not a negotiable instrument under UCC section 3-104 and therefore is not governed by UCC Article 3; consequently, a claim on the certificate of deposit was not governed by the Article 3 statute of limitations at UCC section 3-118. Instead, the customer’s claim against the bank was subject to the state’s general commercial law statute of limitations.

8. See e.g., 826 N.W.2d 785 (Minn. 2013), 450 U.S. 295 (1981).


IV. Forged Indorsements -- Delivery to the Payee

As noted above at Part II.B., a person cannot sue for conversion of property unless the person has received the property. In Parkway Bank & Trust Co. v. State Farm Fire & Cas. Co., insurance claim drafts were made payable jointly (but not in the alternative) to three payees: the owner of the insured building; the repair contractor; and the mortgagee. The repair contractor forged the indorsement of the mortgagee and obtained payment of the drafts. The mortgagee sued the drawer (the insurance company), but the trial court rejected the mortgagee’s claim. The mortgagee could not recover from the drawer on the underlying obligation because that was suspended under UCC section 3-310 by delivery of the drafts.

The appellate court affirmed, noting that the mortgagee’s remedy was limited to a conversion action and that the deposit or payment of a draft with a forged indorsement is conversion under UCC section 3-420. The court’s opinion provides only minimal discussion of the requirement in UCC section 3-420(a) for delivery of the instrument to the payee as a prerequisite to an action for conversion; apparently the court believed that the mortgagee payee received delivery via an agent (the repair contractor who received the drafts and forged the indorsement) as authorized in the repair contract. However, it does not appear that the mortgagee was a party to the repair contract.

The mortgagee could not recover from the insurance company for a lost instrument under UCC section 3-309 because the location of the drafts was known. If the repair contractor who received the drafts did not do so as an agent of the mortgagee, the mortgagee could not sue for conversion and there was no suspension of the underlying obligation under section 3-310. The mortgagee would then have an action against the insurance company on the underlying obligation (under the loss payee clause in the insurance contract). Compare discussion of the Regions Bank case, immediately below.

In Regions Bank, already noted above at Part II.B., the trial court’s holding for the plaintiff (as against the payor bank) on grounds of conversion was reversed on appeal because a depositary or payor bank is not liable to a payee for conversion unless the payee received delivery of the instrument. As noted, this recognizes the basic point that a person cannot sue for conversion of property the person does not own.

In Regions Bank, the court held that the payee plaintiff did not receive delivery of the checks via an agent because the plaintiff was unaware of the deposits and did not authorize them. Since the plaintiff never received delivery of the checks via an agent, the plaintiff could not sue the depositary or payor bank for conversion. However, the court affirmed the plaintiff’s underlying claim to payment for the vehicle sales to which the plaintiff did not receive payment.

V. Statute of Limitations

In Pilkinton v. Hartsfield, the holder sued to collect a past due promissory note, with installment payments more than ten years in arrears. The maker defended on grounds that the action was barred by the six-year statute of limitations in UCC Article 3. The court granted the holder’s motion for summary judgment as to the installment payments due within the six years preceding the lawsuit, on grounds that the statute of limitations began to run as the cause of action accrued on the due date of each installment. Thus, the cause of action was barred as to all installments due more than six years before the case was filed.

In Specialized Loan Servicing, LLC v. January, an insurance claims draft was payable to multiple payees (not in the alternative). It was negotiated to a bank with the indorsement of only one payee. Thirteen months later, the other payee sued the bank for conversion. The Supreme Court of Louisiana held that the (non-uniform) one-year limitation period for conversion actions in Louisiana UCC section 3-4200 barred the claim. In addition, the Court adopted the majority position as regards the “discovery rule,” holding that the discovery rule is limited to unusual circumstances, e.g., where there has been fraudulent concealment. The Court reasoned that this rule places the burden of discovery on the party best able to discover the fraud. A dissenting opinion disagreed.

As noted above at Part III.B., in Swift v. Norwest Bank-Omaha West, the court held that a non-transferable certificate of deposit was not a negotiable instrument and therefore was not governed by the UCC Article 3 limitations period. The customer’s claim against the bank was barred by the state’s general statute of limitations.

In Schmelz v. Mrs. & Traders Trust Co., a daughter claimed a bank deposit allegedly owned by her deceased mother; the only evidence of the deposit was the daughter’s recollection of a conversation with her mother. The daughter sought admission of her own testimony as indicative of her mother’s state of mind. The court disagreed, holding that this was inadmissible hearsay and, in any event, would be insufficient to overcome the common law presumption that debts are deemed to be paid after twenty years. Similarly, Clute v. Guaranty Bond Bank rejected the unsubstantiated testimony of an ex-convict.

14. 118 So.3d 251, 2013 Fla. App. LEXIS 11234, See supra this text and note 9.
15. 129 So.3d 900, 2013 Fla. App. LEXIS 11234, See supra this text and note 9.
16. See generally supra Part II.B, and 65% Part V.
18. See UCC 3-318.
claiming that he had deposited $5,500 in a bank account prior to his incarceration more than twenty years earlier.

VI. Negotiation

A. Allonges

The increased use of securitization and the high volume of mortgage foreclosures have been accompanied by an increase in cases dealing with allonges.24 For example, Kohler v. U.S. Bank Nat’l Ass’n,25 affirmed a bankruptcy court decision holding that the bank was the owner of two mortgage notes by reason of allonges indorsing the notes in blank. The Kohler court rejected the argument that the allonges were not sufficiently affixed to the notes, as required at UCC section 3-204(a).26

The Kohler court reasoned that the indorsing information on the allonges, including a sticker on each allonge with the account number of the matching note, was sufficient to indicate indorsement of the notes. The possibility that “the pages may have been detached for photocopying did not mean that they were not otherwise ‘firmly affixed’.”27

Evidence that the notes and allonges were delivered in “stacked order” also was deemed significant. Note that a written assignment which does not quality as an allonge or indorsement nonetheless may be sufficient to transfer the right to enforce the instrument pursuant to contract law and UCC section 3-301.28 This may be all that is needed, e.g., for purposes of foreclosure, unless the debtor asserts a defense that can be defeated by a holder in due course.29

Clearly, negotiation and holder status are unneeded in many scenarios, e.g., where the debtor does not assert a defense to liability and the creditor can demonstrate that it is entitled to enforce the instrument (or an underlying lien) under contract, property or agency law. On the other hand, holder status makes things easier. In Deutsche Bank Nat’l Trust Co. v. Brock,30 for example, the court recognized that the transferee of a note, indorsed in blank by three undated indorsements on an allonge, was entitled to enforce the note and foreclose the mortgage as holder, even if the holder was not the owner of the loan.31

Similarly, in Wells Fargo Bank, N.A. v. Settmeier32 the court upheld the right of the holder of a note, indorsed in blank on an allonge, to enforce the note and foreclose the mortgage. The Settmeier court rejected various spurious arguments by the debtor, e.g., that the note could not be enforced because: (1) the holder’s corporate status was suspended; (2) the allonge was not dated; (3) the indorsement was not notarized; and (4) the indorsement did not include other (unnecessary) information.

Whether an indorsement is on the instrument or an allonge, it need not be dated, although the date may be important for other reasons. For example, in In re Gould33 the court rejected the use of an undated allonge to establish the time of an indorsement on a promissory note, for purposes of establishing standing as of the bankruptcy petition date. An allonge that has been separated from the note can create other problems. In Wells Fargo, N.A. v. Bohatka,34 the mortgagee relied on an allonge that allegedly became separated from the note, in order to establish standing to foreclose the note and mortgage. In determining whether the allonge had been previously attached to the note, the trial judge utilized several informal tests, including: (1) smelling the note for traces of glue; and (2) examining it for paperclip indentations, staple holes or pin marks. Based on these tests, the trial court concluded that the allonge had never been affixed to the note, and dismissed the mortgagee’s foreclosure suit with prejudice for lack of standing.

