NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

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BANKING

Fraudulent Checks: A Material Alteration or Unauthorized Signature? [ND NY]

The depository bank deposited a check (for over $180,000) with drawee and drawer names that were not associated with the routing and account numbers listed. Those routing and account numbers belonged to a different customer of the payor bank. Besides the routing and account number, the check appeared not to have any connection to the payor bank or its customer. The same day the depository bank deposited the check, the payor bank issued payment to the depository bank by debiting its customer's account, and subsequently, the customer complained that the payor bank had mistakenly posted the check to its account. The payor bank returned the check to the Federal Reserve Bank (FRB), the FRB credited the payor bank's FRB account, and the payor bank returned the funds to the customer's account. However, the depository bank contested the return of the check, and in turn, the FRB debited the funds from the payor bank's account. Consequently, the payor bank sued, alleging a "(1) material breach of warranty under the N.Y. UCC §§ 3-416, 3-417, 4-207, and 4-208; (2) material breach of 12 C.F.R. § 229 in violation of N.Y. UCC § 4-103, and (3) negligence." The depository bank responded with a motion for judgment on the pleadings.

In **Cmty. Bank, N.A. v. JPMorgan Chase & Co.**, 5:24-cv-00363, 2024 WL 5212818, 2024 Dist. LEXIS 232152 (N.D. N.Y. Dec. 23, 2024) (opinion not yet released for publication), the court denied the motion for judgment on the pleadings for the first cause of action and granted it concerning the second and third causes of action. First, the court addressed the payor bank's breach of warranty cause of action. N.Y. UCC § 4-207(c) establishes that a customer or collecting bank that obtains payment of an item warrants to the payor bank that "the item has not been materially altered." The payor bank claimed that the check had been "materially altered;" therefore, the depository bank breached the warranty under § 4-207(c). In response, the depository bank claimed that the check was forged and that "where a check contains a forged signature, liability generally rests with the payor bank." Thompson v. First Bank Americana, 518 F.3d 128, 131 n.2 (2d Cir. 2008). Further, the court explained that 12 C.F.R. § 229.38 created a rebuttable presumption that the "electronic check contains an alteration." Therefore, the court denied the depository bank's motion because there were no "allegations in the pleadings concerning the authenticity of the signature of the drawer." The unresolved material facts concerning the check led the court to conclude that the presumption had not been rebutted. Second, the court granted the depository bank's motion regarding the payor bank's second cause of action, claiming a material breach of 12 C.F.R. § 229. Section 229.38(a) requires "ordinary care" and "good faith" standards. The payor bank alleged that the depository bank failed to meet this standard. However, § 229.38(a) requires a showing that the condition of the check "adversely affects the ability of the bank to indorse the check legibly." Because the payor bank failed to allege factual allegations about its ability to indorse the check, the court granted the defendant's 12(c) motion concerning § 229.38. The court also disagreed with the payor bank's § 229.13(b) argument that the depository bank had violated the statute by "fail[ing] to exercise ordinary care or act in good faith... by making the funds available too soon." Section 229.13(b) permitted banks to "delay the availability of funds deposited in an account" for a "reasonable period" if the deposit is greater than $5,525. However, the court found that § 229.13(b) does not create an obligation to delay the availability of funds and found insufficient factual allegations to support the payor bank's claim. Finally, the court granted the depository bank's motion regarding the negligence cause of action. The depository bank responded to the negligence claim, citing Article 4 of the N.Y. UCC, which "precludes common law claims that would impose liability inconsistent" with Article 4. The court found that the payor bank did not adequately respond to the depository bank's motion as to whether it sought to base its claim on N.Y. UCC § 4-202, and there was no case law supporting its claim that the cause of action was sufficient, whether construed as a common law claim of negligence or a breach of the N.Y. UCC.

