2015 Update on Drafts, Notes and Bank Accounts Under the UCC

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I. Introduction

As in previous years, this report focuses on selected Uniform Commercial Code (UCC) Article 3 and 4 issues and case law developments believed to be of general interest. While the scope is reasonably comprehensive, reflecting the broad sweep of negotiable instruments law and bank deposit and collection issues and cases, there has been no effort to include every case, issue or development. Moreover, as always, the reader should consult primary authority before relying on any argument or position, as there may be disagreements over interpretation of the case decisions noted here.

Despite these limitations, this report reflects the continuing importance of negotiable instruments law and bank account transactions. The relatively large number of case law decisions reported each year (only partly reflected here), despite the extraordinarily clear and well-written rules in the UCC and enormous increases in the use of alternative payment systems (and the dramatic contraction in the number of banking institutions and bank lending transactions and the virtual disappearance of traditional private mortgage finance,2), reflects the amazing volume and variety of private economic transactions being conducted under state law using traditional contracts and negotiable instruments law, essentially as it has existed for over 250 years and despite the unprecedented (in the United States) recent expansion of inconsistent federal administrative law.3

Though seemingly obvious to nearly all concerned, it can be noted here that the large volume of (sometimes unmeritorious) litigation on these issues, even in the face of probably the best-drafted statute in history, serves as a reminder of how much our society depends on the UCC. One can only marvel at how these important and routine transactions could be impaired, and at what cost to our economy and standard of living, if instead they were governed by the kinds of ambiguous and poorly-drafted rules so evident in other contexts. As it is, and as reflected in this report, with (always a few) notable exceptions, the courts are guided by the UCC to reach consistent and legally-correct results in the vast majority of cases. It is a remarkable achievement.

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II. Scope, Definitions, Choice of Law and Modification by Agreement

A. Jurisdiction and Choice of Law

Though not a UCC case, Garrett v. ReconTrust Co., N.A. is of note. The United States Court of Appeals for the Tenth Circuit held that a national bank located in Texas could conduct a nonjudicial foreclosure under Texas law, on real property located in Utah. In response to the Texas nonjudicial foreclosure, the debtor sued the Texas bank in Utah federal court, arguing that Utah law should apply to the foreclosure of real property located in Utah. The court disagreed, citing the National Bank Act and federal regulations authorizing banks acting in a fiduciary capacity (here, as trustee in a deed of trust) to act pursuant to the laws of the bank's state.

Similarly, in Kennedy v. City First Bank of D.C., the court upheld a right of the bank to enforce the guaranty of an insolvent debtor’s loan. Following entry of a default judgment against them, the guarantors moved to vacate the judgment on grounds the bank was not registered or licensed to do business in the District of Columbia (D.C.), and therefore was precluded from maintaining the action under D.C. Code section 29-105.02. The Kennedy court noted that the National Bank Act preempts the D.C. Code on this issue and thus permitted the bank to sue without regard to a state or local registration.

The “separate entity rule” treats bank branches in different countries as separate entities for some purposes. The separate entity rule was at issue in The Engg., & Dist. v. Bank of China. The plaintiff won a $26 million judgment against foreign debtors in a copyright infringement case, and traced some of the debtor’s assets to a foreign bank that had a branch in New York. The judgment creditor served legal process against the New York branch as a means to reach deposits of the debtors in the foreign bank. The court concluded that the outcome depended on the separate entity rule, which on these facts was unsettled law in New York. The issue was certified to the New York Court of Appeals.

In Hutchins v. Modern Woodmen Fraternal Financial, a thief opened a joint checking account with an annuitant as the other joint tenant, using a forged power of attorney, then fraudulently transferred funds from the annuity into the joint account and withdrew the funds. The annuitant sued the depositary bank and the annuity company, and the bank removed the case to federal court pursuant to 28 U.S.C. section 1441(a), on grounds there was federal question jurisdiction under 28 U.S.C. section 1331 because the state law on wire transfers (UCC Article 4a) was preempted by Federal Reserve Board Regulation J, subpart B. The court disagreed, noting that there is not a complete preemption of state law by Regulation J. Regulation J creates only ordinary preemption (the court noted that only Congress can completely preempt a field of state law). Therefore the presence of federal law did not justify removal where important state law issues also existed.

In Henderson v. Wells Fargo Bank, the mortgagee “force-placed” hazard insurance on the mortgaged property after the mortgagor defaulted on the obligation to provide evidence of insurance coverage. The mortgagee sued the mortgagee for breach of contract and made claims under state consumer protection laws. The mortgagee responded that the federal Home Owners’ Loan Act (HOLA) preempted the state law claims, but the court rejected this defense, noting that HOLA section 560.2(c) provides no preemption for state laws that “only incidentally” affect federal law.

In Greisch v. Vantage Capital, Inc., the mortgage loan servicer entered a Service Participation Agreement with Fannie Mae, pursuant to the federal Home Affordable Modification Program (HAMP). When the servicer cancelled the loan modification agreement entered into by the mortgagee with a previous servicer, the mortgagee filed a class action alleging violations of state consumer protection laws. The mortgagee challenged the mortgagee’s standing to sue on grounds that there is no private right of action under HAMP, but the court disagreed, holding that HAMP did not preclude standing to assert state law claims.

B. Ordinary Care

“Ordinary care” is defined at UCC section 3-103(a)(7). Ordinary care is to be distinguished from the duty of good faith (which is separately defined and more broadly imposed); ordinary

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9. 740 F.3d 108 (2d Cir. 2014). See also Monmouth Credit Corp. v. Uzan, 578 F. Supp. 2d 205 (D.N.J. 2008), discussed in Harrell, supra note 1 at 3144.
10. 978 F. Supp. 2d 657 (S.D. Miss. 2011). For discussion of a case with somewhat similar facts but focusing on the state law and bank account issues, see the Harrell case, discussed infra at notes 23-24. See generally infra Part V.G.
13. See id.
19. See UCC § 3-103(a)(7). For good faith, see id. at 3-103(a)(7).
20. See UCC § 3-103(a)(7).
21. See generally supra note 6.
22. See generally supra note 6.
care is imposed largely as a condition to assertion of rights provided in Article 3 Part 4 and at section 4-406, essentially as a prerequisite for rules that preclude a shifting of losses between innocent parties. As such, under the UCC ordinary care is limited to specified issues, primarily affecting forgery and alteration. For example, in National Union Fire Ins. Co. of Pittsburgh, Pa. v. Raczkowski,20 a company employee used a bogus driver’s license to open an unauthorized d/b/a (“doing business as”) checking account in the employer’s name, and used the d/b/a checking account in a scheme to intercept, steal and deposit checks payable to the employer. After paying the employer’s claim, the employer’s insurance company sued the bank for failure to exercise ordinary care in opening the checking account, and for negligent failure to investigate the authority of the employee to open the checking account. The trial court dismissed the complaint and the United States Court of Appeals for the Eighth Circuit affirmed, noting that a bank has no such duty to investigate.

The Raczkowski court noted that federal anti-money laundering regulations require the bank to exercise care in confirming the identity of a customer (e.g., by requiring photo identification such as a driver’s license); however, these are federal regulatory requirements that do not include a private right of action, and in any event a bank is not obligated to research and determine the ownership of a d/b/a name, trademark or a trade name. That would impose an impossible burden on ordinary account-opening transactions, e.g., by creating an obligation to address and resolve highly technical issues of intellectual property law. However, it can be noted that related UCC provisions remain applicable, as illustrated in Miller v. Benriner,21 where the bank’s motion for summary judgment was denied under UCC section 3-405 because of factual issues as to whether the bank exercised ordinary care in opening the account.

In Ward v. Wells Fargo Bank, N.A.,22 the plaintiff alleged that the bank allowed the customer to open multiple d/b/a accounts as part of a “Ponzi scheme” to defraud third parties and steal their funds. The allegations included violations of federal money laundering regulations and customer verification procedures. The court granted the bank’s motion for summary judgment, noting that banks do not have a duty to investigate transactions conducted by authorized agents. The decision essentially recognizes that the standard of ordinary care is limited to UCC check processing and negotiable instrument issues (as specified in UCC Articles 3 and 4) and (except for section 4-406) does not apply to the bank-customer relation.

Similarly, in Charter v. Farm Family Life Insurance Co.,23 a bank customer opened a checking account with his wife. She then cashed-out her annuity and received a check payable to him. She endorsed the check “For Deposit Only” and deposited it in the joint checking account, then withdrew the funds (and filed for divorce). The husband sued the bank, but the court granted the bank’s motion for summary judgment and this was affirmed on appeal. The court noted that the bank did not violate any duty of ordinary care. UCC section 4-205 authorizes a bank to supply an indorsement for a deposit, and as joint tenant the wife had a contractual right to withdraw the funds.24

Hantz Financial Services, Inc. v. Chemical Bank25 is another case that illustrates the role of ordinary care in UCC Article 3. Hantz Financial Services (HFS) hired a representative to advise its clients about HFS investment plans. The representative directed clients to make investments by writing checks payable to “HFS”; the representative then deposited the checks in a bank account he opened in the name “Henry Armistead Services.”

HFS sued the bank for conversion under UCC section 3-420; the bank countered that HFS was responsible for the acts of its employee under section 3-405. HFS then argued that the bank was contributorily liable under section 3-405 because it failed to exercise ordinary care. The trial court allocated $78,854.95 of the loss to the bank under section 3-405. This was reversed on appeal, on grounds that the trial court should not have included checks deposited outside the applicable statute of limitations period. Since the trial court found that the bank exercised ordinary care as to the checks deposited within the limitations period, the bank was not liable under the comparative negligence standard at section 3-405.

C. Definition of Depository Bank

The term “Depository bank” is defined in the UCC at section 4-105.26 This is an important term because depository and other collecting banks (see section 4-105(5)) have distinct duties under Article 4 Part 2.27 In HH Computer Systems, Inc. v. Pacific City Bank,28 a corporate employee stole checks payable to the employer, forged the employer’s indorsements, and cashed the checks at check-cashing businesses, which
deposited the checks into their accounts at depository banks. The employer sued the banks, alleging they were liable as depository banks for conversion under UCC section 3-420. The banks responded that they were not depository banks for purposes of section 3-420, because the check-cashing businesses dealt with the employee and the banks did not; therefore, the banks argued, they were only serving as intermediaries (see the definition of “intermediary bank” at UCC section 4-105(4)). The court rejected the banks’ argument, noting that the banks were the first banks in the collection chain and thus were depository banks under section 4-105(2), and therefore were responsible for the validity of the indorsement and subject to liability under section 3-420 (and the duty of ordinary care for purposes of the comparative negligence standard at section 3-405). 30

D. Deposit Agreement

In Clemente Bros. Contracting Corp. v. Hafen-Miletzko, 31 the bank’s customer provided a corporate resolution to the bank, agreeing that the customer would notify the bank of any erroneous payments from the bank account within fourteen days of the bank’s mailing or the customer’s receipt of each periodic bank account statement. An employee of the customer forged draw requests for the customer’s line of credit at the bank, thereby embezzling some $386,000 over a period of two years. The customer sued the bank to recover the payments, on grounds that the payments were unauthorized. In its defense, the bank asserted that it was protected by the customer’s failure to give notice within fourteen days as required by the corporate resolution in conjunction with UCC section 4-406. The customer then argued that the draw requests were not “items” governed by the corporate resolution and section 4-406.

The trial court granted summary judgment for the bank, and this was affirmed on appeal. The appellate court concluded that the draw requests were “items,” and emphasized that UCC section 4-103 allows the parties to modify their statutory duties, including the time periods in section 4-406, so long as there is no disclaimer of the duties of good faith or ordinary care. Here, the modification of the section 4-406 time periods in the deposit agreement was reasonable and effective. However, there was a dissent on the issue of whether the one-year limitations period at UCC section 4-406 can be changed by agreement (on grounds it relates to ordinary care). 32

E. “Credit Instruments”

In Zogolis v. Wyom Las Vegas, LLC, 33 the court held that “credit instruments” issued by a casino as draws on a line of credit for gambling purposes (pursuant to Nevada Statutes section 463.361(1)) were “identical to a personal check” (allowing suit for breach of contract without first exhausting administrative remedies). 34

F. Electronic Note

In Good v. Wells Fargo Bank N.A., 35 the bank sought to foreclose a mortgage based on the debtor’s failure to pay an electronic promissory note (a “transferable record” under the federal ESIGN Act). 36 The debtor argued that the bank did not have the right of a holder under ESIGN Act section 7021, because the bank did not meet the section 7021 requirements for “control.” 37 The electronic note included some of the section 7021 requirements, but the court concluded that the section 7021 requirements were not met. This illustrated the importance of the requirements for control of a transferable record, if there is not a negotiable instrument. Arguably, however, the Good case should have been governed by state law rather than the federal ESIGN Act, at least in a state like Indiana that has enacted the Uniform Electronic Transactions Act (UETA). 38 It appears that the issues in Good should have been governed by UETA section 16, rather than ESIGN section 7021, but the result should be the same in either case. 39

G. Non-Negotiable Note

The requirements for the form of a negotiable instrument are provided at UCC section 3-104 (and section 3-103). 40 In Bank of America v. Alta Logistics, Inc., 41 the promissory note was held to be non-negotiable because it did not meet the requirement at section 3-104(2) that it be payable for a fixed amount.