The court of appeals reversed, holding that the mortgagee should have been allowed an opportunity to amend its petition to establish standing by other means. The court of appeals also rejected the trial court’s evidentiary approach, concluding that the trial court should have conformed to the more structured approach required by the Florida Evidence Code (which provides for the use of testimony and expert analysis).

In Bennett v. Deutsche Bank Nat’l Trust Co.,35 the mortgagee argued as a defense to foreclosure that the indorsement on an allonge transferring the note was not an authorized signature. The court referred to UCC section 3-308, which creates a presumption that carries the burden of proof as to the genuineness of a signature. This shifts the burden of proof to the person challenging the signature. Since the mortgagee did not provide any evidence to rebut the presumption, the court of appeals affirmed summary judgment for the mortgagee.

B. Holder Status Not Required

As noted above at Part VI.A., holder status may not be needed in order to enforce a note or foreclose a mortgage.36 In Lewis v. Wells Fargo Bank, N.A.,37 for example, the mortgagee claimed wrongful foreclosure, alleging that the mortgagee violated the Texas Property Code, the Texas Finance Code and the

24. See U.C. §3-204(a) et seq. for the purpose of determining whether indorsement may be made on an instrument; a paper affixed "in accordance with a part of the instrument", Sec. 3-101, supra note 1, at Part II D.


26. See supra note 24 & 25.

27. Id. at 2013 WL 3159557, at 15 (emphasis omitted).

28. See supra U.C.C. § 3-204.

29. See supra UCC Article 3, pt. 3.


34. 112 So. 4th 496 (Fla. Dist. Ct. App. 2013).


36. See supra Harrell, supra note 1, at Part III D.

Texas Debt Collection Act, on grounds that the mortgagee was not the holder of the mortgage note. The court dismissed all of these claims, concluding that the mortgagee was not required to present the note prior to commencing the non-judicial foreclosure of a lien, and was authorized to conduct the foreclosure as successor to the original mortgagee. The court noted that the Texas courts have rejected the “show me the note” defense in non-judicial lien foreclosures.

The equivalent issue was raised in a judicial foreclosure in Focht v. Wells Fargo Bank,28 where the mortgagor alleged that the foreclosure was conducted by the bank without evidence that the bank was the holder of the mortgage note. The appellate court remanded for a determination of whether the bank had standing to sue at the time of commencing the foreclosure case, noting that the bank could establish standing in any of three ways: (1) by showing that the bank was the holder of the note by reason of either a blank or special indorsement; (2) by showing that the bank took the note by assignment from a party entitled to enforce it; or (3) by an affidavit otherwise showing the bank’s right to enforce the note. However, the court held that this standing had to be established in a time the foreclosure lawsuit was filed, not nine months later as in the Focht case. The appellate court also urged the Florida Supreme Court to consider whether the latter requirement should be abandoned in view of modern securitization and electronic data storage techniques.29

Also recall Kohler v. U.S. Bank Nat’t Ass’n,30 where the district court affirmed a bankruptcy court decision allowing the bank’s foreclosure to go forward based on a finding that the bank was entitled to enforce two mortgage notes, by reason of indorsements on the notes, holding that the identifying information on the indorsements, including a sticker on each indorsement with the loan number of the matching note, and the “stacked order” of the pages, was sufficient as affixation and to constitute indorsement of the notes. Of course, as also noted above, even if this was not sufficient for indorsement it would be sufficient to transfer a right to enforce the notes pursuant to UCC section 3-301.

C. Enforcement by the Holder

Deutsche Bank Nat’l Trust Co. v. Brock31 is yet another case recognizing that the holder of a note, in this case indorsed in blank by three undated indorsements on an allonge, was entitled to enforce the note and foreclose the mortgage even if the holder was not the owner of the note.32 Bank of Am. v. Indus33 similarly recognized that the party in possession of a note indorsed in blank was the holder entitled to enforce the note, regardless of ownership. As noted above at Part VI.A., Wells Fargo Bank, N.A. v. Settoon34 also upheld the right of the holder of a note, in that case indorsed in blank on an allonge, to enforce the note and foreclose the mortgage. The Settoon court rejected unmeritorious defenses asserted by the debtor, e.g., that the note could not be enforced because: the holder’s corporate status was suspended; the allonge was not dated; the indorsement was not notarized; and the indorsement did not include other (superfluous) information.35 However, compare the Gould case,36 rejecting the use of an undated allonge to establish the date of an indorsement on related promissory notes for purposes of standing. And recall Wells Fargo, N.A. v. Bulatka,37 also noted above at Part VI.A., where the foreclosing mortgagee relied on an allonge to the mortgage note as an indorsement of the note in order to establish standing to enforce the note and mortgage. In determining whether the allonge had been affixed to the note, the Bulatka trial judge devised various ad hoc tests, including smelling the note for traces of glue and examining the documentation for paperclip indentations, staple holes and pin marks. Based on these tests, the trial court concluded that the allonge had not been affixed to the note, and dismissed the foreclosure suit with prejudice for lack of standing. The court of appeals reversed, holding that the mortgagee should have been allowed an opportunity to amend its complaint to establish standing and rejecting the trial court’s evidentiary approach to determining the validity of the allonge.

In Bennett v. Deutsche Bank Nat’l Trust Co.,38 yet another case already noted above, the mortgagor did not provide any evidence to rebut the Article 3 presumption that the signatures were genuine and authorized.

D. Assignment and the Shelter Doctrine

In Martins v. BAC Home Loans Serv., L.P.,39 the mortgagor argued that the nonjudicial foreclosure by BAC was wrongful because: (1) a transfer from MERS to BAC was “robosigned”; (2) BAC had possession of the note but not the deed of trust (mortgage), and therefore the note and mortgage were split; (3) these allegations created material issues of fact; and (4) therefore, the court should provide a remedy based on promissory estoppel. The United States Court of Appeals for the Fifth Circuit rejected all of these arguments, concluding that: (1) the assignment of mortgage was effective...

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40. See supra this text at Part VI.B.
41. See supra this text at Part VI.A.
42. See supra Part VI.A
43. See supra note 31.
44. See supra note 31.
45. See supra note 31.
46. See supra note 31.
47. 117 So. 3d 309, 2013 Fla. App. LEXIS 23196.
even if "robosigned" (because MERS provided adequate supporting documentation); (2) the "show me the note" and "splitting of the note and mortgage" theories have been rejected by the Texas courts; (3) there was no other issue of fact or evidence that the foreclosure was procedurally deficient; and (4) evidence relating to promissory estoppel was barred by the statute of frauds. 50

In Bank of New York Mellon v. Mathews, 51 the debtors argued that the assignee of the mortgage lacked standing to conduct a judicial foreclosure because the assignee did not establish that it was the holder of the note as of the time the foreclosure was commenced. The trial court rejected this argument and on appeal this was affirmed. The appellate court applied the Restatement (Third) of Property section 5.4(b) (1997), providing that an assignment of the mortgage inherently includes a transfer of the note secured by the mortgage unless the assignment says otherwise. The Restatement view recognizes the basic point that the sale of a mortgage signifies a sale of the loan (including the note) unless there is an agreement otherwise. This transfers to the assignee of the mortgage a right to enforce the note, e.g., as recognized at UCC section 3-301, and the assignee therefore has standing to sue.

VII. Mortgage Foreclosure

A. Nonjudicial Foreclosure

In Greene v. Midland Mortgage Co., 52 a law firm conducted a nonjudicial foreclosure on behalf of the servicer and mortgagee. The mortgagor sued the lender, loan servicer and law firm, alleging breach of contract, negligent misrepresentation, violations of the Texas Deceptive Trade Practices Act and the Texas theft liability act, and

fraud. The mortgagor argued that the law firm was acting without authorization as a substitute trustee under the deed of trust (i.e., a mortgagee), and alleged other procedural deficiencies. The court rejected all of these arguments, affirming the trial court's grant of summary judgment for the defendants.