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FORECLOSURE

The Fight Against Foreclosure [5TH CIR]

The debtors executed a note and security instrument (the "loan agreement") with the mortgagee, who held a security interest in the property under the security instrument. The loan agreement provided that the lender could sell the property if the debtors defaulted. The mortgagee assigned the loan to the Federal National Mortgage Association ("Fannie Mae"), which then assigned the loan agreement to an investment company. The debtors defaulted, and the investment company issued a notice of acceleration. The district court then entered a final judgment against the debtors and permitted a nonjudicial foreclosure of the property. The debtors appealed the final judgment, and the Fifth Circuit affirmed the district court. However, while the appeal was pending, the investment company assigned the loan agreement to the bank. The bank sent a notice of default to the debtors with an option to cure, but the debtors still failed to pay on the note. The bank then filed suit and moved for summary judgment, asserting it could foreclose on the property because of the issuance of the previous final judgment. The magistrate judge recommended that the district court grant the bank's motion for summary judgment in his report. In response, the debtors filed an unopposed motion to extend the deadline to file their objection to the magistrate judge's report, which the district court granted. The debtors filed for a second extension on the day of the new deadline, but the request "was the same in form and substance as the first." The debtors then filed a corrected second motion requesting an extension of the deadline, which the district court denied. The debtors then filed a motion for leave to file a motion and a motion for a new trial. The district court denied all the debtors' motions and granted summary judgment for the bank, and the debtors appealed to the Fifth Circuit.

In **United States Bank Tr. Nat'l Ass'n v. Walden**, 124 F.4th 314 (5th Cir. 2024), the Fifth Circuit affirmed in part and reversed in part the district court, finding the district court did not abuse its discretion in denying the debtors' motions but reversing the district court's order granting summary judgment. First, the Fifth Circuit held that the district court did not abuse its discretion in denying the debtors' second motion to extend the deadline. Fed. R. Civ. P. 72 provides that a party has 14 days to object to a magistrate judge's proposed findings and recommendations. However, the court explained that district courts have broad discretion over dockets and may extend deadlines before they expire for good cause. The court found that the debtors' second motion to extend the time, filed on the day of the deadline from the first extension, was both substantively and procedurally insufficient. Although the debtors then fixed the insufficiencies in their corrected motion, that corrected motion was filed after the date of the deadline of the first extension. Under, Fed. R. Civ. P. 6(b)(l)(B), "the court may for good cause extend the time after it has expired 'if the party failed to act because of excusable neglect.'" The court explained that a district court weighs several factors in determining if a party had excusable neglect in its failure to act, including danger of prejudice to parties, the length and impact of the delay on the proceedings, whether the moving party had control over the delay, and whether the moving party acted in good faith. United States v. Clark, 51 F.3d 42, 44 (5th Cir. 1995). In finding a lack of good faith from the debtors, the district court noted the initial errors in the debtors' motion to extend, specifically their failure to check for mistakes regarding dates (even after being informed by the court they existed) and failure to conference with the opposing party to allow it sufficient time to note opposition to the motion. Therefore, the Fifth Circuit found the denial fell "well within" the district court's discretion and did not constitute abuse. Second, the Fifth Circuit similarly concluded that the district court did not abuse its discretion in denying the debtors' motion for leave to file objections to the magistrate judge's report. The district court found no good cause to grant the motion. However, the debtors argued that the denial was improper because of the incorrect date on the motion. The Fifth Circuit explained that there is no abuse of discretion when a district court denies a motion raised after final judgment (Fed. R. Civ. P. 60(b) motion) if '"the proffered justification for relief is the mistake or carelessness of the party's own counsel." Lozano v. Donna Indep. Sch. Dist., 648 F. App'x 412, 413 n.2 (5th Cir. 2016). Therefore, because the debtors admitted the mistake was their own, the court found the district court did not abuse its discretion in denying the motion based on the counsel's "mistake or carelessness." Next, the Fifth Circuit reversed and remanded the district court's order granting summary judgment in favor of the bank. The court first rejected the debtors' argument that the bank lacked standing. The debtors argued that the investment company improperly assigned the loan to the bank, claiming it never had an interest in the loan agreement to transfer. The debtors claimed that Fannie Mae lacked the authority to assign the loan agreement to the investment company because the Federal Housing Finance Agency (FHFA) served as Fannie Mae's receiver. The court then explained that the Housing and Economic Recovery Act of 2008 created the FHFA, giving it ultimate authority over