H. Certificates of Deposit

One type of instrument that can be negotiable is a certificate of deposit (CD), as provided at UCC section 3-104(j). In King v. Bank of New York Mellon Corp., 42 the plaintiff held five CDs received from their father’s estate. They sued to collect the CDs from the successor of the trust.

30. See first footnote, last page.

31. See second footnote, last page.

32. See third footnote, last page.

33. See fourth footnote, last page.

34. See fifth footnote, last page.

35. See sixth footnote, last page.

36. See seventh footnote, last page.

37. See eighth footnote, last page.

38. See ninth footnote, last page.

39. See tenth footnote, last page.

40. See eleventh footnote, last page.

41. See twelfth footnote, last page.

42. See thirteenth footnote, last page.
company payce. The successor trust company declined to pay, noting that the CDs had been paid upon their maturity in 1977 to the predecessor of the trust company, which was in possession of the CDs at that time, and were stamped “Payment Received” at that time. The court rejected the plaintiffs’ claims, holding that payment to the prior holder of the CDs discharged the liability of all parties to the instruments. The King court dismissed as totally unfounded the holder’s claim that the stamp on the CDs transformed the CDs into “CD Receipts” that were separately enforceable.42

1. Incorporation by Reference

In Alpacas of America, LLC v. Groome,43 the trial court concluded that the execution of sales contracts in conjunction with related promissory notes rendered the notes non-negotiable (and triggered the four-year (non-UCC) contract law statute of limitations). On appeal the appellate court reversed, emphasizing that the notes were not governed by or made subject to the sales contracts, and therefore the contracts were not incorporated by reference into the notes so as to make the notes non-negotiable. The contracts were entirely separate from the notes although executed as part of the same transactions. A statement in the notes that they were executed “pursuant to” the sales contracts did not render the notes subject to the sales contracts.44 Thus the notes were negotiable instruments, and subject to the six-year statutory limitations period in UCC section 3-118. Upon disbarment, the holder could sue either for breach of the sales contracts or to enforce the notes pursuant to UCC Article 3, with the applicable limitations period dependent on the alternative chosen.45

J. Acceleration

The UCC expressly permits the use of acceleration clauses.46 Such a clause in a note does not impair negotiability, but it must be exercised in good Faith.47 In In re Denver Merchandise Mart, Inc.,48 the court considered whether a notice of acceleration triggered the obligation to pay a prepayment fee, to be included in the proof of claim in the debtor’s bankruptcy case. The court interpreted the terms of the promissory note to mean that there was no obligation to pay the prepayment fee unless there was an actual prepayment. Since no prepayment occurred, no prepayment fee was owed. The court also held that, under Colorado law, a creditor cannot charge a prepayment fee when exercising a right of acceleration.49

In ABI Investments, LLC v. FSG Bank N.A.,50 the debtor had an unpaid loan with a bank that failed. The FDIC was appointed receiver, assumed the position of the failed bank, and sued to accelerate the debt on grounds that the failure of the bank was an event of default that created uncertainty as to the likelihood of repayment of the debt, thereby permitting the FDIC to exercise the acceleration clause in the note.51 The trial court granted summary judgment for the FDIC, but on appeal this was reversed. The appellate court noted that the terms of the note said the right of acceleration depended on the debtor becoming insolvent or otherwise causing the creditor to doubt collection of the debt. Insolvency of the creditor (the bank) did not create uncertainty as to the debtor’s ability to repay. The debtor was up-to-date on the loan payments and there was no indication that the debtor was insolvent or had done anything to suggest doubt as to its ability to pay. The basis for the FDIC’s acceleration was the insolvency of the bank (the original creditor), and this was not attributable to the debtor (even though the debtor and failed bank shared some members and directors). The court also concluded that a creditor’s ability to accelerate the debt on the basis of a good faith declaration of insecurity involves issues of fact for a jury, and is not suitable for disposition in a summary judgment motion.52

In In re Rosas,53 the mortgagee gave notice of acceleration and foreclosure, but later the mortgagee and debtor executed a forbearance agreement. Still later, the debtor filed bankruptcy, and argued that the running of the statute of limitations for the debt had commenced upon the earlier notice of acceleration. The court disagreed, holding that the forbearance agreement terminated the acceleration and prior running of the limitations period. There was no detrimental reliance by the debtor on the earlier acceleration, and the debtor abandoned any rights relating to that acceleration in the forbearance agreement. The court distinguished Callam v. Deutsche Bank Trust Co. Americas,54 where the debtor did not execute a forbearance agreement and instead the mortgagee attempted to unilaterally rescind the acceleration over the objection of the debtor.55

42. See supra, note 19.
43. 2 Supp. 2d 600, deciding payment and discharge for negotiable checks, see also UCC §§ 3-502 & 3-504, and note 39, supra, Part IV, IV-B.
44. See id.
46. See supra, note 19.
47. See also UCC §§ 3-109(b) and 3-110. On incorporation by reference, see generally Alfreid, Electronic Contracts, and Incorporation in Online Contracts, 30 Ohio St. L.J. 795 (Nov. 21, 2015).
50. See supra, note 19.
51. See infra, note 19.
52. See supra, note 19.
55. See supra, note 19.
K. Statute of Limitations

In *In re Washington,* a debtor in bankruptcy objected to the mortgagee’s claim on grounds that the due date of the loan payments meant the claim was unenforceable because it was outside the six-year statute of limitations period in UCC section 3-118(a). The debtor had defaulted on the loan payments in 2007, and the mortgagee accelerated the due date of the payments and filed a foreclosure petition at that time. The debtor filed an answer in 2008 and in 2010 the mortgagee recovered an initial foreclosure judgment, but the mortgagee lacked certain required documentation and as a result the foreclosure case was dismissed before the mortgagee received a final judgment.

The *Washington* court reasoned that the six-year limitations period began to run in 2007 when the mortgagee accelerated the debt, and therefore the claim was outside the six-year limitations period and was unenforceable. The court also permitted avoidance of the mortgage lien under Bankruptcy Code section 506(d), and allowed the debtor to retain the house free of the mortgagee’s lien and claim. The foundational point was that acceleration of the debt began the six-year period, which ran from the due date of the payments. The court observed that this is an exception to the general rule that “[i]n no case does a free house.”

In *Alpacas of America, LLC v. Groome,* noted above Part H.I., the court of appeals reversed a trial court holding that the execution of sales contracts in conjunction with the promissory notes rendered the notes non-negotiable (and meant the notes were subject to the four-year non-UCC statute of limitations). The court of appeals observed that the notes were not governed by or subject to the sales contracts, even though the notes were executed as part of the same transactions. Thus the notes were negotiable, and subject to the six-year limitations period at UCC section 3-118. The holder could sue either for breach of the sales contracts or dishonor of the instrument under UCC Article 3, and this choice would determine the applicable limitations period.

In *Hubbard v. BancorpSouth Bank,* the bank sued to enforce a promissory note and foreclose the mortgage; the suit was brought twenty-one months after the debtors’ default. The debtors argued that the action was barred by the state’s one-year statute of limitation for foreclosure actions. The bank argued that the state’s three-year contract law limitations period applied. The Mississippi Supreme Court upheld the trial court’s decision for the bank, concluding that the suit was timely, but observed that the arguments of both parties were incorrect, as the applicable limitations period was six years under UCC section 3-118 (for enforcement of the promissory note).

In *Kirsch v. Cranberry Financial, LLC,* the holder of an installment note filed suit to collect the debt, but allowed the suit to remain dormant for five years. The suit was subsequently dismissed without prejudice. Later the debtor sought a declaratory judgment, arguing that the six-year limitations period at UCC section 3-118 had expired and that this barred enforcement of the note. The debtor argued that the payment due dates were accelerated by the filing of the lawsuit more than six years earlier, and this triggered commencement of the limitations period. The holder of the note argued that the limitations period ran separately based on the due date of each installment. The court agreed with the debtor that filing the lawsuit accelerated all of the installment due dates, commencing the six-year limitations period for the entire note under section 3-118.

In *Bank of America v. Alta Logistics, Inc.*, illustrates again that the applicable limitations period (e.g., that for an ordinary contract versus UCC section 3-118) may depend on whether the instrument is negotiable under UCC section 3-104. In *Alta Logistics,* the note was non-negotiable and therefore subject to the four-year contracts limitations period rather than the six-year limitations period for negotiable instruments.

In *Mark D. Dean, P.S.C. v. Commonwealth Bank & Trust Co.,* the bookkeeper for a lawyer was authorized to sign checks on the law office bank account. The bookkeeper embezzled money from the account using a check-kiting scheme. The lawyer sued the payor bank, arguing that the bank had a “duty to protect the account from theft.” The court dismissed the lawyer’s claims as un timely under the three-year statute of limitations period at section 3-118, and further noted that the lawyer was in the best position to discover and prevent the fraud. The court also recognized that the comprehensive system of UCC check fraud remedies displaces alternative claims such as those asserted by the lawyer in this case.

In *Ward v. Stanford,* the beneficiary of a trust sued the trustees for fraud, mismanagement and breach of fiduciary duty, including a failure to collect the payment of a promissory note due from the settlor of the trust. The district court held that the cause of action was untimely under the
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six-year statute of limitations at section 3-118. The appellate court affirmed but
remanded to determine when the six-year period began to run, because there
was an issue of material fact as to whether the note payments were accelerated prior to
the installment due dates. The appellate
court reasoned that the cause of action
accrued at the time of the legal injury
or (in limited circumstances) upon its
discovery, and here the injury was the
failure to collect the payments when
due. The court noted that the “discovery
rule” normally does not apply absent
fraudulent concealment; however, in this
case the beneficiary asserted fraudulent
concealment, presenting factual issues
not suitable for summary judgment. 87

In Knuthowski v. Cross, 88 the court
applied section 3-118(a) to preclude the
enforcement of all installment note payments that came due out-
side the six-year limitations period.

1. Terms of the Instrument

Payment of an instrument without a
required indorsement constitutes conver-
sion under UCC section 3-420. 89 North-
east Bank v. Hanover Ins. Group 90 illus-
trates this all-too-common problem:
An insurance company issued two drafts to
pay a property loss claim; the drafts were
made payable to three parties (not in the
alternative): the insured; the loss payee
(the mortgagee); and the claims adjuster.
This required indorsement by all three
parties. However, the insured received
the drafts and obtained payment for both
drafts from a bank, without the required
indorsement of the loss payee (the
mortgagee). The loss payee demanded
compensation from the bank on grounds of
conversion under UCC section 3-420.
The bank rejected this demand and later
the loss payee foreclosed the mortgage,
suffering a $400,000 loss, although it
later resold the mortgaged property in a
separate transaction for a full recovery.

The loss payee then sued the bank un-
der section 3-420, alleging conversion of
the drafts because of the breach without a
proper indorsement. The bank argued that
this would provide a double recovery, but
the court agreed with the loss payee, hold-
ing that the bank was liable for conversion
under section 3-420 for taking the drafts
without a required indorsement, regard-
less of the loss payee’s later disposition
of the mortgaged property in a separate
transaction following the foreclosure.

In Charles R. Tips Family Trust v.
PB Commercial LLC, 91 the promissory
note was payable for "$1,700,000" in
numbers, but only "one million, seven
thousand dollars" in words. Pursuant to
UCC section 3-114 the words controlled
the numbers and the holder could collect
only the lesser amount. Citing Gathrie v.
National Home Corp., 92 the court
applied section 3-114 even though the
note in question was non-negotiable.

III. Negotiation, Assignment,
Indorsement, Liability and
Standing to Sue

A. Standing

The collapse of subprime mortgage
lending in 2007–2008, and the resultant
foreclosure crisis continues to generate
cases questioning the mortgagee’s stand-
ing to foreclose. 93 In Bank of America

N.A. v. Morris, 94 for example, the debtor
objected to enforcement of the note and
foreclosure of the mortgage on grounds
the mortgagee lacked standing at the time
the foreclosure petition was filed because
the mortgagee officer’s affidavit indicated
that the mortgagee had possession of
the note "directly or through an agent.
" The debtor contended that possession
via an agent was not sufficient for standing
to sue. The court of appeals rejected this
argument and affirmed summary judg-
ment for the mortgagee, stating (in accor-
dance with well-established law): "This
Court holds that mere possession by an
agent is possession by its principal."

In Bank of America, N.A. v. Moody, 95
the debtor also argued that the bank did
not have standing to enforce the mort-
gage note at the time of the foreclosure
petition, as required by rule of law such
as Deutsche Bank National Trust v.
Brombaugh 96 and Deutsche Bank Na-
tional Trust v. Byrans. 97 In Moody, the
court recognized that the right to enforce
a negotiable promissory note is governed
by UCC section 3-301, which provides
for enforcement by: (1) the holder; (2)
a nonholder in possession who has the

87. 358 P.3d 138 (Ohio 2016).
89. Id. at 140, 515 (Other recent cases have rejected similar foreclosure defenses. See, e.g., L.P. Family Trust, Inc. v. Charterbank, 785 A.2d 1093 (Pa. 2001) (requiring the debtor to demonstrate that the existence of the note and mortgage failed to establish the assignment, and an effort to use proof evidence to impose conditions not apparent on the face of the note). In National Mortg. v. Wells, 2014 WL 340088 (Ohio App. Feb. 20, 2014) (misinterpretation of the note to the assignee resulted in the assignment of the mortgage, regardless of who was the assignee).
91. 358 P.3d 138 (Ohio 2016).
97. 341 S.W.2d 147 (Tex. 1959).
98. 702 F.3d 361 (4th Cir. 2013).
99. 702 F.3d 361 (4th Cir. 2013).
102. 232 F.3d 129 (2d Cir. 1999).
103. 232 F.3d 129 (2d Cir. 1999).
rights of a holder (e.g., by assignment; or (3) a person with a right of enforcement under § 3-109 or § 3-418(d)). This recognizes, e.g., a right of enforcement under general contract and agency law, as explicitly stated in UCC section 1-103.