In JP Morgan Chase Bank, N.A. v. Johnson, 53 the mortgagor argued that the defendant national bank had no authority to conduct a nonjudicial foreclosure under state law because the bank was not licensed by state authorities, as allegedly required by state law. The court rejected this argument, noting that the state law does not require licensing of national banks and that the National Bank Act authorizes national banks to exercise such authority under the incidental powers provision. 54

B. Authorized Signatures

As already noted, in Bennett v. Deutsche Bank Nat'l Trust Co., 55 the mortgagor defended against foreclosure by claiming that the indorsement on an allowance was not an authorized signature. Since the mortgagor did not provide any evidence to rebut the UCC section 3-308 presumption that the signatures were genuine and authorized, the court of appeals affirmed summary judgment for the mortgagee.

Similarly, in Estate of Kojua v. Rockstar Media, LLC, 56 an elderly woman extended loans in excess of $4 million to the debtor. Upon her death, her will excused the debt in the amount of $3 million, but the estate sought to collect the remaining $1 million note. The debtor argued that the estate had failed to prove that his signature on the note was genuine. Recognizing that the note was a negotiable instrument governed by UCC Article 3, the court held that the signatures on the instrument were presumed to be valid and it was presumed to be enforceable. 57 Without evidence to the contrary, the debtor failed to rebut this presumption.

In Howard v. JP Morgan Chase NA, 58 the mortgagor argued that the assignment of the mortgage to the foreclosing mortgagee was signed by an agent of the assignor who did not have the required authority. The court rejected the argument, holding that the mortgagor's allegation was not sufficient and the mortgagee had authority to foreclose as holder of the mortgage note indorsed in blank. As a result of this holder status, the mortgagee had a right to enforce the note and mortgage, and a separate assignment of the mortgage was not needed. 59 The court noted that this is consistent with UCC Article 9 section 9-203(g) and the general rule that "the mortgage follows the note." 60

C. Person Entitled to Enforce the Instrument

I. Time of Indorsement

An indorsement is necessary to negotiate an "order" instrument to a holder. 61 However, indorsements need not be dated. 62 Nonetheless, the date of an indorsement may be important, e.g., to determine the time when negotiation to the holder occurred. 63 This may be required for purposes of standing to foreclose or other efforts to enforce the instrument.

50 Id. (the "show me the note" argument). See also Aresenios, 979 F.2d at 227 (noted in the note 37. The dissent of hands. See also Aresenios, 979 F.2d at 228.


55 125 S. W. 2d 157, 1940 S. W. 2d 102 (1940).


57 See UCC §§ 3-301, 3-305 & 3-308.


59 M.J. O'Connell UCC § 3-308(b).


61 See UCC §§ 3-206(a) & 3-201.

62 See, e.g., UCC section 3-204(g) ("indorsement on an allowance") and UCC section 3-204(h) (other characterization of the instrument), see also Krietsch Q. Apperson, Case Note: UCC Home Loans—The, Interstate Federal de Novo. 25th Congress Inc. L.Q. Rep. 410 (2011), Harrell, supra note 1, at Part III.

63 See UCC § 3-204. See also Harrell, supra note 1, at Part III.
For example, as noted, Gould\(^4\) cited a two-pronged "Holder Test" for determining the right to enforce an instrument, pursuant to UCC sections 3-201 and 3-205. Gould held that the creditor was required to prove possession of the note and indorsement prior to the debtor's bankruptcy filing, in order to establish standing to file a proof of claim. In Gould, the creditor could not meet either test because the instrument did not reflect the date of indorsement, and the court rejected the use of an allonge for this purpose.

2. Lost Notes

The 2002 revisions to the uniform text of UCC Article 3 make clear that the person seeking to enforce a lost note under UCC section 3-309 need not have been in possession of the note at the time the note was lost. This is essentially a clarification, and even without this change in the statutory text many courts and commentators agreed with the position of the revision. General contract law recognizes that there can be an assignment of rights and this supplements the UCC as noted at section 1-103(b). Moreover, the law of assignment is expressly codified at UCC section 3-203(b).\(^6\)

However, some courts have taken an unduly narrow view, in cases where the 2002 revisions are not applicable. For example, in In re Harborage of Gloucester, LLC\(^6\) rejected the mortgagee's claim to enforce a lost note, assigned to the mortgagee by the party who had lost the note and executed the lost note affidavit, under the pre-2002 uniform text of UCC section 3-309. The court agreed with the bankruptcy trustee that the party entitled to enforce a lost note under pre-2002 UCC section 3-309 cannot assign that right to another party. The Harborage court acknowledged that the 2002 uniform text revisions are contrary to this holding.

3. Separation of the Note and Mortgage

In Nevez v. Residential Credit Solutions, Inc.,\(^6\) the court rejected the mortgagor's argument that the note was separated from the mortgage when the servicer took possession of the note as an agent of the mortgagee, noting that this argument has been rejected by all state and federal courts in Texas that have considered the issue. Deutsche Bank Nat'l Trust Co. v. Brock\(^6\) recognized that the holder of a note indorsed in blank (by blank indorsements on an allonge) was entitled to enforce the note (and the mortgage that secured the note) even if the holder was not the owner of the note or the mortgage loan.\(^7\)

4. Is Possession of the Note Required?

Compare In re Steinberg,\(^2\) holding that the bankruptcy court should have held an evidentiary hearing before granting the mortgagee relief from the automatic stay to commence foreclosure, to ascertain whether the mortgagee had possession of the note or another basis for enforcing it. However, the court rejected the debtor's argument that the mortgage note was not negotiable because it contained a prepayment provision.\(^5\) In Steinberg, the debtor had listed the mortgage loan as a secured claim on her bankruptcy schedules. When the mortgagee sought relief from the bankruptcy stay to commence foreclosure, the debtor argued that the mortgagee lacked authority to seek relief from the bankruptcy stay because the mortgagee did not have possession of the note and therefore was not a creditor of the bankruptcy estate. The bankruptcy court rejected this argument and the debtor appealed to the Tenth Circuit Bankruptcy Appellate Panel (B.A.P.). The B.A.P. reversed, holding that the bankruptcy court should have conducted an evidentiary hearing to determine whether the mortgagee had possession of the note or was otherwise entitled to enforce it.

In Bank of New York Mellon v. Matthews,\(^7\) the debtor argued that the assignee of the mortgage lacked standing to foreclose because it did not show that it was the holder of the note when the foreclosure suit was filed. As noted above at Part V.D., the court followed the Restatement (Third) of Property\(^2\) rule that an assignment of the mortgage carries with it a transfer of the note unless the parties agree otherwise. This recognizes the right of an assignee to enforce the note,\(^2\) and the assignee therefore has standing to sue. However, as noted above, in Harborage of Gloucester, the bankruptcy trustee disputed the assignee's right to enforce a lost note. The court agreed with the trustee that the party entitled to enforce a lost note under section 3-309 (before the 2002 uniform text revisions) cannot assign that right to another party. As noted, the]
court likewise took an unwarranted view of the requirements of pre-2002 UCC section 3-309 in holding that the claimant's witness failed to establish the right to enforce a lost note under section 3-309 because the witness could not testify how the original note was lost.