Fannie Mae, but Fannie Mae retains the power to transfer assets without the need for approval given that the FHFA does "not control daily operations." Therefore, the assignment was proper because the investment company had an interest in the loan agreement, which it was subsequently allowed to transfer to the bank. Additionally, the debtors argued that the bank "did not suffer a concrete injury," which the court rejected. It explained that the bank suffered a financial loss, which is a well-established form of injury; this injury supported the bank's possession of standing. Finally, the court addressed the debtors' argument that the notice they received from the bank "was an unequivocal express notice of abandonment of any prior acceleration" brought by a prior party (here, the investment company). The district court granted summary judgment despite this argument, but the circuit court reasoned that the district court's holding was contrary to controlling precedent. Boren v. US. Nat'l Bank Ass'n, 807 F.3d 99, 106 (5th Cir. 2015). Thus, the Fifth Circuit reversed the summary judgment entered in favor of the bank and remanded for proceedings consistent with precedent. Lastly, the debtors argued that the bank could abandon acceleration despite the court's prior judgment because the foreclosure had been non-judicial, and the acceleration was later rescinded. This court instructed that on remand, the district court must address these arguments.

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JURISDICTION

Check Fraud and a Federal Fumble: A Bank's Failed Removal Attempt [SD TX]

Bank One sued Bank Two, alleging that Bank Two accepted and deposited fraudulent checks stolen from Bank One's customers. Bank One claimed that several account holders of Bank Two stole checks issued by its clients, altered them to list themselves as payees, and then deposited them. The fraudulent checks totaled $153,879.31. Bank One sued under state law, asserting claims for breach of UCC warranties, unjust enrichment, fraud, and aiding and abetting. Bank Two removed the case to federal court, arguing that federal jurisdiction was proper because the claims involved federal banking regulations, particularly Regulation CC and Anti-Money Laundering (AML) requirements. It further argued that the aiding and abetting claim raised a substantial federal issue because of alleged violations of federal banking laws. However, Bank One moved to remand, asserting that the claims arose solely under state law and that removal was improper because of Bank Two's failure to obtain a co-defendant's consent.

In **NewFirst Nat'l Bank v. JPMorgan Chase Bank, N.A.**, No. 24-3352, 2024 WL 5170755, 2024 U.S. Dist. LEXIS 229446 (S.D. Tex. Dec. 19, 2024) (opinion not yet released for publication), the court granted the bank's motion to remand, ruling that the case did not create a substantial issue of federal law to establish subject-matter jurisdiction. The court explained that simply referencing Regulation CC does not automatically create a federal question. A state law claim must raise a "actually disputed and substantial" federal issue to be eligible for removal. Grable & Sons Metal Prods. v. Dante Eng'g & Mfg., 545 U.S. 308 (2005). Further, Bank Two needed to prove that "(1) resolving a federal issue is necessary to resolution of the state-law claim; (2) the federal issue is actually disputed; (3) the federal issue is substantial; and (4) federal jurisdiction will not disturb the balance of federal and state judicial responsibilities." Singh v. Duane Morris LLP, 538 F.3d 334, 339 (5th Cir. 2008). Here, Regulation CC's creation of a rebuttable presumption regarding the altered checks was insufficient to establish federal jurisdiction. Merrell Dow Pharmaceuticals, Inc. v. Thompson, 478 U.S. 804,814 (1986). The court also rejected Bank Two's argument that the aiding and abetting claim warranted federal jurisdiction. Applying the Fifth Circuit's test for federal jurisdiction, the court determined that Bank One's reliance on federal law to assert the aiding and abetting claim satisfied the first and second factors. The court found that the third factor, however, weighed in favor of remand because Bank Two failed to show that a substantial federal issue existed by failing to demonstrate how the issue would "bear heavily on 'the federal system' as a whole." Furthermore, analyzing the fourth factor, the court noted that aiding and abetting fraud is not yet an "explicitly recognize[d] cause of action" under Texas law. Therefore, the court found that the fourth factor favored remand. Because the court found no federal question, it declined to consider whether the failure to obtain a co-defendant's consent also rendered the removal improper. Ultimately, the court remanded the case back to the state court.