In *Moody*, the mortgagor argued that the bank failed to meet its burden of proving that: (1) the indorsement of the note occurred before the foreclosure petition was filed; (2) the indorsement was properly authorized; and (3) the bank was in possession of the note when it filed the foreclosure petition. All of these arguments failed, the court noting that the bank attached the indorsed mortgage note to the foreclosure petition, thus establishing that the note was indorsed and the bank was the holder at the time the foreclosure petition was filed. As the court noted, the bank was not required to further demonstrate that the indorsement was authorized, absent evidence to the contrary. The *Moody* court found that there was no issue of material fact and noted that the debtor did not raise an affirmative defense. Thus the bank had standing to foreclose and its motion for summary judgment was affirmed.80 In *J.P. Morgan Chase Bank, N.A.*, *Successor by Merger to Bank One, N.A. v. Shane A. Mitchell and Wells Fargo Bank, N.A.*, the debtor objected to foreclosure of the mortgage securing his home equity line of credit (HELOC) on grounds that J.P. Morgan Chase Bank (the bank) did not establish that it was the holder of the note, for purposes of standing to sue, because the note was payable to a predecessor of the bank. The bank provided an affidavit attesting that it acquired the rights of the payee (Bank One, N.A.) by reason of the merger of the two banks, and that it was the servicer of the loan and holder of the note as successor to a subsidiary of J.P. Morgan Chase Bank. The trial court's judgment for the bank was affirmed.

B. Assignment Issues

_Bank of Kremlín v. Davis_, presented an unusual issue that arose as the consequence of a refinancing transaction. A mortgage loan was originally made to two cousins (and the spouse of one cousin), but later was refinanced upon execution of a new note; the original mortgage was assigned to secure the new note, which was signed by only one of the cousins (and the spouse). When there was a default on the new note, the mortgagee sued both cousins, arguing that the original note had been assigned along with the mortgage as part of the refinancing transaction, rather than being paid (so as to discharge the makers on the original note). In effect, the mortgagee was arguing that the note followed the mortgage.

The court considered whether execution of the new note and loan agreement, along with the assignment of mortgage, also assigned, or alternatively discharged, the original note. The court of appeals concluded that this was an issue of fact, to be determined by the intent of the parties. The trial court had interpreted the transaction to mean that the new note was intended to replace the original note; the court of appeals affirmed, concluding that the original note was paid, discharging the liability of the cousin who did not sign the new note.81

Issues relating to the law of assignments and standing to sue also can arise in a non-mortgage context, as in suits to collect credit card debt. In *Faust Corp. v. Priddy*, for example, the credit card debtor challenged the evidence of the assignment of the credit card contract, as provided by the assignee seeking to collect the debt. At the trial the assignee successfully argued that it was the assignee in interest to the card issuer, by reason of an assignment shown by the following evidence: (1) a written assignment; (2) a record of the unpaid account history; and (3) the debtor's admission that he had received and failed to dispute the credit card billing statements.

The trial court denied the debtor's motion for summary judgment, and on appeal the creditor contended that: (1) the creditor failed to prove the assignment; (2) the creditor should be required to produce the credit card agreement; and (3) the trial court should have granted the debtor's motion for summary judgment. The court of appeals affirmed denial of the debtor's motion, concluding that the assignee met its burden in presenting evidence of the assignment, and that the debtor failed to present evidence sufficient to justify summary judgment or trial on the merits. The court expressly rejected the debtor's contention that the assignee was required to produce the credit card contract, concluding that the assignee's evidence was sufficient to show the existence of the credit card account and the amount of the outstanding debt.

In *Skaggs Regional Medical Center v. Powers*, the hospital assigned the debtor's past due account to a debt collector. When these collection efforts were unsuccessful, the hospital filed suit to collect the debt. The debtor argued that the hospital had assigned the debt to the debt collector and therefore only the debt collector had standing to sue. Both the trial court and the court of appeals rejected this argument, as the assignment to the debt collector was for collection only and was not an absolute assignment. The court noted that an absolute assignment would transfer all rights of the assignor, limiting enforcement to the assignee, but concluded that this was not the case here.
C. Other Requirements to Enforce the Instrument

In Wells Fargo Bank N.A. v. Boehrenbeck, the court held that the promissory note in question met the UCC section 3-104 requirements for a negotiable instrument, and was negotiated to the bank as a holder in due course by indorsement of the prior holder. This was not impaired by the bank placing its own blank indorsement on the note, since the bank retained possession of the bearer paper and therefore had holder status. The court also recognized that indorsements need not be dated. In Iowa Mortgage Center, L.L.C. v. Baccam, the debentors contended that the holder was not entitled to enforce the promissory note because the holder failed to meet the burden of proof required for a contract claim. This argument was misplaced -- see, for example, UCC section 3-308. Surprisingly, the district court and court of appeals agreed with this argument, but the Iowa Supreme Court reversed, recognizing that introduction of the note into evidence creates a presumption that satisfies the plaintiff's burden of proof and shifts the burden to the debtor to rebut the presumption by coming forward with contrary evidence.

In Federal Nat'l Mortg. Ass'n v. Conover, the mortgagors argued that the foreclosure of their mortgage was wrongful because the note and mortgage had become "separated" and therefore the foreclosure trustee was not properly appointed. As in Baccam (noted immediately above), the district court surprisingly granted summary judgment for the mortgagors. This was reversed on appeal: the appellate court observed that the note and mortgage were cross-referenced and should be treated as parts of a single transaction. There is no requirement that they be physically joined together (or even cross-referenced), so long as the mortgage can be identified as securing the note.

In Conover, the appellate court also noted that a loan can be sold or transferred without prior notice to the borrower, e.g., by transfer of the note alone, as the mortgage rights follow the note, so that the holder of a note has the right to foreclose the related mortgage. Viewing the facts "in the light most favorable to the nonmovants" (for purposes of a summary judgment motion), in Conover the transfer of the loan was proper, and therefore the appointment of the foreclosure trustee, and the foreclosure itself, also were proper. The court of appeals concluded, however, that neither party was entitled to summary judgment at that stage of the case.

In Bank of New York v. Romero, the borrowers argued that the bank did not have standing to foreclose the mortgage on their home because the bank was not the holder of the note and also on grounds the loan violated the New Mexico Home Loan Protection Act (HLPA). The bank admitted that it did not take an assignment of the mortgage until three months after the foreclosure petition was filed, but observed that it had possession of the note, indorsed in blank, at the time the foreclosure petition was filed and therefore was the holder entitled to enforce the note under UCC section 3-301. The note submitted into evidence was indorsed in blank but also had a second indorsement to another bank not involved in the case.

The district court held that the bank was the holder of the note, had standing to foreclose, and did not violate the HLPA. and the court of appeals affirmed. However, on appeal the New Mexico Supreme Court concluded that the bank was not the holder or otherwise entitled to enforce the note or foreclose the mortgage. The Supreme Court concluded that the note was not bearer paper because of the special indorsement and therefore the bank was not a holder of the note under UCC section 3-201. Nor did the bank produce evidence that the note was transferred to it by any other means as required by UCC sections 3-203 and 3-301. The Court also held that the HLPA is a state consumer protection law not preempted by federal law and regulations.

On a somewhat similar issue, in Bank of New York Mellon v. Grund, the court held that an attempt to negotiate a note by an indorsement on an allonge failed because the indorser had previously made a special indorsement on the instrument to another person. Although the indorser retained possession of the note, prior to the attempted negotiation by means of the allonge, the court concluded that the indorser on the allonge did not thereby become the holder because the note itself was indorsed to a different person. However, the indorsee on the note later indorsed the note to the indorsee on the allonge, constituting indorsement to a holder at that time. Moreover, the indorsee on the allonge had standing to foreclose even before becoming the holder, because it was a person entitled to enforce the note under contract law, as recognized at UCC section 3-301.

In Mink v. Mortgage Electronic Registration Systems, Inc., the court concluded that a mortgagor, not a party to the assignment of the note and mortgage, had standing to challenge the validity of
the assignment. The court reasoned that the mortgage lien provided the mortgagor an interest in the subsequent assignment between the other parties, allowing the mortgagee to challenge the validity of the assignment. Similarly, the court in Ortiz v. Citimortgage, Inc., held that the mortgagee could assert that the assignee of the note did not have standing to foreclose because of alleged defects in the chain of mortgage assignments.

In Ortiz, the assignee argued that the mortgagor did not have standing to attack the validity of the assignments because the mortgagor was not a party to the assignment transactions. The court disagreed, holding that the mortgagor had standing to assert that the assignment was void (as opposed to merely voidable), in order to assert a claim of tortious interference against the assignee. But compare the more conventional analysis in HSBC Bank USA, Nat’l Ass’n v. Surratt, holding that the mortgagor could not dispute the validity of a mortgage assignment that did not affect the mortgagor’s contractual obligations.

In Deutsche Bank Nat. Trust Co. v. Beneficial New Mexico Inc., the bank filed a foreclosure petition as assignee of the mortgage loan. The copy of the note attached to the petition was payable to the bank’s assignor and was not indorsed. At trial, the bank produced the note with a blank, undated indorsement. The trial court awarded a foreclosure judgment to the bank, reasoning that the note and mortgage had been assigned to the bank. This was reversed on appeal; the court concluded that the bank lacked standing to foreclose at the time the petition was filed, as indicated by the undorsed note attached to the foreclosure petition. The subsequent, undated indorsement was not sufficient to cure this error at the time the petition was filed.

In Roth v. JPMorgan Chase Bank, the issue was whether the bank met the burden of proof required for summary judgment, as regards a claim to enforce promissory notes, by a showing that there was no issue of material fact. The bank produced two affidavits, one attested that the bank was the holder of the notes, that they were signed by the maker, and that they were in default and subject to a demand for payment; a second affidavit was provided in support of the bank’s claim to attorney fees. On appeal, the court affirmed the trial court’s ruling for the bank, holding that the maker waived the right to object to admission of the evidence and (in a de novo review) that the evidence supported the award of summary judgment to the bank. The affidavits were sufficient because they established: (1) the existence of each note; (2) that each note was signed by the defendant as maker; (3) that the bank was entitled to enforce each note; (4) the balance due; and (5) reasonable attorney fees.

D. MERS

In Dallas County v. MERSCORP, Inc., the county sued MERS and Bank of America, claiming fraudulent misrepresentation, unjust enrichment and civil conspiracy because the defendants allowed mortgage assignments to be registered privately between the parties (via MERS) rather than being recorded with the county. The court rejected all of these arguments and denied the county’s claim for injunctive relief, noting that detrimental reliance and proof of injury are necessary elements and were absent in the case. The court also recognized that there is no legal obligation to record assignments, and thus there is no liability or unjust enrichment for a failure to do so.

In a subsequent decision in Dallas County v. MERSCORP, Inc., the court also rejected the county’s claim that Texas Local Government Code section 192.007(a) requires assignments to be recorded. In the latter case, the court granted summary judgment to MERS, holding that section 192.007(a) does not create a private cause of action or require the recording of mortgage assignments.

E. Possession of Note

In Morlock, LLC v. Bank of N.Y., the debtor sued the assignee of a deed of trust (i.e., the mortgagee), seeking to prevent the assignee’s nonjudicial foreclosure on the debtor’s home. The debtor asserted that the assignee could not foreclose because the assignee was not the holder of the note and the assignment was executed by an unauthorized person. The court rejected these arguments and affirmed summary judgment for the assignee, recognizing that a nonjudicial foreclosure can be conducted by a mortgagee who is not the holder of the note, and the debtor (as a third party who was not a party to the assignment) had no standing to question the authority of the person who executed the assignment.

In In re Harbortowne of Gloucester, LLC, the debtor acquired real property subject to a mortgage but did not assume liability for the debt. The mortgage was then assigned to the first assignee, accompanied by a lost note affidavit because the promissory note had been lost. This first assignee then assigned the lost note (but not the mortgage) to a second assignee, who filed a secured claim in the debtor’s bankruptcy case. The mortgage property was sold and the bankruptcy court held that the first
assignee held the foreclosure proceedings in trust for the party entitled to enforce the note. The court reasoned that the mortgage secured the note and the first assignee was no longer entitled to enforce the note because it had assigned the note to the second assignee, who was not entitled to enforce it under the Justin rationale. The debtor had no liability on the note, but enforcement of the note was necessary to allow foreclosure of the mortgage.

The Harborhouse court emphasized that Massachusetts did not enact the 2002 uniform text revision to UCC section 3-309, and instead follows the rule of Dennis Justin Co., LLC v. Robinson Broad Corp. Thus, the second assignee could not enforce the lost note, because the second assignee was not in possession of the note when it was lost. The court required the sale proceeds to be held by the first assignee until it was determined who had the right to enforce the note.

Delta v. GMAC Mortgage Corp. reversed a foreclosure judgment and remanded the case to determine whether the mortgagee seeking to enforce a lost note had provided adequate protection for the debtor as required by UCC section 3-309. The court concluded that the mortgagee had not met its burden of proof as regards the obligation to provide adequate protection, because it did not provide security to protect the debtor from subsequent liability in the event the lost note was found and enforced by a holder in due course.