D. Other Issues

A report of the Permanent Editorial Board for the UCC (PEB), dealing with similar and related issues, is available at http://www.ali.org/00021333/PEB%20Report%2020Nov2011.pdf.78

In *Bell v. Bank of America, N.A.*,79 the mortgagor asserted defenses to foreclosure based on an alleged oral agreement with the mortgagee regarding modification of the terms of the mortgage loan. The mortgagor asserted promissory estoppel to overcome the statute of frauds. The court rejected this on the grounds that promissory estoppel can overcome the statute of frauds only if there is a promise to execute a writing that will satisfy the statute. In *Bell*, there was only a promise to conduct a loan modification review, not a promise to execute a written loan modification agreement. Therefore there was no contract to modify the loan and no basis for promissory estoppel or a defense based on breach of contract. In addition, under the applicable state law an agreement to lend in excess of $50,000 is not enforceable without a signed writing.

However, in *Backus v. Bank of America*,80 a promissory estoppel claim was allowed to proceed on grounds it was not an action for breach of contract but rather was the basis of a tort claim for misrepresentation and therefore was not subject to the statute of frauds. In *Roxeburg v. Bank of America*,81 the debtors claimed there was an oral promise to modify the debtors’ mortgage loan, asserting that the mortgage foreclosure was wrongful. The court held that the alleged oral promise to modify the loan was unenforceable under the statute of frauds, and that the debtors failed to properly plead promissory estoppel because there was no harm suffered in reliance on the alleged oral promise.82

In *Clay v. First Horizon Home Loan Corp.*,83 the court noted that there is no private right of action under the Home Affordable Modification Program (HAMP). The mortgagor sought relief as a third-party beneficiary under HAMP, and claims the mortgagee received a federal bailout under the Troubled Asset Relief Program (TARP). The court recognized that there is no private right of action under HAMP, and that private parties are not third-party beneficiaries of the TARP.84

*Bell*,85 noted above, additionally rejected the mortgagor’s claim that the mortgagee breached the UCC duty of good faith (imposed at UCC section 1-304, and including a duty of fair dealing).86 Bell recognized that a mortgage transfers a real property interest not subject to the UCC, and also noted that Texas law does not impose a duty of good faith in the mortgagor-mortgagee relation.

As in the cases cited above, in *Gossett v. Fed. Home Loan Mortg. Corp.*,87 the mortgagees objected to the foreclosure of their home mortgage on grounds of an alleged oral agreement promising modification of their mortgage loan. In *Gossett* the mortgagees asserted violations of Texas Property Code section 11.002(b) and (d); the Texas Fair Debt Collections Act; and the Texas Deceptive Trade Practices-Consumer Protection Act. The mortgagee explained that the parties had entered a trial loan modification under HAMP, and the mortgagee gave timely notice to the mortgagees that they did not qualify for a modification due to the required net present value calculation. The court granted the mortgagee’s motion for summary judgment on grounds that Texas law requires a written contract for loan agreements that exceed the amount of $50,000; consequently, any oral agreement to modify the loan was unenforceable. The Texas Deceptive Trade Practices-Consumer Protection Act did not apply because it is limited to goods or services.88

VIII. Defenses to Enforcement

A. Notice of Breach of Fiduciary Duty

In *W. Bend Mut. Ins. Co. v. Belmont State Corp.*,89 an authorized corporate check signer wrote a check on the corporate checking account payable to a bank, and the bank complied with the signer’s instructions to apply the funds to the signer’s personal debt. When the corporation was unable to pay its subcontractors and suppliers, an insurance company paid the claims pursuant to a surety bond, and then sued the bank alleging that a corporate check payable to the bank constituted notice of the signer’s breach of fiduciary duty.90 The court noted that an authorized check signer is not per se a fiduciary, and, even if the signer was a fiduciary under the Uniform Fiduciary Acts, he had corporate authority to

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78 See supra note 2, 2011 Tex. App. Lexis 1282, supra part VIII.
79 See supra note 2, 2011 Tex. App. Lexis 1282, supra part VIII.
80 2011 W. Tex. App. Lexis 1282, supra part VIII.
81 2011 W. Tex. App. Lexis 1282, supra part VIII.
82 2011 W. Tex. App. Lexis 1282, supra part VIII.
83 2011 W. Tex. App. Lexis 1282, supra part VIII.
84 2011 W. Tex. App. Lexis 1282, supra part VIII.
85 2011 W. Tex. App. Lexis 1282, supra part VIII.
86 2011 W. Tex. App. Lexis 1282, supra part VIII.
87 2011 W. Tex. App. Lexis 1282, supra part VIII.
88 2011 W. Tex. App. Lexis 1282, supra part VIII.
89 2011 W. Tex. App. Lexis 1282, supra part VIII.
90 2011 W. Tex. App. Lexis 1282, supra part VIII.
conduct the transaction in question. Thus, the bank acted properly in following the instructions of the authorized party.

Note that this issue is different from asking whether the bank was a holder in due course under UCC section 3-302; for this purpose the notice imputed by UCC section 3-307 would be dispositive.

B. Unauthorized Signatures

In *Bennett*, as noted above, the mortgagee attempted to defend against foreclosure of the mortgage by arguing that the indorsement on an allonge transferring the note was not an authorized signature. The court applied UCC section 3-308 (providing that a presumption carries the burden of proof as to the genuineness of a signature). The court of appeals affirmed summary judgment for the mortgagee.

Also noted above is *Howard v. JP Morgan Chase NA*, where the mortgagee attacked a nonjudicial foreclosure on grounds that the assignment of mortgage to the foreclosing mortgagee was signed by an agent of the assignor who lacked the necessary authority. This is essentially the "rubosigning" defense. The *Howard* court granted the mortgagee's motion for judgment on the pleadings, because the mortgagee's claim was not sufficient to support a cause of action, given that the mortgagee had authority to enforce the mortgage note and foreclose the mortgage as holder of the note indorsed in blank.

C. Holder Issues and Standing

Also noted above is *Bank of New York Mellon v. Matthews*, where the mortgagees argued that the assignee of the mortgage did not have standing to foreclose because the mortgagee did not present evidence that it was the holder of the note when the foreclosure case was filed. The court cited the Restatement (Third) of Property, stating that an assignment of the mortgage carries with it a transfer of the note unless the parties agree otherwise. This provides the assignee of the mortgage a right to enforce the note, e.g., as recognized at UCC section 3-301, and the assignee therefore has standing to sue.

However, as also noted above, in *Steinberg* the debtor listed the mortgage loan as a secured debt on her bankruptcy schedules, but then objected to the mortgagee's motion for relief from the stay to enforce the lien on grounds that the mortgagee lacked standing under 11 U.S.C. section 362(d) because it did not have possession of the note and therefore was not a creditor of the bankruptcy estate. The Tenth Circuit B.A.P. reversed a holding for the mortgagee on grounds that the bankruptcy court should have conducted an evidentiary hearing to determine whether the mortgagee had possession or was otherwise entitled to enforce the note against the bankruptcy estate.

D. Lost Notes

1. FDIC

In *FDIC v. Cashion*, the FDIC was enforcing a lost note payable to a failed bank. The FDIC presented a copy of the note and a supporting affidavit of an FDIC employee familiar with the books and records of the failed bank, and moved for summary judgment on grounds that there were no issues of material fact. The debtor responded that there were two unresolved issues of material fact: (1) whether the FDIC was the holder of the note; and (2) whether the note was cancelled by reason of a Form 1099-C sent to the debtor indicating "Cancellation of Debt." The United States Court of Appeals for the Fourth Circuit held that the FDIC established that it was entitled to enforce the note, by submitting the copy of the note with an employee affidavit stating that the FDIC had held the original note; it had not been assigned or cancelled; and it remained unpaid. The court also held that the Form 1099-C did not constitute cancellation of the debt, as it was intended to meet income tax reporting requirements rather than to effect a debt cancellation. Nonetheless, summary judgment was inappropriate because the issue of whether the debt had been cancelled was dependent on other facts to be determined at trial.