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JURISDICTION

National Banking Laws Preempt State Legislation that Significantly Interferes with Federal Powers [ND ILL]

TThe state legislature passed the Illinois Interchange Fee Prohibition Act ("the Act") to take effect on July 1, 2025. The bankers association objected to two provisions of the Act: the prohibition of interchange fees and the limitation of data usage. The interchange fee prohibited banks from charging or receiving interchange fees on state or local taxes and gratuity, and the data usage element limited nonmerchant entities from using data except to process transactions or to fulfill legal requirements. The bankers' association sought a pre-enforcement injunction from enforcement because of the immense burden of compliance and preemption by three federal statutes: "(i) the National Bank Act ("NBA"), (ii) the Homeowners Credit Loan Act ("ROLA"), and (iii) the Federal Credit Union Act ("FCUA")." Conversely, the State moved to dismiss, arguing that the bankers' association lacked standing and that the State has sovereign immunity.

In **Ill. Bankers Ass'n v. Raoul**, No. 24 C 7307, 2024 WL 5186840, 2024 U.S. Dist. LEXIS 230650 (N.D. Ill. Dec. 20, 2024) (opinion not yet released for publication), the court granted the preliminary injunction for national banks and federal savings association regulated by the NBA and the ROLA. First, the court addressed the State's motion to dismiss. The State argued that the bankers' association lacked standing to challenge the interchange fee prohibition because the state Attorney General did not have the authority to enforce the Act, and regardless, the alleged injury would not be redressed by an injunction. The court disagreed, finding that not only did the Attorney General have the authority but had the "duty to enforce both provisions.", Further, the court found that members of the bankers' association had suffered "injury-in-fact" after the passage of the Act. Therefore, the court dismissed the State's motion to dismiss for lack of standing. However, the court did dismiss the bankers' association's state law claims because the State had not waived sovereign immunity for those claims. Second, the court considered the bankers' association's motion for a preliminary injunction. The court noted that the bankers' association needed to demonstrate "(1) 'that [they] [are] likely to succeed on the merits,' (2) 'that [they] [are] likely to suffer irreparable harm in the absence of preliminary relief,' (3) "that the balance of equities tips in [their] favor, and' (4) 'that an. injunction is in the public interest"' Halczenko v. Ascension Health, Inc., 37 F.4th 1321, P24 (7th Cir. 2022) (quoting Winter v. Nat. Res. Def Council, Inc., 5.55 U.S. 7, 24 (2008)). The court held that the NBA "likely preempted" both provisions of the Act because the bankers' association had made a sufficient showing that the Act "significantly interferes" with national banking laws. 12 U.S.C. § 25b(b)(1)(B). The court also found that the bankers' association demonstrated they were "likely to prevail" for the same reasons the NBA preempted the Act. For the FCUA, the court concluded that neither party explained whether the Federal Credit Union Act established a private right of action for these claims, so it refrained from ruling on that issue pending supplemental briefing. Third, the court found that the bankers' association had proven that "irreparable injury" would occur without the injunction. Finally, the court found that "the balance of equities and public interest considerations weighs in favor of [the bankers association]," partly because the preliminary injunction prevents financial institutions from being driven out of the market. Ultimately, the court granted the preliminary injunction under the NBA and HOLA.

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SECURITY INTERESTS

Commercial Tort Claims Must Be Described With Specificity [JJTH CIR]

The company's offshore rig exploded, causing a massive oil spill and economic losses to thousands of businesses, one of which was the debtor. The debtor sued the company but ultimately settled, foregoing further litigation. Per the settlement agreement, if the debtor submitted claims and documentation showing the cause of the economic losses, the company would reimburse the debtor if the documentation was sufficient. The debtor filed a claim with the company, but the debtor's financial situation worsened while it was waiting for a decision on the claim. During this period, the debtor sought insurance to cover its employees, and the creditor agreed to insure the debtor in exchange for a security agreement granting the creditor a security interest in all the debtor's assets. The creditor recorded the security agreement. Subsequently, the claims administrator decided that the debtor would not receive the full amount of its claim, so the debtor appealed. The debtor could not keep up financially and ultimately defaulted on its obligation to the creditor and missed federal employment tax payments. The Internal Revenue Service (IRS) then filed a tax lien notice against the debtor and recorded it. The debtor then filed for Chapter 11 bankruptcy. Around the same time, the debtor agreed to settle the claim with the company for the original amount offered and signed a release. The creditor then filed an adversary complaint against the debtor's other creditors and moved for summary judgment, arguing that it held a perfected first-priority security interest in the claim amount and that its security agreement covered the debtor's contracts. The IRS filed a cross motion for summary judgment, arguing that the. claim amount was a commercial tort claim, not a contract. For that reason, the IRS argued, the tax lien automatically attached to and became perfected when it had filed the federal tax lien notice against the debtor. The bankruptcy court granted summary judgment in favor of the IRS, and the creditor appealed.