As noted above at Part III.B., in Bank of America, N.A. v. Morris, the mortgagor filed a Motion to Vacate Judgment in an effort to reverse the foreclosure of his home mortgage, arguing that the mortgagee (the bank) failed to show that it had possession of the mortgage note when the foreclosure petition was filed, because the relevant bank officer's affidavit stated only that the bank had possession of the mortgage note "directly or through an agent." The court rejected this argument and affirmed the grant of summary judgment for the bank, noting: "This Court holds that mere possession by an agent is possession by its principal." In L.D.F. Family Farm, Inc. v. Charterbank, the court rejected the debtor's argument that the assignee of the note and mortgage failed to establish the assignment, and rejected the debtor's effort to use parol evidence to impose conditions not apparent on the face of the note. In Nationstar Mortg., LLC v. West, the court recognized that transfer of the note to the assignee entitled the assignee to foreclose the mortgage, regardless of who owned the loan. In U.S. Bank v. Ugrin, the holder status was established by the affidavit from the prior holder; this was sufficient to establish standing in the absence of contrary evidence.

F. Contract Law Issues

Bank of Kremlin v. Davis was previously noted above at Part III.B., but also deserves mention here. A mortgage note was executed by two cousins (and the spouse of one), but later the debt was refinanced and the mortgage assigned to secure a second note and loan agreement executed by only one of the cousins and the spouse. When the new loan went into default, the holder sued both cousins, claiming that the old note had been assigned with the mortgage as part of the new loan agreement, rather than being paid in full so as to discharge the makers of the old note. The issue was whether execution of the second note, assignment of mortgage and loan agreement discharged, or alternatively assigned, the old note. This was a contract law issue that depended on the intent of the parties. The trial court concluded that the second note (signed by only one cousin) was intended to replace the old note (signed by both cousins); the court of appeals affirmed, concluding that the old note was paid and merged into the second note when the loan was refinanced, discharging the liability of the cousin who did not sign the second note.

In Faust v. Pridgy, also noted above at Part III.B., a credit card debtor (Pridgy) objected to the evidence used by Faust to establish the assignment of the debt. Faust claimed that it had a right to collect the debt as assignee of the card issuer, as indicated by: (1) a written assignment; (2) a record of the unpaid account history; and (3) the debtor's admission that he had received and failed to dispute the credit card billing statements. The trial court denied the debtor's motion for summary judgment.

On appeal the debtor asserted that: (1) Faust failed to prove the assignment; (2) Faust did not produce the credit card agreement; and (3) the trial court should have granted the debtor's motion for summary judgment. The appellate court affirmed the holding for Faust, concluding that Faust met its burden of proof as to the assignment and observing that the debtor failed to present rebuttal evidence to justify summary judgment or a trial on the merits. The court of appeals rejected Pridgy's argument that Faust should have produced the written credit card agreement, concluding that the evidence presented by Faust was sufficient to show the existence of the credit card account and the debt.

In Skaggs Regional Medical Center v. Powers, another case noted above at Part III.B., the hospital assigned the debtor's past due account to an agency for collection. When these efforts failed,
the hospital sued to collect the debt. The debtor asserted that the hospital had assigned the debt to the collection agency and therefore only the agency had standing to sue. The court disagreed, noting that the assignment was for collection only and was not an absolute assignment.

Other recent cases on contract law issues (previously noted above at Part III.E) include: Nationalstar Mort., LLC v. West,78 where the court recognized that the assignee of the note was entitled to enforce the note and foreclose the mortgage regardless of who owned the loan; L.D.F. Family Farm, Inc. v. Charterbank,101 rejecting the debtor’s argument that parole evidence could be used to establish unwritten conditions limiting enforcement of the note and mortgage; and U.S. Bank v. Ugrin,102 holding that the bank established holder status as to the note (and standing to foreclose the mortgage) based on an affidavit from the prior holder, which was sufficient because the debtor provided no evidence to the contrary.

G. “Transferee” under Article 9

UCC Article 9 section 9-332 terminates a prior security interest that was perfected against a deposit account, as against a payment of the funds, unless there was collusion between the debtor and the transferee. This requires that there be a noncollusive payment to a “transferee,” a more lenient standard than for a holder in due course under UCC section 3-302. But section 9-332 does not require a “transfer” to a transferee.103

In Zimmerling v. Affinity Financial Corp.,104 the funds were transferred, from a deposit account that was subject to a security interest, to an escrow account pursuant to an order of the trial court, pending resolution of the priority dispute. One claimant argued that this was a transfer to a transferee that terminated the security interest of the competing secured party under section 9-332. Both the trial court and the appellate court rejected this argument, holding that a “transfer” under section 9-332 requires payment of an obligation or other relinquishment of claims to the funds by the transferor. Here, the transfer to the escrow account, by order of the court, was intended to preserve the status quo and leave the prior claims intact and unresolved. Thus, it was not a transfer that would cut off the security interest.

H. Negotiation to a Holder

As noted above at Part III.C., Wells Fargo Bank N.A. v. Roehrenbecker involved a promissory note that met all of the requirements for a negotiable instrument and was negotiated to the bank as a holder in due course, with an indorsement to the bank by the prior holder. It did not matter that the bank subsequently placed its own blank indorsement on the note, since the bank retained possession of the note and continued to be the holder. The court also recognized that indorsements need not be dated.105

As also noted above at Part III.C., in Iowa Mortgage Center, L.L.C. v. Baccam106 (the debtors argued that the promissory note should not be enforced because the holder did not meet the burden of proof necessary to enforce a contract. While a negotiable instrument clearly is a type of contract creating a contractual obligation to pay -- see UCC sections 3-412 - 3-414, it is a special type of contract as provided in UCC Article 3 (which supersedes contrary contract law rules -- see section 1-103).107 This is a fundamental point that could not be more clear; yet, in Baccam the district court and court of appeals agreed with the debtor’s argument to the contrary. Fortunately, the Iowa Supreme Court recognized the error and reversed, observing that admission of a promissory note into evidence creates a presumption that satisfies the holder’s burden of proof and shifts the burden to the debtor to come forward with contrary evidence.108

In Bank of New York Mellon v. Grindel,109 an attempt to negotiate a note by indorsing an allonge failed because the indorser had previously made a special indorsement to another person on the instrument itself. Because of this prior indorsement, the indorser was not the holder and therefore could not make an effective indorsement on the allonge; however, as long as the indorser retained possession of the note, the indorsee on the note also was not the holder.110 When the indorsee on the note indorsed the note to the indorsee on the allonge who was in possession of the note, this constituted indorsement to a holder at that time.111 Moreover, the indorsee on the allonge had standing to foreclose even before becoming the holder, because it was a person entitled to enforce the note under contract law and section 3-301.112


120 Note also that this is more lenient than the comparable requirement for “negotiation” to a “holder” under UCC 3-301. See supra Part III.N.


127 The district court agreed with the holder, see supra Part III.A. 2, note 113, the court of appeals reversed, see supra Part III.A. 2, note 113, and the supreme court agreed with the district court, see supra Part III.A. 2, note 113.
1. Indorsements

_Cruisin’, Inc. v. Springleaf Financial Services of Indiana, Inc._132 illustrates the use of a restrictive indorsement to impose limitations on payment of the instrument. The buyer of a vehicle financed the purchase by obtaining a loan from the lender. The lender issued the loan proceeds check payable to both the buyer of the vehicle and the seller (a vehicle dealer), with a restrictive indorsement indicating that the check could be negotiated and paid only after: the purchase price of the vehicle (the “account”) was paid in full; all prior liens were satisfied; and the certificate of title (CT) had been mailed to the lender. Instead, the seller mailed the CT to the buyer and then negotiated the check. When the buyer defaulted on the loan and disappeared, the lender sued the seller, noting that the restrictive indorsement created a contract between the lender, the buyer, and the seller, which was breached by the seller. The court agreed, holding that the restrictive indorsement was an express condition to negotiation, agreed to by the seller when it indorsed the check, creating a duty which the seller breached.133

_HSB Bank USA, Nat’l Ass’n v. Surrauer_134 held that the mortgagee did not establish standing to enforce the note and foreclose the mortgage because the mortgagee did not provide evidence of a proper indorsement of the mortgage note, as required to create holder status.135 The court is so held that the mortgagee in that case was not a non-holder in possession because it had delivered possession of the note to the loan servicer. This latter conclusion is questionable, as the mortgagee should be able to establish possession by the servicer as an agent of the mortgagee, or another contractual basis for the right to enforce the note, under UCC sections 3-301 or contract law.136 However, the Surrauer court was on firmer ground in holding that a mortgagee does not have standing to dispute the validity of an assignment that does not affect the contractual obligations of the account debtor.137

2. Good Faith

_UCC Section 1-304 imposes an obligation to perform and enforce UCC contractual obligations in good faith, but this does not create new substantive obligations based on a duty of good faith._ In _Bank of America, N.A. v. Moody_,138 for example, the mortgagors defended against foreclosure of their mortgage on grounds there was a violation of the duty of good faith because the foreclosing bank did not comply with the requirements of the federal Home Affordable Modification Program (HAMP). The court noted that there is no private right of action under HAMP, and rejected the mortgagors’ claim that a failure to comply with HAMP is a breach of an independent duty of good faith or an affirmative defense to foreclosure.139

3. Required Evidence

_Thuy Binh Si Ho v. Saigon Nat. Bank_140 involved a suit by the bank to enforce a promissory note, based on an affidavit by a bank officer stating that the bank was entitled to enforce the note and loan agreement. The trial court granted the bank’s motion for summary judgment, rejecting the debtor’s argument that this evidence was not sufficient. This decision was reversed on appeal, because the affidavit did not state that the bank was the holder of the note. The appellate court also concluded that the bank was required to show: (1) the note or its terms; (2) that the defendant signed the note; (3) that the plaintiff was the holder or owner; and (4) the current balance due. The court held that presenting the affidavit and a copy of the loan agreement was not sufficient to meet these tests, in particular the third requirement.141 As noted above at Part III.H., in _Bank of New York Mellon v. Grand_,142 there was an attempt to negotiate a note by an indorsement on an allowance. This attempt failed because the indorser had previously made a special indorsement on the instrument itself, to another person. Therefore, even though the indorser retained possession of the note, the indorser was no longer the holder because the note was indorsed to a different person.143 However, when the indorse on the note indorsed the note to the indorsee on the allowance, who had possession of the note, this constituted indorsement to a holder. Moreover, the indorse on the allowance had standing to foreclose even before becoming the holder, because it was a person entitled to enforce the note under contract law, e.g., pursuant to UCC sections 1-103 and 3-301.

_In Roth v. JPMorgan Chase Bank_,144 the bank sought to meet the burden of proof required for summary judgment in a suit to enforce a promissory note, by showing that there was no issue of material fact. In support the bank provided two affidavits: (1) an affidavit attesting that the bank was the holder of the notes signed by the debtor, that the notes were in default, and there had been a demand for payment; and

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132. _Cruisin’, Inc. v. Springleaf Financial Services of Indiana, Inc._ 338 P.3d 138 (2014) (noted above at Part III.A). The bank is the non-holder in possession by an agent in possession by the principal since there was no prior bank. See also _UCC § 3-206_.

133. _Surrauer_ 2013 WL 6910942 (7th Cir. Dec. 5, 2013) (noted above at Part III.A). The court is so held that the mortgagee in that case was not a non-holder in possession because it had delivered possession of the note to the loan servicer. This latter conclusion is questionable, as the mortgagee should be able to establish possession by the servicer as an agent of the mortgagee, or another contractual basis for the right to enforce the note, under UCC sections 3-301 or contract law. However, the Surrauer court was on firmer ground in holding that a mortgagee does not have standing to dispute the validity of an assignment that does not affect the contractual obligations of the account debtor.


(2) an affidavit evidencing a claim for attorney fees. The appellate court affirmed summary judgment for the bank, concluding that the debtor waived his right to object to this evidence and (in a de novo review) that the evidence supported the award of summary judgment. The affidavits were sufficient as evidence of: (1) the terms of the note; (2) the signature of the defendant; (3) the bank’s right to enforce it; (4) the balance due; and (5) reasonable attorney fees. 146

In Morlock, L.L.C. v. Bank of N.Y., 147 the debtor sued the assignee of the deed of trust (i.e., a mortgagee) in an effort to contest the nonjudicial foreclosure on the debtor’s home, arguing that the assignee could not foreclose because it was not the holder of the note and because the assignment was made by an unauthorized person. The appellate court affirmed summary judgment for the assignee, recognizing that a nonjudicial foreclosure is a lien enforcement that can be conducted by a mortgagee who is not the holder of the note; moreover, the debtor (as a third party who was not a party to the assignment) had no standing to question the authority of the person who made the assignment. 148

It is clear that the holder of a note (among others) has a right (and therefore standing) to enforce the note (and foreclose an underlying mortgage), regardless of who owns the loan. In In Re Sia, 149 the debtors objected to a creditor’s claim in their bankruptcy case on grounds that the securitization trust holding the note was not the owner of the loan and therefore lacked standing to file the claim and enforce the note. The court disagreed, noting that ownership of the note is not necessary under UCC section 3-301. Once holder status is established, a lack of ownership does not preclude enforcement. As holder of the note, the trust was entitled to file a proof of claim and enforce the note and mortgage. 150

L. Lost Notes

In In re Harborhouse of Gloucester, LLC, 151 the debtor acquired real property that was subject to a mortgage, but did not assume liability for the mortgage debt. The mortgagee then assigned the mortgage to the first assignee, using a lost note affidavit because the original note was lost. This first assignee later assigned the lost note (but not the mortgage) to a second assignee, who filed a secured claim when the debtor filed bankruptcy. The mortgaged property was sold and the bankruptcy court ordered the first assignee (of the mortgage) to hold the foreclosure proceeds in trust for the holder or owner of the note, since the note had been subsequently assigned, and the mortgagee merely secured the note and did not create or represent the debt.