2. Assignment of Rights and UCC Section 3-309

As noted, the 2002 revisions to the uniform text of UCC Article 3 reject the argument that the party seeking to enforce a lost note under UCC section 3-309 must have been in possession of the note at the time it was lost. Even without this revision, the result should be the same, pursuant to contract law and the law of assignment, e.g., as codified in the UCC "shelter rule" at section 3-203(b).

However, some courts have taken the unduly restrictive view rejected in the 2002 revisions in cases where the 2002 revisions are not applicable. As noted, in *Harborhouse of Gloucester*, the bankruptcy trustee disputed the mortgagee's right to enforce a lost note, assigned to the mortgagee by the party who lost the note and executed the lost note affidavit pursuant to UCC section 3-309. The court agreed with the trustee and held, i.e., that the party entitled to enforce a lost note under UCC section 3-309 cannot assign that right.
another party. Correa, like wise took an unnecessarily narrow view on this issue, concluding that a witness for the proponent failed to establish the right to enforce a lost note under section 3-309 (prior to the 2002 uniform text revisions) because the witness could not testify how the original note was lost. These cases can be regarded as incorrect; the 2002 revisions should now resolve this issue.

In contrast to the Harborhouse and Correa decisions, S. Fid. Managing Agency, LLC v. Citizens Bank & Trust Co. reflects a correct analysis of assignee issues, benefiting from application of the UCC Article 9 provision at UCC section 9-310(c) (expressly recognizing that a perfected security interest can be assigned). In this case, the original secured party (later the assignor) took a security interest in the debtor's interest in shares of stock (labeled a participation agreement); the security interest was perfected by the secured party/assignor taking possession of the collateral. The court held that this perfection was transferred by assignment to the assignee pursuant to UCC section 9-310(c). The district court recognized that the assignment of the security interest did not undermine the perfection, and reversed the bankruptcy court's decision that the assignee had only an unperfected security interest because it did not make a separate perfection. This makes clear that a secured party (here, the assignee) can have perfection via an agent or assignor.

E. Assignments and Standing

1. Mortgage Foreclosure

Recent Oklahoma appellate cases indicate that the courts are getting a better handle on common securitization and foreclosure issues, and perhaps returning to the routine treatment of foreclosure cases where there is little or no doubt of the debtor's default and the mortgagee's lien. For example, in OneWest Bank, F.S.B. v. Jacobs, the mortgagor asserted the usual laundry list of defenses to foreclosure (lack of standing, violations of the Truth in Lending Act (TILA), breach of a forbearance agreement, bad faith and fraud). The trial court granted the mortgagee's motion for summary judgment. The only issue on appeal was standing.

The court of appeals noted that the mortgagee (here, OneWest Bank) must show that it is the party entitled to enforce the note, e.g., as: (1) holder; (2) a non-holder with possession and the rights of a holder; or (3) a person not in possession who is otherwise entitled to enforce the note, e.g., under UCC section 3-309 or 3-418(d). In OneWest Bank, the evidence included a copy of the note indorsed in blank (which alone would be insufficient, the court noted), plus uncontested testimony and affidavit evidence indicating that the prior holder “delivered the note, whether indorsed or not,” to the predecessor in interest of OneWest Bank, who in turn transferred the right to service and enforce the note to OneWest Bank via the FDIC and a pooling and servicing agreement. Therefore, the predecessor (and, by assignment, OneWest Bank) “was, at worst, a non-holder in possession of the instrument who had the rights of a holder,” and thus had standing.

2. Debt Buyers and Collection Agents

In contrast to the above, however, the focus of controversy seems to have shifted to issues that arise when debt buyers are seeking to collect on defaulted credit card debt, a scenario where documentation of the debt and multiple assignments may make the creditor's claim more difficult to substantiate. These cases often present issues of ordinary contract law (without the procedural benefits of negotiable instruments law as codified in the UCC), making summary judgment difficult or even inappropriate. Moreover, consumer advocates often cite this scenario as an example of abusive practices, suggesting that hard-fought battles may lie ahead.

Some of these issues are illustrated in Unifund CCR, LLC v. Ekpo. Unifund was a debt buyer seeking to enforce defaulted credit card debt against Ekpo, who asserted a litany of defenses, but on appeal the issue was limited to standing. The trial court granted summary judgment for Unifund, but the court of appeals reversed on grounds the documentation of multiple assignments between the credit card issuer and Unifund was inadequate.

Without dwelling here on the minor details of all of the intervening assignments, your author will simply observe that: (1) as probably would be expected in these circumstances, the court of appeals was likely correct that the account documentation provided by Unifund was less than perfect; but (2) as the trial court concluded, it nonetheless appears that Unifund was contractually entitled to collect the debt. Thus, the court of appeals may have imposed an
unnecessarily high standard for ordinary contractual assignments. The result may be a replay of some of the mortgage foreclosure cases, where courts sought technical reasons to delay routine foreclosures in an apparent (and arguably misguided) effort to stem the foreclosure crisis. At least in the mortgage foreclosure cases there is a reasonable expectation of a clear and simple chain of assignments. Credit card debt can be quite different, with assignments merely a matter of contractual language and intent, and if courts are seeking technical reasons to deny summary judgment there will be many opportunities to require extensive litigation. Indeed, your author would hazard to guess that the evidence of standing in Unifund was better than in many such cases.

It was not, however, enough for the Oklahoma Court of Appeals. The primary problem (among numerous other, but apparently more minor issues) seems to have been that Unipac I, LLC, was the owner of the debt and assigned some undefined right to its agent, Unifund CCR Partners, who in turn assigned its rights to Unifund CCR, LLC as a subagent. As a result the court concluded that Unifund CCR, LLC (the plaintiff in the case) had no interest in the accounts to support its claim of standing. Apparently the court's primary concern was that the assignment from Unipac I, LLC, to the Unifund CCR Partners "did not empower Unifund CCR Partners to establish subagents or to delegate its duties to another." It is up to a court to decide if disputed contract language is sufficient to transfer the rights being claimed by a plaintiff, and no doubt greater specificity and clarity as to the intent of the parties would be preferred. But it can be noted that the court's explanation of the standing requirement indicates that the "key element of standing is whether the party whose standing is challenged

has sufficient interest or stake in the outcome." It seems likely to your author that this requirement was met in Unifund, and that there was little point in requiring a trial on this issue.

IX. Signatures and Liability on the Instrument

A. Representative Capacity

Williams v. Bell addressed the impact of UCC section 3-402, concerning the liability on the instrument of a person signing in a representative capacity. In Bell, the holder sued the maker claiming that the maker was personally liable on a corporate note. However, the maker had signed only in a representative capacity, as an officer of the corporation. Pursuant to UCC section 3-402, the note indicated the corporation name, and the maker's signature was followed by his corporate title. The court held that the officer was not personally liable.

B. Unauthorized Signatures

As noted, in Bennett the mortgagor asserted that a mortgage foreclosure was wrongful because the indorsement of a third party transferring the note was not an authorized signature. The court applied UCC section 3-308 (providing a presumption that carries the burden of proof as to the genuineness of a signature), recognizing that this shifts the burden to the person challenging the signature. Since the mortgagor did not present any evidence to rebut the presumption that the signatures were genuine and authorized, the mortgagor's argument was rejected.

C. Fictitious Payees and Contributory Negligence

In Nat'l Union Fire Ins. Co. v. First Am. Bank, an employee created a phony business entity in order to send invoices from the entity to the employer for fictitious services. The employer paid the invoices by issuing checks payable to the phony entity and these were deposited in a bank account opened by the employee in the name of the phony entity. When the employer discovered the fraud, the insurer paid the claim and sued the depositary bank. The insurer asserted that UCC section 3-404 (the UCC imposter and fictitious payee rule) did not protect the depositary bank from a contributory negligence claim because the bank failed to exercise ordinary care (as required at section 3-404(d)).