In **Sunz Ins. Co. v. United States Internal Revenue Serv. (In re Payroll Mgmt.)**, 125 F.4th 1035 (11th Cir. 2025); the United States Court of Appeals for the Eleventh Circuit affirmed the bankruptcy court's decision granting the IRS's motion for summary judgment. The court first analyzed whether the claim was a commercial tort or a contract.

Under Florida law, a creditor's security interest attaches when the debtor signs a security agreement that. describes the collateral, with a general description being sufficient to attach in most cases. Fla. Stat. Ann. § 679.2031(2)(c), 679.1021(pp), 679.1081(1). However, with respect to a commercial tort claim brought by a business for economic damages, a creditor's security interest does not attach unless the commercial tort claim is "explicitly describe[d]" in the security agreement. § 679.1081(5)(a). On the other hand, federal law does not require a security agreement for a tax lien to attach. Instead, under federal law, once taxes are assessed, the IRS's interest attaches to all the debtor's assets, and the interest becomes perfected when notice is filed with the appropriate state registry. 26 U.S.C. § 6323(a), (f)(l)(ii). The court explained that if the IRS perfected its interest first, then the tax lien took priority under federal rules. The creditor asserted that the claim was not a commercial tort, arguing that it had converted into a contract before the creditor and the debtor entered into a security agreement because the creditor had previously submitted its claims, and the settlement agreement was already active. The court disagreed, finding that a commercial tort converts to a contract "when the claim has been (1) 'settled' and (2) 'reduced to a contractual obligation to pay.'" Fla. Stat. Ann.§ 679.1091 cmt. 15. The court reasoned that the second element of reduction to a contractual obligation to pay did not arise until the parties signed the release, which did not occur until after the IRS filed its lien. Therefore, the claim was a commercial tort claim because the settlement agreement did not create an automatic obligation to pay the debtor due to the multiple processes between the initial offer and the acceptance of the offer. Additionally, because the security agreement between the creditor and the debtor did not describe the commercial tort claims as collateral, the creditor's security interest did not attach to the debtor's claim. For these reasons, the court held that the IRS's tax lien took priority in the claim payment and affirmed the district court's order for summary judgment in favor of the IRS.

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No Security Interest in Commercial Tort Claim Not Described With Particularity [3RD CIR]

The creditor purchased a promissory note from the debtor. Both parties entered into a security agreement, which granted the creditor a security interest in the debtor's assets. Later, the debtor sued former consultants for embezzling funds. The creditor and other creditors of the debtor filed an involuntary Chapter 7 bankruptcy against the debtor. The embezzlement litigation ended in a settlement, and the bankruptcy court awarded some of the settlement proceeds to other creditors. The creditor then filed a motion requesting the settlement proceeds, arguing that the proceeds were a part of his collateral. The bankruptcy court denied the motion because it concluded that the security agreement did not encompass settlements. The creditor appealed to the district court, which affirmed the bankruptcy court's decision. The creditor then appealed to the United States Court of Appeals for the Third Circuit.

In **Main St. Bus. Funding, LLC v. Lane (In re Main St. Bus. Funding, LLC)**, No. 23-2430, 2024 WL 4056601, 2024 U.S. App. LEXIS 22551 (3rd Cir. June 24, 2024) (opinion not yet released for publication), the Third Circuit affirmed the district court's order affirming the lower court's decision. Applying Pennsylvania's "gist of action" doctrine, the court held that the embezzlement lawsuit was a commercial tort claim. However, the security agreement did not describe the commercial tort claim with "sufficient particularity," thus, the bankruptcy court found that the embezzlement claim was not a part of the creditor's collateral. 13 Pa. Cons. Stat. § 9108(e)(l). Further, under 13 Pa. Cons. Stat. § 9204(b)(2), a commercial tort claim could not fall under the after-acquired provision in the security agreement. The embezzlement claim had to have been already in existence when the parties authenticated the security agreement. The creditor also argued that the proceeds of the collateral settlement were "encumbered in his favor," even if the security agreement did not directly encompass settlements because it was the proceeds of his collateral. Because the district court concluded that the debtor did not have rights to the money that the consultants stole, the creditor also did not have a right to the settlement proceeds. Finally, the creditor relied on one case where the court decided that a creditor had rights to collateral that constituted commercial tort claims. Bayer Cropscience, LLC v. Stearns Bank National Ass'n, 837 F.3d 911, 916-17 (8th Cir. 2016). But in Bayer, the embezzled funds had been subject to the security interest, unlike in this case. For these reasons, the court affirmed the denial of the creditor's motion to receive the settlement proceeds.