In Harborhouse, although the debtor had no personal liability on the note, the debt created by the note still existed, and a right to collect the debt was necessary in order to foreclose the mortgage. The court held that the second assignee (of the lost note) could not enforce the lost note under UCC section 3-309 because the second assignee was not in possession of the note when it was lost; and the first assignee (of the mortgage) (who had assigned the note) was not entitled to the foreclosure proceeds because the mortgagee followed a lost note. Therefore, the court required the sale proceeds to be held by the assignee of the mortgage until it was determined who had the right to enforce the note.

The bankruptcy court decision in Harborhouse was affirmed by the United States Bankruptcy Appellate Panel (B.A.P.) for the First Circuit, citing among other authorities Dennis Jostin Co., LLC v. Robinson Broad Corp. 152 The B.A.P. noted that Jostin has been rejected in subsequent UCC amendments, but that Massachusetts did not adopt this revision and instead retains the Jostin rule.

Another case that applied section 3-309 was Delia v. GMAC Mortgage Corp., 153 where the court reversed a prior foreclosure judgment and remanded the case to determine whether the mortgagee had provided sufficient protection against double liability for the debtor, as required in order to enforce a lost note. The court concluded that the mortgagee had met its burden of proof as regards the provision of adequate protection, as required under section 3-309, in that the mortgagee failed to provide security to protect the debtor from the potential for double liability if the lost note was subsequently found and enforced. 154

M. HAMP

As noted above, in Bank of America, N.A. v. Moody 155 the mortgagors defended against foreclosure by arguing that the foreclosure petition was not filed in good faith because the bank failed to comply with the requirements of the federal Home Affordable Modification Program (HAMP). The court noted that this argument has been widely rejected, because there is no private right of action under HAMP; the court also rejected the mortgagors’ argument that a mortgage servicer’s failure to comply with HAMP was a breach of the duty of good faith or an affirmative defense to foreclosure. 156

The United States Supreme Court denied certiorari in Bioch v. Wells Fargo

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145. [Footnote text and notes 98, 99, 100 & 101].
149. 116 L.S.B. 251, 39 (5th Cir. 1990) (citing supra Part III.E. (Possession of Notes).]
150. 114 L.S.B. 251 & 39 (5th Cir. 1990) (citing supra Part III.E. (Possession of Notes).]
155. [Footnote text and notes 150 & 151].
security interest and a law firm's claim to funds in its client trust fund account. The Article 9 secured party traced the proceeds of its security interest into the client trust fund account of the law firm, which claimed the funds as legal fees. The law firm argued that it had priority as a holder in due course of the deposited checks. The court disagreed, holding that the deposited checks were negotiated to the law firm subject to the prior security interest and that the law firm had notice of the security interest when it took the checks (and therefore the law firm did not take the checks as a holder in due course). 162

O. Holder in Due Course – More on “Notice”

In Bank of New York v. Ukpe, 163 the mortgagees defended against foreclosure of the mortgage on their home by alleging that misrepresentations were made by the mortgage broker who arranged the loan. The originating lender had transferred the loan to an assignee pursuant to a pooling and servicing agreement, and the assignee commenced foreclosure. The trial court held that the assignee had standing to foreclose and granted a foreclosure judgment. This was affirmed on appeal, because the assignee was a holder in due course of the note and therefore was not subject to personal claims or defenses assertable against prior parties such as the mortgage broker. The assignee took the instrument as a holder pursuant to UCC section 3-201, and at that time had no notice or knowledge of any representations by the mortgage broker. Moreover, there was no “close connection” between the holder and the mortgage broker. On the latter point, the court distinguished these facts from those in the famous “close connection” case of Unico v. Owen. 164

P. Cashier’s Checks

In Shaw v. Suntrust Title, 165 a credit union customer deposited a $67,890 check and received provisional settlement pursuant to UCC Article 4 Part 2, then used part of the funds in the account to purchase a cashier’s check from the credit union. When the $67,890 deposited check was dishonored, the deposit was charged-back to the customer’s account at the credit union, pursuant to UCC section 4-214, creating an overdraft. The credit union then refused to pay the cashier’s check it had issued on grounds it was drawn on a subsequently revocable provisional settlement for the $67,890 check. Clearly, the credit union’s right to collect the overdraft by setoff would constitute a defense as regards its liability to its customer. However, the holder of the cashier’s check successfully argued that it was entitled to payment from the credit union as a holder in due course. 166

In State Bank v. Smith, 167 a bank customer deposited a $294,500 cashier’s check and requested that the depository bank send a wire transfer of roughly $275,000 to Japan. Before the wire was sent, the depository bank contacted the issuer of the cashier’s check (the issuing bank) to confirm the check number and amount of the cashier’s check. Upon presentation of the cashier’s check, however, it was dishonored by the issuing bank.

162. 126 N.J. 101 (1967). In Unico v. Owen, 531 F.2d 30 (2d Cir. 1976), the court held that a trust instrument was not so irregular to give notice and preclude holder in due course status under UCC section 3-202. In the case, a trust instrument was held to be neither accessible nor negotiable, thus requiring a different UCC section 3-303 approach. The court distinguished Unico v. Owen, 531 F.2d 30 (2d Cir. 1976).


because the issuing bank's signature was forged. The depository bank then sued the issuing bank, as a drawer liable on the instrument under section 3-412. The court affirmed summary judgment for the issuing bank, correctly noting that the depository bank's claim to holder in due course status was irrelevant as against a drawer (the issuing bank) that did not sign the check. The issuing bank did not sign or issue the cashier's check and therefore had no liability on the instrument.

In In re Estate of Falcon there was a dispute between family members over a joint bank account and a cashier’s check. One of the joint account holders withdrew funds from the account to purchase a cashier’s check. After the other account holder died, the executrix found the cashier’s check and delivered it to an attorney for the family. Subsequently the joint account holder who had withdrawn the funds and purchased the cashier’s check filed a declaration of loss with the issuing bank, stating that the cashier’s check was lost and seeking reimbursement from the issuing bank under UCC section 3-312.

The issuing bank honored the declaration of loss and refunded the money into the joint account. Another family member then acquired and presented the cashier’s check; upon presentation it was dishonored by the issuing bank on grounds that it had been paid pursuant to the prior declaration of loss. The executrix then sued the surviving joint account holder and sought to add the bank as a defendant. The court refused to allow the complaint to be amended to add the bank, noting that the issuing bank had no duty to resolve disputes between joint account holders and no obligation to pay the cashier’s check a second time, after its payment pursuant to section 3-312. Moreover, the bank was entitled to allow either joint account holder to withdraw the funds.

Q. Section 3-308 Presumptions

In Iowa Mortgage Center, LLC v. Baccam, the debtor defended against enforcement of a promissory note by arguing that the holder failed to meet the burden of proof for enforcement of a contract claim. Surprisingly, the district court and court of appeals agreed with the debtor, but the Iowa Supreme Court remedied this and reversed by reason of UCC section 3-308, noting that presentation of a negotiable promissory note creates a presumption that satisfies the creditor's burden of proof and shifts the burden to the debtor to come forward with countervailing evidence. This case recognizes that the section 3-308 procedural requirements for enforcing a negotiable instrument differ from those for an ordinary contract.

However, in In re Carrosse-Franklin the bankruptcy court upheld the debtor's objection to the creditor's evidence regarding an indemnity on a note. The court noted the presumption at section 3-308, but held that, once the debtor produced evidence contrary to that presumption, the burden shifted to the holder to prove the validity of the signature. In Carrosse-Franklin, the debtor asserted "robo-signing" and "sloppiness" in the indorsement process, and the court held that this was sufficient to shift the burden to the holder of the note to prove that the indorsement was genuine. However, it can be noted that the presumption at section 3-308 should still have evidentiary value, arguably sufficient to satisfy the burden of proof against such generalized allegations.

In Schaumburg Bank & Trust Co. v. Bellomy Real Estate & Dev., LLC, an affidavit was sufficient to show that the FDIC was entitled to enforce the note as successor to the former holder of the note (a failed bank).

IV. Bank Account Issues

A. Liability on Corporate Checks

In Big Bang Miami Entertainment, LLC v. Monmirail, a company's chief executive officer (CEO) signed three company checks on behalf of the company (as drawer) for payment on a loan owed by the company. The checks did not state the CEO's representative capacity, as would be ideal for a representative signature pursuant to UCC section 3-402(b)(1). When the checks were dishonored, the holder of the checks sued the company and the CEO personally, arguing that the CEO was liable on the instruments. The trial court entered judgment against both defendants, but on appeal this was reversed. Applying the exception to the general rule at UCC section 3-402(c) (for checks), the court of appeals concluded that the company became liable based on the signature of its agent (the CEO), but, since the checks were clearly labeled as company checks, the CEO was not personally liable.
B. Opening the Deposit Account

In National Union Fire Ins. Co. of Pittsburgh, Pa. v. Raczekowski, an employee opened an unauthorized d/b/a account in the bank's name, using a counterfeit driver's license, and stole and deposited checks payable to the employer and deposited them in the d/b/a account. The employer's insurance company sued the bank for failure to exercise ordinary care in opening the d/b/a account, and negligent failure to investigate the authority of the employee to open the account. The trial court dismissed the complaint and the United States Court of Appeals for the Eighth Circuit agreed, noting that the bank had no duty to investigate such matters when opening an account.

The Raczekowski court reasoned that (under federal law) a bank has a duty to exercise ordinary care in confirming the identity of a customer (e.g., by requiring photo identification such as a driver's license); however, a bank is not obligated to research and determine the ownership of a d/b/a name, trademark or trade name. That goes beyond ordinary care and would create an impossible burden for routine account-opening transactions, i.e., requiring research into trademark claims and resolution of highly technical issues of intellectual property law.

As noted above at Part II.B., in Wunder v. Wells Fargo Bank, N.A., the plaintiff argued that he was damaged because the defendant bank permitted its customer to open multiple d/b/a accounts in creating a "Ponzi scheme" to defraud investors and convert their funds. The plaintiff alleged that the bank failed to follow federal money laundering regulations and customer verification procedures. The court granted the bank's motion for summary judgment, emphasizing that banks are not required to investigate whether transactions conducted by agents are authorized by the terms of the agency agreement. Moreover, the standard of ordinary care at UCC section 3-103(a)(9) expressly applies to check processing issues, as stated in Article 4 Parts 2 and 3 (and section 4-406), not to the general bank-customer relation. It can also be noted that the plaintiff was not a customer of the bank, and a bank does not owe a duty to protect non-customers. As also noted above, in Charter v. Farm Family Life Insurance Co., the plaintiff opened a joint checking account with his wife. She cashed out his annuity and received a check payable to him, then endorsed the check "For Deposit Only" and deposited it in their joint checking account. She then withdrew the funds. The husband sued the bank but the court granted the bank's motion for summary judgment and this was affirmed on appeal. Under UCC section 4-205, the bank was authorized to supply the husband's indorsement for a deposit to the joint account, and as joint tenant the wife was entitled to withdraw the funds from the account.

C. Indorsement and Deposit Issues

In Hantz Financial Services, Inc. v. Chemical Bank, a representative of Hantz Financial Services (HSF) instructed the firm's clients to write checks payable to "HFS" and then deposited them in an account he opened in the name "Henry Firearm Services." HFS sued the depositary bank, asserting conversion under UCC section 3-420; the bank countered that HFS was responsible for the indorsements of its employees under UCC section 3-405. HFS then argued that the bank was contributorily liable because it failed to exercise ordinary care, as required under section 3-405(b), and the trial court agreed, imposing $98,945.95 of the loss on the bank under UCC section 3-405. This was reversed on appeal, because the trial court erred by including checks deposited outside the applicable limitations period. Since the trial court found that the bank exercised ordinary care as to the checks deposited within the limitations period, the bank could assert UCC section 3-405 as a defense, and there was no contributory negligence.

In HH Computer Systems, Inc. v. Pacific City Bank, a corporate employee intercepted checks payable to the corporation, forged the indorsements of the payee, and cashed the checks at check-cashing businesses, which deposited the checks into their accounts at depository banks. The corporation sued the depository banks for conversion under section 3-420; the banks defended by arguing that they were not depository banks because the check-cashing businesses dealt with the retail customers and thus the banks were only serving as intermediary banks. The court rejected this argument, noting that the banks were the first banks in the collection chain and thus were depository banks responsible for the validity of the indorsements and subject to liability for conversion under section 3-420 and for comparative negligence under section 3-405.