The trial court did not allow the insurer's expert witness to testify on the issue of the bank's ordinary care, on grounds that the expert did not have experience with banks of similar size in that geographic area (see the definition of ordinary care at UCC section 3-103(a)). Without that evidence, the trial court granted a directed verdict for the depositary bank. On appeal this was reversed, on grounds the expert should have been allowed to testify because ordinary care as to account-opening procedures requires a bank to meet legal standards that are uniform regardless of the bank's size and location.

In National Union Fire Ins. Co. v. Guaranty Bank, an employee similarly embezzled funds from the employer by submitting bogus invoices payable to a phony business created and controlled by the employee. The employee indorsed the checks in the name of the phony business and deposited them in his personal account at the depositary bank. The employer's insurance company paid the claim and sued the depositary bank for negligence, breach of warranty and

114. See e.g. writers cited supra note 103.
116. Id at 989.
117. See e.g. writers cited supra note 103.
118. See supra notes 35 & 48, and Parts VI A & VII.
conversion. The conversion claim was dropped (possibly because the indorsements were valid under UCC section 3-404). The court rejected the negligence claim because a bank does not owe a duty to non-customers. However, the bank’s motion to dismiss was denied on grounds there was a plausible issue as to whether the depositary bank breached the UCC transfer or presentment warranties.

X. Fraud and Conversion

A. Indorsement Fraud

As noted, Brown v. Pub. Ins. Adjusters of N.Y., Ltd. was another case involving an insurance claims draft issued in partial payment of a fire insurance claim. The draft was payable to the insured and the mortgagee, requiring both to indorse; both payees’ indorsements were forged and the draft was deposited in the deposit account of a repair contractor. Among other defendants, the insured sued the insurance adjuster who received the check from the insurance company issuer. The adjuster’s motion for summary judgment was granted in part, but was rejected in part on grounds that the insured’s allegations of negligence contributing to an unauthorized signature under UCC section 3-406 raised material issues of fact requiring a trial. The court’s analysis seems muddled on this issue, and it is not clear to your author that this use of section 3-406 is correct.

The factual scenario was similar in Parkway Bank & Trust Co. v. State Farm Fire & Cas. Co., where insurance claims drafts for fire damage to a building were made payable to three payees — the owner, the repair contractor and the mortgagee — requiring indorsement by all three payees. The contractor forged the indorsement of the mortgagee and obtained payment of the drafts. The mortgagee sued the drawer of the drafts (the insurance company), but the trial court granted the defendant’s motion for summary judgment and the court of appeals affirmed, stating that the mortgagee’s remedy was an action for conversion under UCC section 3-420, against the payee and the banks that cashed or paid the drafts.

A draft lacking a required indorsement is not properly payable under 4-401 and the depositing or payment of that check is conversion under 3-420 (subject to a limited exception at UCC section 4-205). But note again that a payee cannot sue for conversion of an instrument under section 3-420 unless the payee has first received possession of the instrument. While the Parkway court did not emphasize the point, apparently the court concluded that the repair contractor received the drafts as agent of the mortgagee, thereby satisfying the requirements for a conversion action at section 3-420(a).

But compare Regions Bank v. Marconne Chevrolet, LLC, where a car rental company financed the purchase of vehicles from a dealer using bank loans, and deposited the loan proceeds (in checks payable to the dealer and car rental company) in the car rental company’s bank account without the dealer payee’s required indorsement. The dealer sued the depositary and payor banks for conversion of the checks. The court held that the depositary or payor bank is not liable to a payee for conversion unless the payee received delivery of the instrument (i.e., a payee cannot sue for conversion of property the payee does not own). The court held that the car rental company could not have received delivery of the checks as an agent of the dealer because the dealer was unaware of the deposits and could not have authorized them. Thus, the court concluded that the dealer never received delivery of the checks and could not sue for conversion.127

B. Drawer Fraud

In Dixon v. Landis, the plaintiff law firm was the victim of a common scam: The law firm deposited a fraudulent check from a purported client; the law firm withdrew the uncollected funds and paid them to the client before the check was presented to the payor bank and dishonored. When the check was returned unpaid to the depositary bank, it was charged-back to the law firm’s deposit account. The law firm sued the depositary bank for negligence and breach of the duty of ordinary care, alleging that the bank had a duty to recognize that the check was fraudulent so as to protect the law firm from this loss. The court rejected the law firm’s claim, noting that the law firm bore the risk of withdrawing uncollected funds on a deposited item, and that a depositary bank has no duty to determine the authenticity of deposited items or otherwise to protect depositors in these circumstances.

C. Fictitious Payee

As noted, in National Union Fire Ins. Co. v. Guaranty Bank, the employee embezzled funds from his employer by submitting false invoices payable to a phony entity controlled by the employee. The employee then indorsed the checks in the name of the phony entity and deposited them in his personal bank account. The employer’s bonding company paid the claim and then sued the depositary bank for negligence, breach of warranty and conversion. The conversion claim was dropped, and the court dismissed the negligence claim because a bank does not owe a duty to

128. 31 App. Div. 3d 171, 785 N.Y.S. 2d 95.
130. 900 N.E. 2d 1201.
131. 344 N.Y.S. 2d 1201.
132. See supra note 121.
non-customers. However, the bank’s motion to dismiss was denied because the court concluded that there was an unresolved issue as to whether the depositary bank breached an Article 3 or Article 4 transfer or presentment warranty. 130

D. Wire Transfer Fraud

As also noted above, Koss Corp. v. American Express Co. 131 involved an embezzlement of corporate funds by an employee who sent wire transfers to herself and additionally created corporate checks to pay her credit card bill and other personal expenses. The credit card company discovered the fraudulent activity but did not report this to the corporation for more than a year. The corporation then sued the credit card company for negligence, conversion, breach of fiduciary duty, and aiding and abetting a fraud. The court of appeals affirmed dismissal of the negligence claim (because there is no duty to report suspicious activities to private parties), but reversed the trial court’s dismissal of the conversion, breach of fiduciary duty, and aiding and abetting claims on grounds that these common law claims were not displaced by UCC Article 4A 132 because they did not arise from a wire transfer. The conversion claims were based on negotiation and payment of fraudulent negotiable instruments and therefore were expressly permitted by UCC section 3-420.

E. Set-Off as Conversion

In American Bank v. Cornerstone Cnty. Bank, 133 the United States Court of Appeals for the Sixth Circuit held that a bank’s set-off of funds in a customer’s deposit account was conversion because

UCC Article 9 (which recognizes the common law right of set-off — see, e.g., UCC sections 9-109(d)(10), 9-340, 9-607(a) and 9-609) does not apply to a security interest in insurance (the funds in the deposit account came from an insurance premium lender and were deposited for the purpose of paying future insurance premiums). 134 The court held that the Tennessee Premium Finance Company Act controlled over UCC Article 9 as to the right of set-off against a general bank deposit. 135

This analysis and all of these conclusions are incorrect. Funds in a general bank deposit are not within the exclusion of insurance from UCC Article 9 (see UCC section 9-109(d)(8)), and in any event the funds in a deposit account are owned by the bank and cannot be converted by its owner. The bank-customer relation is contractual; a deposit account is a debt owed by the bank to the customer as creditor, and the remedy for improper set-off against a general bank deposit is damages for breach of contract. Moreover, the right of set-off is a common law right that exists in this context regardless of UCC Article 9. 136