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Read the Fine Print: Bank Violates Deposit Account Control Agreement [WD PA]

The creditor and the bank entered into a Deposit Account Control Agreement ("DACA") to "govern the parties' control" over the debtor's accounts in the event of default and "create an enforcement mechanism... to perfect the parties' agreement."

Later, to satisfy the debtor's obligations, the creditor foreclosed and retained money that was in the debtor's account and sent the bank a Notice of Exclusive Control. Subsequently, the bank made credit withdrawals from the debtor's account despite the creditor's protests. The parties disputed the legal implications of the foreclosure on the parties' obligation to abide by the DACA. The bank claimed that the credit withdrawals from the debtor's account were legal because the foreclosure of the account "discharged [the bank's] secured status and the DACA." The creditor refuted this argument by claiming that the DACA was still binding among the parties arid the agreement prohibited the · bank from materially breaching the DACA. The creditor filed five claims against the bank and the bank's holding company, including a breach of contract claim, two claims of conversion, and two claims for declaratory judgment claims.

In **Studio Enter. LLC v. SSB Bancorp, Inc.**, No. 2:23-CV-02095, 2024 WL 5263590, 2024 U.S. Dist. LEXIS 234517 (W.D. Pa. Dec. 31, 2024) (opinion not yet released for publication), the court considered cross motions for summary judgment on the creditor's breach of contract and conversion claims. First, the court found that the creditor had retained secured status and the DACA controls "because 'foreclosure does not discharge a security interest for the purpose of enforcing that interest.'" Bayer CropScience V. Stearns Bank Nat'l Ass'n, 837 F.3d 911, 915 (8th Cir. 2016). Second, the court noted that the bank's statutory discharge argument was inconsistent with the Pennsylvania UCC's promotion of enforcement agreements. The court found that "[t]he record indisputably establishes" that the bank understood that the DACA governed the parties' control over the debtor's account when it requested permission to make withdrawals after the foreclosure. Therefore, the court determined the credit withdrawals were a material breach of the DACA and granted the creditor's motion for summary judgment on its breach of contract claim. Third, the court addressed the creditor's conversion claims and found that the creditor "attempts to have its cake and eat it too." The creditor argued that the conversion claims were independent of the DACA. The court disagreed and stated that because the creditor's ownership interest in the debtor's accounts relied on the DACA, the conversion claims also "fall within the purview of the DACA," and no independent tort claim was available. Therefore, the court granted summary judgment regarding the conversion claims in favor of the bank and its holding company. Finally, the court dismissed the breach of contract and conversion claims against the bank's holding company because it was not an "actual part[y]" to the DACA.

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Tractors and Trailers Tug of War [ED MI]

The creditor entered into loan and security agreements with the debtor. The debtor purchased eighteen tractors and trailers (the "collateral") and granted the creditor a "first priority security interest in the collateral." The debtor defaulted on the loan agreement, and the creditor demanded possession of its collateral. However, the debtor notified the creditor that two storage companies were in possession of the collateral. The two storage companies refused to return the collateral and argued that a purchase agreement with the debtor entitled it to the repayment of its investments and payments for unpaid parking obligations. The creditor argued that it had a superior claim to the collateral and, therefore, the court should award it possession of the collateral and damages or a judgment against the storage companies for the value of the collateral. Further, the creditor requested a declaratory judgment that it has a "perfected first-priority security interest in the collateral," the storage companies have no liens on the collateral, and that it did not have to pay parking rental fees to the storage companies.