D. "Responsibility" under Section 3-405

In 24-7 Group of Companies, Inc. v. Roberts, the issue was whether an employee had "responsibility" for processing checks that the employee...
stole from the employer. The employee opened an unauthorized bank account in the employer’s name, then deposited checks stolen from the employer. The employer sued the bank for negligence and conversion pursuant to UCC section 3-405(a)(3), arguing that the bank was negligent in opening the account because the employer’s Articles of Incorporation, submitted by the employee to the bank when the account was opened, did not authorize the employee to open the account. The bank countered that the employer entrusted the employee with “responsibility” for the checks, as that term is defined at section 3-405(a)(3), so that the indorsements were deemed to be authorized pursuant to section 3-405(b).

This defense depended on what the term “responsibility” means. The court concluded that the definition of this term at section 3-405(a)(3) requires the bank to demonstrate that the employer authorized the employee to process, indorse, prepare, deposit or receive the checks in question. The court rejected the bank’s section 3-405 defense because in this case the employee was hired as an independent contractor to perform duties not related to processing the checks, and therefore was not entrusted with responsibility as to the subject checks.

In contrast, in *Coastal Agricultural Supply, Inc. v. J.P. Morgan Chase Bank N.A.* the employer’s bookkeeper clearly was responsible for processing and depositing incoming checks sent to the employer. The bookkeeper opened an unauthorized bank account in a name similar to the employer’s name, then intercepted checks payable to the employer and deposited them into this account. The employer sued the depositary bank, and the bank asserted section 3-405 as a defense. The court agreed with the bank that section 3-405 was an affirmative defense, because the bank exercised ordinary care and the bookkeeper was entrusted with responsibility for the checks. The court also held that any liability of the bank could be first offset against the settlement received from the bookkeeper, rather than being used to reduce the company’s loss.

As in the other cases noted immediately above, in *Miller v. Bennett* the bookkeeper for a small business opened an unauthorized bank account in the name of the employer, then intercepted checks payable to the employer and deposited them in the unauthorized account. Once again, the employer sued the bank where the unauthorized account was opened and maintained. The trial court granted the bank’s motion to dismiss on grounds the bank owed no duty to the employer, as the employer was not a customer of the bank. On appeal, the court reversed, on grounds of UCC section 3-405. The employer was responsible for the actions of its employee under UCC section 3-405, but the bank could partially lose this defense and be held liable under the section 3-405 comparative negligence standard if it did not exercise ordinary care. The court concluded that this issue was not suitable for disposition on a motion to dismiss.

In *Concord Servicing Corp. v. J.P. Morgan Chase Bank N.A.*, an employee embezzled funds by using refund checks for actual customers of a related corporation and then forging the customers’ indorsements and depositing the checks in an account of the employee at another bank. Payment of the checks was reflected in the monthly account statement sent by the payor bank to the related corporation. When the fraud was discovered, the related corporation filed suit against the payor bank. The payor bank argued that the checks were properly payable despite the unauthorized indorsements, pursuant to section 3-405, and the court agreed. The court held that the employee was responsible for handling the checks for purposes of section 3-405, even though the employee was employed by a different company: he was an agent of the related corporation because the related corporation authorized his role in the issuance of the checks.

**E. Impact of Bankruptcy**

In *Shapiro v. Heaston*, the debtor wrote checks but then filed a Chapter 7 bankruptcy petition before the checks were presented to and paid by the payor bank. The bankruptcy trustee sought turnover of the funds in the checking account at the time the bankruptcy petition was filed, citing Bankruptcy Code sections 541 and 542(a) (defining the bankruptcy estate), even though by then the payor bank had made final payment of the checks under UCC section 4-215. The debtor argued that the funds were not part of the bankruptcy estate because she wrote the checks before filing bankruptcy, and the checks were subsequently paid. However, a check is not an assignment of funds (see UCC section 3-108) and the United States Court of Appeals for the Ninth Circuit held that Bankruptcy Code section 542(a) allows turnover from a third party in possession of property that was part of the estate at any time during the bankruptcy case. The court reversed the bankruptcy and district courts, creating a circuit split between its decision and the United States Court of Appeals for the Eleventh Circuit in *In re Pyron*.

**F. Cashier’s Checks and Checking Account Fraud**

In *Amazon Properties U.S., LLC v. Park Avenue Bank*, a bank customer purchased a cashier’s check with funds from a deposit account of the customer at the bank. The customer also owed an unpaid loan at the same bank. When the customer presented the cashier’s check...
for payment, the bank dishonored it, apparently intending to set-off the funds owed to the customer on the cashier's check against the customer's debt to the bank. The customer sued for conversion (under UCC section 3-420), arguing that the bank could not set-off the debt as a basis for dishonor of the cashier's check, and the court agreed. This does not appear to be a correct analysis on these facts (assuming the bank had a defense to liability that was good against the holder of the cashier's check), as the bank (like any obligor — including a bank obligated to pay a cashier's check) has a right to assert any claim or defense it has against the party demanding payment (unless that party is a holder in due course, see UCC section 3-305).

Of course, once the cashier's check was issued, the funds were removed from the customer's account and paid to the bank, in return for the bank assuming liability on the cashier's check under UCC section 3-412. Thus, funds in the debtor's account were no longer available for set-off against the loan. However, the bank's obligation to pay the cashier's check represented a debt payable to the holder of the cashier's check, which could be offset against an obligation of the holder of that check to repay the bank loan. Assuming the customer remained the holder of the cashier's check. If the cashier's check had been negotiated by the bank's customer to a holder in due course, these set-off rights would be cut off pursuant to UCC section 3-306, but even so the bank would be entitled to litigate the relevant issues including the viability of its claim or defense, subject to the liability rules at UCC section 3-411.

Moreover, an obligor (such as a bank that issues a cashier's check) does not commit conversion by failing to pay the debt when a debt is owed by a debtor, the debtor is the owner of the funds, subject to a contractual obligation to repay. A debtor cannot commit conversion of his or her own funds. A cashier's check is evidence of a debt owed to the party entitled to enforce the instrument. If the party presenting the cashier's check is not a holder in due course, and the issuing bank has a proper claim or defense that is good against that party, the bank is entitled to refuse payment on that basis.

If the bank's defense fails, it is liable for breach of contract under sections 3-411 and 3-412, not conversion. The 1990 UCC uniform text amendments at UCC section 3-411 (not enacted in New York) make this more clear, but this has always been a proper interpretation of the law. Even though New York has not enacted the clarifications in the 1990 uniform text amendments, absent a holder in due course the Amazon Properties result is incorrect; and, even if there was a holder in due course, the stated reasoning is incorrect.

Further illustrating this point is Shain, where the holder of a $67,890 check deposited it at a credit union and received provisional settlement, then used part of the funds to purchase a cashier's check from the credit union. When the $67,890 check was dishonored, the deposit was charged-back to the account pursuant to UCC section 4-214, and the credit union asserted the customer's overdraft as the basis for refusing to pay the cashier's check. The holder of the cashier's check issued by the credit union successfully argued that it was entitled to payment as a holder in due course; the court also rejected the account holder's argument that the credit union was precluded from revoking the provisional settlement because the account holder had instructed the credit union not to make the funds available until the $67,890 check had cleared.

Thus, and despite UCC section 3-310(a), cashier's checks are not entirely "like cash," as they are not legal tender, and are subject to dishonor by the issuing bank in some circumstances (where the bank has a defense good against the holder). Still (and especially for a holder in due course), they are generally superior to a non-bank obligation. However, this may create a false sense of security and confidence that facilitates payment fraud (if a person assumes that cashier's checks will always be paid).

One example of a scam that illustrates this point, and sometimes targets lawyers, is Mechanics Bank v. Mathsen. The fraud in this case began when the perpetrator retained the lawyer to collect debts supposedly owed to the perpetrator; subsequently, the lawyer received a cashier's check from one of the supposed debtors, and deposited the check in the lawyer's IOLTA (client trust) account. Then, at the request of the perpetrator, the lawyer initiated a wire transfer of the funds (after deducting an attorney fee) to foreign bank accounts of the perpetrator. The cashier's check was fraudulent and was later dishonored and returned unpaid to the lawyer's bank (the depository bank, see Article 4 part 2), where it was charged-back to the lawyer's account creating an overdraft (because the funds had been wired out of the account by the lawyer at the request of the perpetrator, thus leaving an insufficient account balance to cover the charge-back). The bank then successfully sued the lawyer to recover the amount of the overdraft.

Another variation of the same scam is illustrated by State Bank v. Smith, where the bank customer deposited a $294,500.99 cashier's check and then requested that roughly $275,000 be sent by wire transfer to Japan. Before sending the wire, the depository bank contacted the issuer of the cashier's check (the issuing bank) and confirmed
the number and amount of the cashier's check. However, the cashier's check was a fraudulent duplicate and upon presentation it was dishonored by the issuing bank because the drawer's signature was forged. The appellate court affirmed summary judgment for the issuing bank, in a suit by the depositary bank to collect the cashier's check.

In State Bank, the depositary bank's status as a holder in due course was irrelevant as against the purported drawer (the issuing bank), since the latter did not sign the check, and thus had no liability to pay the instrument under UCC section 3-412. Of course, when the dishonored cashier's check was charged-back to the account of the depositary bank's customer (creating an overdraft in the account), the depositary bank's customer was liable for the resulting overdraft under UCC section 4-214, but (as perpetrator or dupe in the scam) it is likely this person was long gone or otherwise unable to pay.

In American Founders Bank v. Modern Invs. LLC, an investment group closed its bank account, received a cashier's check for the account balance, and entrusted the cashier's check to its investment advisor. The advisor forged one of the required indorsements and deposited the check into his account at the same bank. The investment group sued the bank for conversion and recovered a judgment. The bank appealed, arguing that the investment company's negligence contributed to the loss and that the trial court failed to credit the bank with payments made by the advisor. The court of appeals affirmed the decision below on procedural grounds, concluding that the bank did not properly preserve its claim to error at trial.

G. Forged Indorsements and Conversion

Butler v. Finley is a case involving convoluted (if not entirely unusual) facts, and illustrating the dangers of "self-help" justice. The check in question was indorsed at the direction of an agent of the payee, but without the payee's knowledge or consent. The payee had sold his home by transferring ownership to the agent, who then transferred ownership of the home to the buyers on behalf of the seller/payee. The mortgagee was not notified of the sale. The buyers obtained insurance coverage, and subsequently the home was destroyed by fire.

The insurance claim was paid to the mortgagee, which sent a check for the excess insurance proceeds (after paying off the mortgage loan) to the agent but payable to the seller, who continued to be indicated in the mortgagee's records as the owner of the property. A second check for additional insurance proceeds also was received by the agent, again payable to the seller for the same reason. Concluding that the excess insurance proceeds should be paid to the buyers rather than the seller/payee, the agent attempted to have the seller/payee indorse the check, but he refused. The agent then directed his sister to supply the indorsements of the agent and the seller/payee, and with those indorsements the agent deposited the check in his bank account. When the seller/payee realized this, the seller/payee sued the agent for conversion under section 3-420, and the court agreed, holding that the agent was liable for conversion of property (the check) payable to another person.

As also indicated by the two cases noted immediately below, forged indorsements on drafts for insurance claim proceeds continue to be an all-too-common problem. In Northeast Bank v. Hanover...
obligation to pay the mortgagor’s claim under the insurance policy.  

H. Payment, Discharge of Liability and Limitations Period

In re Washington

Illustrates that it is possible for a debtor to receive a discharge under a technicality. The debtor, mortgagee objected to the mortgagee’s secured claim in the debtor’s bankruptcy case, on grounds that the debt was unenforceable under the six year statute of limitations at UCC section 3-118(a). The debtor had defaulted on the loan payments in 2007, and the mortgagee accelerated the due date of the payments and filed a foreclosure complaint shortly thereafter. In 2010 the mortgagee recovered an initial foreclosure judgment, but it was then determined that the mortgagee lacked some of the required documentation and as a result the foreclosure case was dismissed. Thus, the mortgagee never received a final foreclosure judgment, but the acceleration of the debt was not expressly cancelled.

In the 2014 bankruptcy court, the court held that the six-year section 3-118(a) limitations period began to run in 2007 when the mortgagee accelerated the debt; therefore, the mortgagee’s bankruptcy claim was unenforceable and unenforceable. This permitted avoidance of the lien under Bankruptcy Code section 506(d), and the debtor was allowed to retain the home free of the mortgagee’s lien and claim. While the court’s statutory analysis was sound (assuming that dismissal of the foreclosure did not inherently cancel the acceleration), this scenario provides an opportunity to note that a bankruptcy court is a court of equity and equity abhors a forfeiture. It does not appear that the mortgagee did anything in this case to suggest the kind of culpability that should trigger forfeiture or unjust enrichment claims in equity.

In King v. Bank of N.Y. Mellon Corp., the heirs of a decedent received five certificates of deposit (CDs) from the decedent’s estate and demanded payment of the CDs from the successor of the trust company payee. The successor trust company refused the demand for payment, because the CDs had been paid to the predecessor trust company upon maturity in 1977 and were stamped “Payment Received” at that time. The court dismissed the heirs’ claim, holding that the 1977 payment discharged the liability of all parties to the instruments. The court also rejected the heirs’ claim that the stamp on the CDs transformed the CDs into “CD Receipts” that were separately enforceable.

In Mosley v. Climenk mortgage, Inc., the debtors on a mortgage note claimed that they made full payment of the loan by means of tendering a personal check. The mortgagee declined to accept the check as a tender of payment, instead requiring certificated funds. The court rejected both arguments and granted the mortgagee’s motion to dismiss, emphasizing that a personal check is not an assignment of funds and does not qualify as an electronic transfer of funds.