XI. Other Bank Account Issues

A. Overdraft Fees

In Camp v. Alabama Telco Credit Union, 137 credit union members alleged that their credit union charged overdraft fees for ATM and debit card transactions pursuant to an overdraft protection plan even though the customers never agreed to the plan and had sought to cancel it. The plaintiffs asserted the following claims: breach of contract; conversion; unconscionability; and unjust enrichment. The court dismissed the claims for conversion and unconscionability, because no property was converted and unconscionability is a defense rather than a cause of action. The court reasoned that, if the contract was enforceable, there could be a breach of a contract duty, but only if a contract provision was breached. Unless there was a breach, there could be no unjust enrichment claim to the extent that the issues were governed by the contract. However, if the contract was unenforceable due to unconscionability, there could be an unjust enrichment claim. The motion to dismiss was denied to allow consideration of these issues. 138

B. Substitute Check

In Melaita v. U.S. Bank, 139 after a substitute check was created and paid pursuant to the federal Check Truncation Act, the original check was reacquired by the payee, who then re-deposited it. Upon presentation it was dishonored by the payor bank and returned unpaid to the depositary bank, because it already had been paid. The depositary bank closed the payee’s account and notified the credit bureau that the closure was due to “transactions involving items for checks belonging to another party.” The payee then sued the depositary bank for libel. The court rejected this argument, because the substitute check (having been paid) was the property of the drawer, not the payee; thus, the statement of the bank’s reason for closing the account was accurate. Another interesting issue, not reached by the court, is whether the payee can be the holder of a dishonored substitute check in these circumstances, given

130. Id. See generally Hughes v. TD Bank, 938 F.Supp.2d 625 (N.D.N.C. 2013) (contractual and tort claims relating to witholding of funds for courier charges); Schillaci v. First State Bank, 802 F.Supp.2d 950 (N.D. Ill. 2011) (discharge settlement agreement similar to set-off with collection fees and overdraft fees were not constitutional); Eiler v. Regions Bank, 914 F.Supp.2d 1237 (N.D. Ala. 2013) (federally preempted reasons to claim of excessive check-cashing fees); In re Cho, 109 F.3d 1019 (9th Cir. 1997) (check overdraft liability); Melaita v. U.S. Bank, 203 F.3d 1067 (9th Cir. 2000) (unpaid checks); Hughes v. City of Pooler, 881 F.Supp.2d 1386 (S.D. Ga. 2012) (same).
131. See generally Breier, supra note 131, at Part VII; see also infra note 151.
132. 938 F.Supp.2d 625 (N.D.N.C. 2013)
133. 446 A.2d 343 (R.I. 1982).
that the substitute check had already been paid and the drawer was the owner.140

C. Section 4-406

In Century Constr. Co., LLC v. BankcorpSouth Bank,141 the court of appeal upheld enforcement of a provision in the deposit contract reducing the notice period to ten days, citing the statutory authorization for an agreement of the parties, at UCC section 4-103(a). The court also concluded that UCC section 4-406(c) requires the customer to discover and separately report each paid item that was not properly payable due to the lack of an authorized drawer’s signature.142

D. Regulation CC

In Rowley v. U.S. Bank Nat’l Ass’n,143 the customer declined the bank’s offer of an overdraft protection plan, then sued for wrongful dishonor when the bank dishonored two checks because they exceeded the amount in the customer’s deposit account that was available for withdrawal. The customer also argued that the bank improperly imposed a hold on the availability of funds from a check deposited into the account by a third party (the hold was imposed pursuant to the federal Expedited Funds Availability Act, or EFAA, and Regulation CC), and that the bank erred in providing notice of the hold to the depositor of the check rather than the bank’s customer (the deposit account holder).

The court of appeals affirmed the trial court’s summary judgment for the bank on all of these issues, noting that (absent a contrary agreement as in an overdraft protection plan) the payor bank has the authority to dishonor a check drawn on insufficient funds.144 The appellate court also held that the bank had complied with the time limit for a hold on deposited funds, as provided in the EFAA (allowing a “reasonable period” up to five additional business days, for deposits exceeding $5,000). Additionally, the court agreed with the trial court that the EFAA requires notice of the hold to the “depositor,” even if that is not the account holder.

E. E-Mail Fraud

In Driesen v. Woodforest National Bank,145 the victim of a scam received e-mail messages telling her that she was entitled to receive payments from the United Nations via the defendant bank, if she would pay certain fees to the perpetrator. She paid some of these fees, then sued the bank when she did not receive the promised funds. The court granted the bank’s motion for summary judgment, because the victim was not a customer of the bank and the bank had no duty to protect her from the scam. The bank had no role in the fraudulent e-mails and no duty or other relation to the victim or the scam. One can only marvel at the gullibility of this victim and the ineptitude of her lawyer in filing this case. Perhaps cases like this, and the Dixon case noted below and supra at Part X.B., are a reflection of the declining number of law schools offering courses on negotiable instruments, bank deposits and collections.146

F. Fraud Against Lawyers

In this regard, see again Dixon, Laukittis & Downing, P.C. v. Busey Bank,147 where the law firm deposited a client’s check and then withdrew the funds before the check was dishonored and charged-back to the law firm’s deposit account. The law firm sued the depository bank for negligence and breach of the duty of ordinary care, on grounds the bank had a duty to recognize that the check was fraudulent so as to protect the law firm from its own foolishness. The court easily recognized that the law firm bore the risk of taking a fraudulent check and withdrawing uncollected funds, and that a depository bank has no obligation to investigate the genuineness of deposited checks or otherwise to protect depositors in these circumstances.

G. Check-Cashing Fees

Pereira v. Regions Bank148 was a class action lawsuit originally filed in state court, alleging that the bank violated a state statute prohibiting check-cashing fees when it imposed charges for cashing checks drawn on out-of-state banks. The case was removed to federal court, and the federal court held that the state statute was preempted by the federal Riegle-Neal Amendments Act of 1997.149 Consider also Asencio v. Wells Fargo Bank, N.A.,150 where a non-customer cashing a payroll check at the defendant bank was charged a check-cashing fee of $7.50. The non-customer filed a class action lawsuit against the bank, alleging that the fee constituted unjust enrichment. The court rejected this argument, noting that there was no unjust enrichment because the bank provided a service to the non-customer in return for a payment of fair value.

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140. See supra at n.1.
141. 765 So.3d 145 (Miss. 2007).
142. Id. at 148.
144. 2013 WL 179607, supra note 139, at 2 (citing UCC 4-401(a) & 4-402).
145. 940 S.W.3d 897 (Tex. 2014).
148. 940 S.W.3d 897 (Tex. 2014).
In re Late Fee & Over-Limit Fee Litigation\textsuperscript{114} was a class action filed by credit cardholders alleging that the late charges and over-limit fees authorized in the credit card agreements exceeded the actual damages caused by the late and over-limit payments, and therefore constituted unconstitutional punitive damages. The district court dismissed the claim and the United States Court of Appeals for the Ninth Circuit affirmed, noting that the constitutional limits on punitive damages in tort cases do not apply to contracts.\textsuperscript{115}

H. Verification of Deposit

In Midland Mortg. Corp. v. Wells Fargo Bank,\textsuperscript{116} a mortgage lender relied on a Verification of Deposit (VOD) provided by the borrower’s bank, in processing the borrower’s mortgage loan application. When the VOD was found to be inaccurate, the mortgage lender sued the bank, alleging negligence and negligent misrepresentation. The court rejected these arguments on grounds that the mortgage lender failed to establish a duty of care. The court noted that banks do not owe a duty of care to either customers or non-customers except as stated in a contract. The VOD did not create a duty of care because the VOD stated that it was not issued in an official capacity; could change without notice; and was not to be used by a third party. The court granted summary judgment for the bank.