In **BMO Bank N.A. v. D H Trucking Inc.**; No. 24-cv-10405, 2024 WL 4995558, 2024 U.S. Dist. LEXIS 220502 (E.D. Mich. Dec. 5, 2024) (opinion not yet released for publication), the court granted summary judgment and declaratory judgment in the creditor's favor. First, the court stated that it was "uncontested" that the creditor was entitled to possession of the collateral against the debtor because it was a secured party with a security interest," the creditor had perfected its security interest, and the debtor had defaulted. Second, the court held that the creditor held a superior claim to the collateral against the storage companies. The court found that the creditor maintained both priority in time and priority in perfection of the security interest, which trumped the storage companies' nonexistent claim to the collateral. Third, the court found that the creditor was not liable for any payments to storage companies, because it was not a party to the agreement between the debtor and storage companies. Finally, the court granted the creditor's motion for declaratory judgment in full. In conclusion, the court ordered that the creditor was entitled to possession of the collateral and may use any lawful means to repossess it.

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UCC You Later: How a Lender's Security Interest Was Left Behind [ED PA]

The lender issued two loans to the debtor, secured by liens on nearly all the debtor's personal property, including accounts receivable. Later, a factor bought a portion of the debtor's future receivables at a time when the debtor was in financial distress.

The lender claimed that the factor either negligently failed to discover the lender's prior security interest in the debtor's assets, conspired with the debtor's officers to hide the transaction, or enabled the debtor's principals to breach their fiduciary duties to creditors. After the debtor ceased operations and several of its principals filed for bankruptcy, the lender sued the factor, seeking "(1) declaratory judgment/injunctive relief; (2) avoidance and recovery of fraudulent conveyances under state law; (3) conversion; and (4) tortious interference with contract," and (5) "enablement of breach of fiduciary duty and deepening insolvency." The purchaser moved to dismiss the case, arguing that the lender had failed to provide sufficient evidence of misconduct or collusion.

In **Newtek Small Business Finance, LLC v. Texas. First Capital, Inc.**, No. 22-2461, 2025 WL 439434, 2025 U.S. Dist. LEXIS 22548 (E.D. Pa. Feb. 6, 2025) (opinion not yet released for publication), the court dismissed all the lender's claims for failure to state a claim. First, the lender had sought a declaratory judgment that it had a senior security interest in the debtor's funds or that the purchaser colluded with the debtor to hide the transaction. The court rejected both theories, noting that under the UCC, the factor took the funds free of the lender's security interest because the lender failed to provide evidence of collusion. 13 Pa. C.S. § 9332(b). The court noted that the lender had merely stated conclusory arguments, and even if it were to accept these arguments, they were still insufficient to support a collusion claim. Therefore, the court dismissed for failure to state a claim. Second, the court dismissed the lender's fraudulent conveyance claims under the Pennsylvania Uniform Voidable Transactions Act (PUVA). A transaction may be voided under PUVA if "(l) the plaintiffs are 'creditors' as defined by the statute; (2) the transfers were made with actual fraudulent intent; and (3) there are no viable defenses." Carroll v. Stettler, 941 F. Supp. 2d 572, 578 (E.D. Pa. 2013). The court found that the lender failed to show that the factor acted with fraudulent intent or that the transactions lacked reasonably equivalent value. Third, the court dismissed the conversion claim because the lender had no present right to the funds at the time of the alleged conversion. Fourth, the lender's tortious interference claim failed because the lender did. not prove the factor had intentionally harmed its contractual rights or acted improperly. Finally, the court dismissed the lender's new claim for aiding and abetting a breach of fiduciary duty because the lender did not show the factor had "actual knowledge" of the debtor's insolvency or provided substantial assistance in breaching fiduciary duties. In short, the court found that the factor cited within the rules of commercial transactions, and the lender's claims had lacked sufficient factual support.

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Tracy Kennedy
NDBA General Counsel

Role of NDBA General Counsel

NDBA's general counsel serves as the attorney for the association. Although Tracy is pleased to be able to serve as a resource for NDBA members in responding to their questions, she is providing general information, not legal advice. Banks must obtain legal advice from counsel who has been retained by the bank to represent the bank's interests in a specific matter.

To contact Tracy Kennedy, NDBA General Counsel, call 701.772.8111 or email at tracy@ndba.com.