V. Bank-Customer Relation

A. Modification by Agreement

In addition to governing the deposit, collection and payment of “items,” the UCC Article 4 applies to the basic bank-customer relationship, in conjunction with contract law. UCC section 4-103 allows modification by agreement of most UCC provisions and obligations (except those requiring good faith and ordinary care).

Clemente Bros. Contracting Corp. v. Hafner-Milazzo illustrates the broad scope of this point. The bank’s corporate customer provided a corporate resolution agreeing that the customer would notify the bank of any payment errors on the customer’s account within fourteen days of the mailing or receipt of the relevant periodic bank account statement. An employee of the customer forged draw requests for the customer’s line of credit at the bank, stealing roughly $386,000 over a period of two years. When this was discovered, the customer sued the bank, arguing that the drafts were not properly payable. The bank responded by citing the customer’s failure to give notice within fourteen days as required by the corporate resolution, in conjunction with UCC section 4-406. The customer then argued that the draw requests were not “items” governed by the corporate resolution and section 4-406. The trial court granted summary judgment for the bank, and this was affirmed on appeal. The court noted that section 4-103 allows the parties to modify their statutory duties, including the time periods in section 4-406, so long as there is no disclaimer of the duties of good faith or ordinary care. The court concluded that the modification of the section 4-406 time periods was reasonable and effective, and applicable in this case. There was a dissent on the issue of whether...
the one-year limitations period at section 4-406 can be changed by agreement (on grounds it relates to ordinary care).

Aliaga Medical Center, S.C. v. Harris Bank, N.A. illustrates an interesting twist on the impact of payment time limitations on the face of a check. A bank customer sued the payor bank for paying a check labeled "void after 90 days" more than five months after the date of the check. In essence, the customer argued that this was equivalent to a stop payment order, so that the check was not properly payable after the end of the ninety day period. In response the bank noted that the deposit agreement provided the requirements for stopping payment and notifying the bank of errors, and that the customer did not meet these requirements. The court held for the bank, rejecting the argument that the notation "void after 90 days" was sufficient as or equivalent to a stop payment order, and giving effect to the notice requirement and other terms of the deposit agreement. The court also rejected the customer's argument that the provision in the bank-customer deposit agreement was unconscionable.

King v. Carolina First Bank was a class action by bank customers asserting state law claims including conversion, unjust enrichment and violations of the duties of good faith and fair dealing, based on the argument that it was unlawful for the bank to post checking account debits before credits in order to maximize overdraft fees. In part, the bank defended the practice on grounds that the claims were preempted by the National Bank Act, but the court rejected this defense. The court also held that the plaintiffs presented a prima facie case for a breach of contract claim (based on violation of the implied covenant of good faith and fair dealing), unjust enrichment and conversion. The bank's motion to dismiss on these issues was denied. However, the plaintiff's cause of action for unconscionability was dismissed.

### B. Check Kiting and Other Schemes

In Mark D. Dean, P.S.C. v. Commonwealth Bank & Trust Co., the bookkeeper for a law office was an authorized sign checks on the lawyer's bank account. She used this authority to conduct a check-kiting scheme. The lawyer sued the bank to recover his losses, arguing that the bank had a "duty to protect the account from theft." The court dismissed the claim as untimely under the three-year statute of limitations period at UCC section 3-118. Additionally, the court held that the lawyer was in the best position to discover and prevent the fraud, noting that the UCC check fraud remedies displaced common law claims such as those asserted in this case.

As noted above at Part IV.B., in Wied v. Wells Fargo Bank, N.A., a receiver sued the bank alleging that the bank allowed its customer to open multiple d/b/a ("doing business as") accounts as part of a "Ponzi scheme" that defrauded other parties and converted their funds. The receiver argued that the bank failed to follow federal money laundering regulations and customer verification procedures. The court granted the bank's motion for summary judgment on all counts, noting that banks do not have a duty to investigate the merits of transactions conducted by authorized agents. It can also be noted that there is no private right of action for violations of federal money laundering regulations, and the standard of ordinary care at UCC section 3-103(a)(9) applies to limited check processing functions (see Article 4 Parts 2 and 3 and section 4-406), not contract law issues or the bank-customer relation generally (see Article 4 Part 4).

As also noted above at Parts I.B. and IV.B., in Chartier v. Farm Family Life Insurance Co., a bank customer maintained a joint checking account with his wife. She cancelled his annuity and received a proceeds check payable to him, then deposited the check in the joint checking account and withdrew the funds. When the husband sued the bank, the district court granted the bank's motion for summary judgment, and this was affirmed on appeal. UCC section 4-205 authorized the bank to supply the husband's indorsement for a deposit to his joint account, and as a joint tenant the wife was entitled to withdraw the funds.

### C. Schemes Targeting Bank Customers (Including Lawyers)

As noted above at Part IV.F., cases such as those noted below continue to arise as a result of a common scenario that frequently targets lawyers. A typical example is Mechanics Bank v. Methven. In Methven, the perpetrator posed as a client, retaining a lawyer to collect purported debts; the lawyer subsequently received a car's check from one of the purported debtors, deposited the check in the lawyer's IOLTA account at the bank, and at the request of the client ordered the bank to send the funds by wire transfer (after deducting an attorney fee) to a foreign bank for the benefit of the client. The car's check deposited by the lawyer turned out to be forged.

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215. Id. See also UCC § 4-401 ("When Bank May Charge Customer's Account") & id. § 4-403 ("Customer's Right to Stop Payment").
216. 295 Supp. 3d 1019 (D. C. 2014). See also id. in 2014 B. App. 90 (Citing UCC § 4-205 for authority that notice of stop payment order is required).
218. 2015 WL 5183913, 2015 U.S. Dist. LEXIS 151640 (M.D. Fla. Feb. 9, 2015), see generally supra Part IV.B.
219. 193 A.3d 524 (Md. 2015).
220. MD. Sup. Ct. R. 14(e); see also infra notes 24 and 25, and Harrell Update, supra note 1, at 140-41.
and was returned unpaid to the bank, and then charged back to the lawyer’s account at the bank, creating a large overdraft (since most of the funds in the lawyer’s account had been wired out to the foreign bank at the request of the client, leaving an insufficient account balance to cover the charge-back). The lawyer’s bank then sued the lawyer to recover the overdraft, and appropriate court of appeals held for the bank.224

Another recent case illustrating this type of scam is Taylor Anderson, LLP v. U.S. Bank N.A.,225 with the distinction that the victim (the bank customer who deposited the forged cashier’s check) asked the deposit bank to confirm that the deposited cashier’s check had cleared, and received an affirmative email response from a bank employee before directing that the wire transfer be sent to the foreign bank account.

When the deposited cashier’s check turned out to be forged, and was dishonored by the issuing bank and charged-back to the victim’s account at the deposit bank (creating a large overdraft), the victim sued the deposit bank for breach of contract, negligent misrepresentation, fraud and negligence. The court granted summary judgment for the bank and dismissed the case with prejudice, reasoning that the term “cleared” (as used in the email response to the victim from the deposit bank) was defined in the deposit agreement to mean that provisional settlement had been credited for the deposited item (which can be reversed under UCC section 4-214). The court also noted that the deposit bank was acting as a collection agent for its customer (the victim), pursuant to UCC section 4-201, and under Article 4 the customer retains the risk that his or her deposits will be dishonored by the payor bank.

Simmons, Morris & Carroll, LLC v. Capital One, N.A.226 illustrates yet another variation of the same basic scam, with a twist: The deposited check was drawn on a foreign bank and neither the law firm nor the depositary bank initially recognized this. The law firm received and deposited the foreign check, sent to the law firm to pay a debt supposedly owed to the law firm’s client. Neither the law firm nor the bank teller handling the deposit noticed that the check was drawn on a foreign bank; when the depositary bank realized this, it put a hold on the provisional settlement and notified the law firm by letter. Before receiving this letter, however, the law firm called the bank and was told that the deposited check had cleared. The law firm then sent a wire transfer of the funds to the client.

When the deposited check was found to be worthless and settlement for the check was reversed by the depositary bank (via charge-back to the law firm’s checking account), the law firm sued the depositary bank for negligent misrepresentation and promissory estoppel based on detrimental reliance. The district court held for the law firm and the bank appealed. The court of appeals reversed, holding that it was error to attribute the loss to the bank and its employee. The appellate court observed that the bank’s own actions made a finding of promissory estoppel advisable to prove that its detrimental reliance was justifiable, and that the depositary bank did owe a fiduciary duty to its customer (the law firm); the bank followed its internal procedures by treating the check as a collection item and promptly putting a hold on the provisional settlement when it discovered that the deposited item was a foreign check; and the law firm could have discovered the hold by reviewing its online account statement prior to sending the wire transfer. Moreover, the law firm was as capable as the bank of recognizing that it had received a foreign check. The bank met its duty by exercising ordinary care, and the law firm was in the best position to have discovered the fraud.227

In Kepler v. RBS Citizens Bank N.A.,228 a bank customer sued her bank in an effort to recover losses incurred when she was fraudulently induced to send wire transfers from her home equity line of credit (HELOC) account to a bank account in Ghana. After the transferred funds were lost, she offered expert testimony to show that her bank’s policies and procedures were inadequate and that this contributed to the loss. The court’s opinion extensively discusses the role and limits of expert testimony in this context.

In Kepler, the court granted, in part, the bank’s motion to strike the expert’s testimony, but permitted the expert to testify regarding the bank’s compliance with regulatory and industry standards for fraud detection and mitigation. Although the expert was not experienced in the precise issues presented in the case, the expert had general expertise in preventing payment system fraud, and this was sufficient. The court was reluctant to disallow expert testimony, noting that contrary experts and cross-examination could be used to counter any weaknesses. However, the expert testimony was disallowed with respect to issues of commercial reasonableness and federal law requirements not at issue in the case.

D. Bank Accounts and Ordinary Care

As noted above at Parts II.B. and IV.B., in National Union Fire Ins. Co. of Pittsburgh, Pa. v. Ramirez,229 an employee opened an unauthorized deposit account in the employer’s name, using a phony driver’s license, then intercepted and stole checks payable to the employer, depositing them in the unauthorized account. The employer’s insurance

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224. Id. see also UCC § 4-201, 4-202 & 4-214. (Bank Guaranty notes
Law and Harrell, supra note 1, at Part VIII.A.)

225. Harrell, supra note 1, at Part VIII.A.

May 3, 2014).

227. Id. at 5300 (6th Cir. 2014).

228. 5300 (6th Cir. 2014).

229. 5300 (6th Cir. 2014).
company paid the employer’s claim and then sued the depository bank for failure to exercise ordinary care in opening the unauthorized account, and for negligent failure to investigate the authority of the employee to open the account.

The United States Court of Appeals for the Eighth Circuit affirmed dismissal of the complaint, noting that banks do not have any duty to investigate such matters. The court recognized that a bank has a duty, as a prerequisite to asserting a defense under UCC section 3-405, to exercise ordinary care in confirming the identity of a customer when opening an account (e.g., by requiring photo identification such as a driver’s license). However, this is a predicate to a UCC defense, not an affirmative duty. Moreover, in excising ordinary care a bank is not obligated to research and determine the ownership of a “doing business as” (d/b/a) name, trademark or a trade name. To require this would impose an undue burden on routine account-opening procedures, requiring research of highly technical issues of intellectual property law.

As also noted previously, in Chartier v. Farm Family Life Insurance Co. the plaintiff opened a joint bank account with his wife. She subsequently cancelled her account and received a check payable to her. She indorsed the check “For Deposit Only” and deposited it in the joint bank account, then withdrew the funds. The husband sued the bank but the court granted the bank’s motion for summary judgment and this was affirmed on appeal. There was no violation by the bank of any duty of care. UCC section 4-205 authorizes a bank to supply a customer’s indorsement for deposit to his or her account, and as joint tenant the wife was entitled to withdraw the funds (but see infra note 343).

In Troy Bank and Trust Co. v. The Citizens Bank, the depository bank misencoded a $100,000 check as $1,000, then sent an adjustment claim through the Federal Reserve System. The payor bank honored the claim, paying the $99,000 difference and charging it to the drawer’s account at the payor bank. However, the drawer’s account did not have sufficient funds to cover the charge, and as a result the payor bank suffered a shortage of $98,436.43, which it sought to recover from the depository bank, alleging breach of the encoding warranty at UCC section 4-209.

The payor bank appealed an adverse judgment and the appellate court reversed, upholding the payor bank’s claim against the depository bank for breach of warranty. The appellate court rejected the depository bank’s argument that Federal Reserve System Operating Circular No. 3 preempted section 4-209, instead holding that the two rules are complementary. The court also rejected the depository bank’s argument that the payor bank’s failure to comply with the Federal Reserve claims procedure barred recovery for breach of warranty under section 4-209, noting that Operating Circular No. 3 preserves other remedies.

The Troy Bank court also rejected the depository bank’s argument that the payor bank’s recovery was barred because the payor bank failed to mitigate the damages when it paid the $99,000 claim to the depository bank. The court concluded that the payor bank’s attempt to recover by charging its customer’s account was sufficient mitigation, and under section 4-209 the depository bank was liable for the damages caused by its encoding error.