I. Control Agreement

In Fifth Third Bank v. USCA-Rural Dev.,\textsuperscript{117} the debtor, secured party and depositary bank executed a Deposit Account Control Agreement giving the secured party “control” over the debtor’s deposit accounts.\textsuperscript{118} Subsequently, a writ of garnishment was issued to the bank, and the garnishment creditor sued the bank for failure to pay the funds in the account to the garnisher. The court held that the security interest in the account was perfected by control, providing the secured party priority over the garnishment lien.\textsuperscript{119}

J. Separate Entity Rule

In Motorola Credit Corp. v. Uzan,\textsuperscript{120} a creditor sought an injunction against a bank in New York referring to the transfer of funds held by a branch of the bank in the United Arab Emirates. The bank objected on grounds of the separate entity rule, which requires such an injunction to be obtained against the branch where the funds are held, as a separate entity. The court agreed with the bank, as otherwise no bank could pay an item or allow withdrawal of funds without confirmation from all of the bank’s other branches everywhere in the world. The court recognized that this could disrupt payment transactions, and subject the bank to conflicting duties and liabilities in different countries.\textsuperscript{121} However, the court allowed the injunction to remain in place temporarily, to prevent irreparable harm to the creditor pending an appeal.\textsuperscript{122}

K. No Fiduciary Duty

As noted above at Part VII.A., in W. Bend Mut. Ins. Co. v. Belmont State Corp.,\textsuperscript{123} an authorized corporate check signer issued a check on the corporate account, payable to a bank, and delivered the check to the bank with instructions to apply the payment to the signer’s personal debt. When the corporation was unable to pay its subcontractors and suppliers, a surety paid the claims and then sought to recover from the bank on grounds the check provided notice of a breach of fiduciary duty.\textsuperscript{124} The court rejected this argument, on grounds it was not dispositive as to the authority to conduct the transaction, noting that the signer was a proper fiduciary under the Uniform Fiduciaries Act and thus had authority to conduct the transaction. The bank acted properly in following the instructions of the party authorized to sign the check. Note again that the impact of notice under UCC section 3-307 could be different if the bank was asserting holder in due course status under UCC section 3-302.

XII. CFPB Issues

A. Deposit Account Screening Policies

The Bureau of Consumer Financial Protection (CFPB) has expressed interest in regulating deposit account opening policies and procedures.\textsuperscript{125} The CFPB indicates that it is exploring ideas for how new account screening policies can be improved, so as to increase consumers’ access to deposit accounts and services. The CFPB also has provided a list of current suggestions for how the account opening process can be improved.\textsuperscript{126}

B. Virtual Currencies

The CFPB also seems poised to enter the realm of virtual currencies.\textsuperscript{127} The CFPB has accepted an invitation from the Government Accountability Office (GAO) to participate in federal agency efforts relating to the regulation of virtual currencies, i.e., with a view toward identifying

\textsuperscript{114} See UCC §8-107.\textsuperscript{115} Id. See also UCC §8-107(2)(a) and UCC §8-107(2)(b)(4).

\textsuperscript{116} See also supra Part V.E. and see Heartland, supra note 1, at Part VII.C.

\textsuperscript{117} 26 F. Supp.2d 390 (S.D.N.Y. 2001).

\textsuperscript{118} See UCC §8-107(a).

\textsuperscript{119} See also supra Part V.E. and see Heartland, supra note 1, at Part VII.C.

\textsuperscript{120} 26 F. Supp.2d 390 (S.D.N.Y. 2001).

\textsuperscript{121} See supra Part V.E. and see Heartland, supra note 1, at Part VII.C.

\textsuperscript{122} See supra Part V.E. and see Heartland, supra note 1, at Part VII.C.

\textsuperscript{123} See supra Part V.E. and see Heartland, supra note 1, at Part VII.C.

\textsuperscript{124} See supra Part V.E. and see Heartland, supra note 1, at Part VII.C.

\textsuperscript{125} See supra Part V.E. and see Heartland, supra note 1, at Part VII.C.

\textsuperscript{126} See supra Part V.E. and see Heartland, supra note 1, at Part VII.C.

\textsuperscript{127} See supra Part V.E. and see Heartland, supra note 1, at Part VII.C.
and addressing consumer protection issues subject to CFPB jurisdiction.

XIII. UCC Article 4A Security Procedures

In Choice Escrow & Land Title v. Bancorp South Bank, the United States Court of Appeals for the Eighth Circuit reversed the district court's grant of summary judgment for the bank, holding that the bank's security procedures were commercially reasonable under UCC Article 4A, thereby preventing the customer (the originator) whose funds were stolen by means of a fraudulent wire transfer from shifting that loss to the bank (the originator's bank). The security procedures offered by the bank included: (1) a unique user ID and password; (2) device authentication; (3) dollar limits on daily transfers; and (4) dual control requiring a second authorization. The customer (Choice Escrow) declined the latter two. The court held that the bank's security procedures were reasonable and that the bank accepted the fraudulent payment order in good faith.

XIV. Conclusion

These cases reinforce the observation that the UCC is the most carefully-drafted statute in history. It can be noted that UCC Articles 3 and 4 are written in relatively clear and simple terms and yet answer most of the legal questions that arise within their scope. It is rare for a modern statute to do this, but the UCC does so on a regular, even continual basis. The result is exceptional legal clarity as important yet routine transactions. Those of us who conduct these transactions should not fail to appreciate the benefits of this legal environment. It is surely a key factor in the continuing prosperity that we often take for granted. Obviously, and as noted by others, it is easier to disrupt such a structure than to create or preserve it. The CFPB was one of the great achievements of the Twenty-First Century. Keeping it may be one of the great challenges of the Twenty-First.

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166. See UCC 3-A-104 for the definitions of these terms.


168. See supra note 165. Good things are easily destroyed, but not easily created. This is especially true of the good things that come in as collective assets: peace, freedom, law, civility, public spirit, the security of property, family life, ... improving Roberts, How to Be a Conservative (2014). See also Harrill, supra note 2.

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CFPB Provides Guidance on Ability-to-Repay Rule Application to Assumptions of Residential Mortgage Loans

by Richard J. Andreano, Jr.

On July 8, 2014 the Bureau of Consumer Financial Protection (CFPB) provided guidance on the application of the Regulation Z ability-to-repay rule to assumptions of residential mortgage loans for purposes of clarifying the application of the rule in cases in which a relative acquires title to a security property upon the death of the borrower and wants to assume the loan, and also in similar situations.1

Creditors may rely on the CFPB interpretation under Truth in Lending Act (TILA) section 1026.12, which provides a safe harbor from TILA liability for actions taken in good faith in conformity with a CFPB rule, regulation or interpretation. Prior CFPB guidance indicated that the rule applied to refinancings and assumptions under Regulation Z sections 1026.20(a) and 1026.20(b), respectively. The CFPB notes that both industry and consumer advocates have expressed uncertainty regarding the application of the ATR rule in cases in which a successor seeks to be added as an obligor or substituted for the current obligor on an existing mortgage. The CFPB describes a successor as a person who acquires a legal interest in a property, typically by a transfer from a family member, by operation of law upon another's death or under a divorce decree or separation agreement. Although the successor acquires title to the property, by virtue of the acquisition the successor does not become legally obligated on any existing mortgage loan. In October 2013, the CFPB addressed the obligations of servicers with regard to successors in Batman 2013-02, and while the CFPB provided guidance regarding assumptions it did not address the ATR rule. The guidance notes that there can be significant consequences for a successor who is not able to become an obligor on an existing mortgage loan, and provides an example of a successor not being able to obtain a loan modification because he or she is not a party to the existing loan and therefore cannot enter into a modification agreement. As the CFPB observes, if the ATR rule applies to an assumption of an existing mortgage loan, such an assumption is less likely to occur.

In the guidance, the CFPB interprets the ATR rule as incorporating the existing Regulation Z standard for transactions involving a change in obligors as set forth in Regulation Z section 12 C.F.R. 1026.20(b) & 1026.20(c).

(Continued on page 245)