In Lorne Star Nat. Bank N.A. v. Heartland Payment Systems, Inc., the bank was a processor of credit and debit card transactions for the issuer of the cards; the bank’s computer system was hacked and customers’ personal information was stolen. The card issuer sued the bank for breach of contract, negligence, misrepresentation and violation of consumer protection laws. The district court dismissed the negligence claim on grounds of the economic loss doctrine (because there was no physical injury); however, the United States Court of Appeals for the Fifth Circuit reversed, holding that it was incorrect to grant the motion to dismiss because the bank had reason to foresee that the card issuer would be damaged by the relevant conduct. The deposit agreement did not establish the applicable standard of care; therefore, the case was remanded for consideration of that issue, including possible tort law issues.

E. Provisional Settlement and the Right of Charge-Back

This issue was previously covered, e.g., at Parts IV.F., IV.B. and V.C. An additional case is noted here. In Sapp v. Flagstar Bank, FSB, the customer opened a checking account for his limited liability company (LLC) and deposited a $125,000 check into the account. Consistent with UCC section 4-214, the deposit agreement provided that deposits were “subject to proof” (i.e., provisional) and the customer was responsible for any overdrafts in the account resulting from the revocation of provisional settlement due to dishonor of deposited items. The $125,000 check became lost in the bank collection system and the bank asked the customer for assistance in identifying its origin, but the customer provided only minimal and ineffective assistance. Eventually, the bank charged-back the $125,000 check to the customer’s account, revoking its provisional settlement for the deposited item. However, the customer previously had withdrawn $100,000 from the account, and when the provisional settlement was revoked it created an overdraft.

Pursuant to UCC section 4-214, the bank sued the customer to recover the amount of the overdraft; the customer defended on grounds the bank was late in providing notice that the check was lost, and also argued that he should not be held personally liable for the overdraft as a debt of the LLC. The court rejected these arguments and held for the bank, observing that the customer transferred the withdrawn funds into his personal account and that he received timely notice of the facts and suffered no loss from any lack of notice. There was no evidence of negligence on the part of the bank and the customer's liability for the overdraft was clear.\(^{225}\)

F. Contractual Basis for the Bank-Customer Relation; No Fiduciary Duty

In *Lamm v. State Street Bank and Trust*, the bank maintained custodial accounts for a customer who authorized an investment firm to invest the funds. As custodian, the bank received promissory notes from the investment firm, evidencing some of these investments, and listed them as having no value on the custodial account statements sent to the customer. When the investments were found to be fraudulent, the customer sued the bank for the loss, alleging negligence and breach of fiduciary duty. The court disagreed and rejected these claims, noting that a bank does not have a fiduciary duty to monitor and detect fraudulent activity in its customers' accounts, unless the bank assumes a special duty of trust and confidence. Moreover, UCC section 4-406 did not apply and there was no obligation for the bank to supply an account statement with the information needed to discover the fraud.\(^{226}\)

In *Arlington Video Productions, Inc. v. Fifth Third Bancorp*, the deposit contract provided the customer's agreement to the bank's rules and regulations, as separately posted in the bank offices. The customer's deposit account was charged service fees pursuant to these rules, but the bank could not provide evidence of a posting or other disclosure describing these charges. The customer sued for breach of contract, and appealed an adverse ruling on the bank's motion for summary judgment. The United States Court of Appeals for the Sixth Circuit reversed the trial court's ruling, holding that material issues of fact remained, sufficient to preclude summary judgment. The Sixth Circuit indicated that the bank had not demonstrated that a proper disclosure was posted or otherwise provided to customers.

As noted above at Part V.C., in *Keppler v. RBS Citizens Bank N.A.*, a bank customer sued her bank in an effort to recover losses incurred when the customer sent wire transfers drawn from her HELOC account at the bank to a fraudster in Ghana. She offered expert testimony to show that the bank's policies and procedures were inadequate and that this contributed to the loss; the court's opinion extensively discusses the role and limits of expert testimony. The court granted in part, the bank's motion to strike the expert's testimony, but permitted the expert to testify regarding the bank's compliance with regulatory and industry standards for fraud detection and mitigation, on grounds the expert had general expertise in preventing money laundering and other payment system fraud.

G. Standard of Care Redux; Limits on Bank Liability

In *Graham v. Central Progressive Bank*, a bank customer authorized his mother and sister (who were employees of the bank) to manage his checking account. However, the monthly bank account statements were mailed to his post office box. After the mother and sister made unauthorized withdrawals from the account, the customer sued the bank for conversion and emotional distress. The bank successfully defended against the claims, essentially under UCC section 4-406. The court rejected the customer's assertion of the “discovery rule,” which would begin the one-year limitation period at section 4-406 upon the customer's discovery of the fraud, regardless of how long ago it occurred, because section 4-406 expressly creates an obligation for the customer to review the periodic account statements and promptly report any fraud to the bank.

As noted above at Part V.B., in *Mark D. Dean, P.S.C. v. Commonwealth Bank & Trust Co.*, an attorney's bookkeeper used her authority as a signer on his checking accounts to steal money in a check kiting scheme. The attorney sued the payer bank, arguing that the bank had a “duty to protect the account from theft.” The court rejected the attorney's claims as untimely under the three-year statute of limitations at UCC section 3-118. Additionally, the court noted that the attorney was in the best position to discover and prevent the fraud, and noted that the comprehensive system of UCC check fraud remedies displaces the alternative common law claims asserted by the attorney.\(^{228}\)

As also noted above at Parts II.B. and V.B., in *Wied v. Wells Fargo Bank,*...
N.A. a receiver sued the bank, alleging that the bank allowed its customer to open multiple d/b/a accounts as part of a "Ponzi scheme" that defrauded third parties. The allegations included a failure by the bank to follow federal money laundering regulations and customer verification procedures.

The Waid court granted the bank's motion for summary judgment on all counts, emphasizing that banks do not have a duty to investigate the merits of transactions conducted by authorized agents. Moreover, the standard of ordinary care at UCC section 3-103(a)(9) applies only to check processing functions as specified in Article 4, not to contracts law and the bank-customer relation generally.

In another case noted above at Parts II.B. and V.B., Chartier v. Farm Family Life Insurance Co., a bank customer opened a joint checking account with his wife. She cancelled her annuity and received a check payable to him, and indorsed the check "For Deposit Only" and deposited it in their joint checking account, and withdrew the funds. The husband sued the bank, but the court granted the bank's motion for summary judgment and this was affirmed on appeal. UCC section 4-205 authorized the bank to supply the husband's indorsement for a deposit to his account, and as a joint tenant the wife was entitled to withdraw the funds.

H. Arbitration

Dasher v. RBC Bank (USA) addressed a bank's effort to compel arbitration of a customer's claim of excessive bank overdraft charges in breach of the deposit agreement. The court held that the presumption of arbitrability under the Federal Arbitration Act did not control because the question was whether there was an agreement to arbitrate, not whether such an agreement was enforceable. Thus, the allegations created an issue of state contract law. The Dasher court held that the deposit contract containing the arbitration clause was retrospectively superseded by a subsequent deposit contract that did not include such a provision; thus, there was no agreement to arbitrate.

1. Stop Payment Orders

In In re Hollar, the debtor stopped payment on a check for the final installment payment on a loan to buy six vehicles, and the payee/creditor subsequently recovered a judgment for breach of contract and fraud. The debtor filed bankruptcy, but the creditor successfully argued that the debt was non-dischargeable under Bankruptcy Code section 523(a)(6), because the debtor's stop payment order reflected an intent to inflict a willful and malicious injury (citing the resulting overdraft in the payee's account and other losses).

In Allegro Medical Center, S.C. v. Harris Bank, N.A., the bank's customer sued the bank for paying a check with a notation on its face stating that the check was "void after 90 days"; the check was paid more than five months after the check date. The customer claimed that the notation was the equivalent of a stop payment order that prevented the check from being properly payable. The bank noted that the deposit agreement provided the requirements for stopping payment and notifying the bank of errors, and that the customer did not meet these requirements. The court agreed with the bank, rejecting the customer's argument that the language "void after 90 days" was sufficient as a stop payment order; the court also gave effect to the contractual notice requirements and other terms of the deposit agreement, and rejected the customer's argument that the terms of the bank-customer deposit agreement were unconscionable.

J. UCC Section 4-406

As noted above at Part V.B., in Lunder v. State Street Bank and Trust the bank maintained custodial accounts for a customer who granted broad authority to an investment firm to invest the funds in the account. The bank accepted custody of promissory notes from the investment firm, reflecting some of these investments, and listed the notes as having no value on the account statements sent to the customer, because the bank did not know their value. When it was learned that the investments were fraudulent, the customer sued the bank for negligence and breach of fiduciary duty. The court rejected these arguments, emphasizing that a bank does not have a duty to monitor and detect fraudulent activity in customer accounts, unless the bank has assumed that duty in a special relationship of trust and confidence. UCC section 4-406 did not apply to the custodial account, and the bank had no duty to supply an account statement with sufficient information to discover the fraud.

As noted above at Part V.A., in Clemente Bros. Contracting Corp. v. Hoffman-Mitauzzi the bank customer provided a corporate resolution to the bank, stating that it would notify the bank of any erroneous payments within fourteen days of the mailing or receipt of the relevant bank account statement. An employee of the customer forged drawings requests for the customer's line of credit at the bank, for deposit into the customer's account, then stole the funds, embezzling some $386,000. The customer...
sued the bank to recover the loss, on grounds the draws were unauthorized. The bank successfully argued that the customer’s claim was barred by the customer’s failure to give notice within fourteen days as required by the corporate resolution and section 4-406. In response, the customer argued that the draw requests were not “items” subject to the corporate resolution and section 4-406.

The district court agreed with the bank, and this was affirmed on appeal. The court emphasized that UCC section 4-103 allows the parties to modify their statutory duties, including the time periods in section 4-406, so long as there is not a disclaimer of the duty of good faith or ordinary care. In this case, there was no improper disclaimer, and the parties’ modification of the section 4-406 time periods was reasonable. However, the court noted that reasonableness is a question of fact that could be viewed differently depending on the facts. There was a dissent on the issue of whether the one-year limitations period at section 4-406 can be changed by agreement on grounds it relates to ordinary care.253

As noted above at Part V.G., in Gist v. Central Progressive Bank,254 a bank customer authorized his mother and sister (who were employees of the bank) to manage his checking account. The bank account statements were mailed to the customer’s post office box. After the mother and sister made unauthorized withdrawals from the account, the customer sued the bank, alleging conversion and emotional distress. The bank successfully defended on grounds of section 4-406. The court rejected the customer’s assertion of the discovery rule, which would have been the one-year limitations period at section 4-406 upon the customer’s tardy discovery of the fraud, because section 4-406 imposes on the customer an obligation to promptly review the bank statements and report the fraud to the bank at that time.

In Contractors Source, Inc. v. Amegy Bank Nat’l Ass’n,255 an employee stole money from the employer by forging checks on the employer’s bank account. The employer sued the payor bank for breach of contract, breach of warranty and negligence, on grounds that the checks were forged and therefore not properly payable.256 The bank responded that the employer failed to discover and report the forged items as required by section 4-406, and therefore the customer was precluded from asserting that the checks were not properly payable. The court agreed with the bank, holding that the bank exercised ordinary care and that section 4-406 displaced the alternative common law causes of action.257

VI. Safe Deposit Boxes

In Krystine Kenworthy Ritter, Personal Representative v. Lynne Roberts,258 the Oklahoma Court of Civil Appeals considered arguments by the representative of a probate estate, seeking to quiet title to the contents of a safe deposit box as against a “joint lessee” of the box.259 Ralph and Florida Kenworthy were the initial lessees of the box; after Ralph’s death Florida added her sister, Lynn Roberts, as a joint lessee.260 After Florida died, Lynne argued that Florida had made an inter vivos gift of the contents of the box (including savings bonds stored there), by naming her as joint lessee. The district court rejected this argument, upholding the claim of Florida’s personal representative that the contents were property of Florida’s estate.

The court of appeals affirmed, noting that the requirements for a gift include a complete and irrevocable delivery and acceptance. The court concluded that a mere granting of access to a safe deposit box does not meet this test, particularly on these facts because the savings bonds in question remained registered in Florida’s name. Lynne claimed ownership by way of joint tenancy, a claim that both courts expressly rejected. The court of appeals expressly held that a joint lease of a safe deposit box does not create a joint tenancy ownership of the contents. The latter requires a clear and express contractual agreement to that effect; becoming a joint signatory on a safety deposit lease merely grants access to the box and is not sufficient to create a joint tenancy as to the contents.261 This permitted Lynne to access the box and remove its contents, but did not transfer ownership or create a joint tenancy with rights of survivorship as to the contents of the box.

254. Id., supra Part V.G.;
255. Id. citing UCC 4-401.
256. Id. citing UCC 4-401.
257. Id. See also supra Part V.G.
259. Id. The contents included $288,000 in U.S. savings bonds.
260. Id.
261. Id. Following Florida’s death, Lynn retrieved the savings bonds from the box. In this action, the personal representative of Florida’s estate sought to recover the bonds.

ARTICLES SOLICITED

The Quarterly Report is seeking submission of manuscripts for possible publication, on the following subjects: consumer protection law and ERLAC; CFPB regulation; Truth in Lending and Regulation Z; access to consumer financial services including fair housing, CRA, and equal credit opportunity; electronic commerce; credit and debit cards; credit insurance; mortgage lending; auto finance; UCC case law and revisions; banking law; debt collection; and bankruptcies. If you would like to contribute to an article or research project, please contact the Editor of the Quarterly Report.