SHERMAN WELLS SYLVESTER & STAMELMAN LLP

BANKING ALERT

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Payees On Check May Not Assert Presentment Warranties Against Depository Bank That Negotiates Check With Forged Endorsement

The New Jersey Appellate Division held that a payee on a check has no right to assert a presentment warranty, held by the drawee bank, against the depository bank. Kilcourse v. Commerce Bank, N.A., et al., No. A-3104-13T (N.J. App Div. Apr. 14, 2015). In Kilcourse, plaintiffs Joseph and Dianne Kilcourse ("Plaintiffs") settled a dispute with their contractor, who, pursuant to a settlement agreement, issued a check to Plaintiffs' attorney, drawn on defendant Susquehanna Bank and made payable to "Gary P. Levin and Joseph Kilcourse and Dianne Kilcourse." Levin, Plaintiffs' attorney, deposited the check into his client trust account at defendant Commerce Bank in March 2007 without informing Plaintiffs and without their endorsements. Levin was disbarred and charged with theft in October 2010 and Plaintiffs did not receive a copy of the settlement check until 2011. Plaintiffs filed suit on July 19, 2013 against Commerce Bank, TD Bank (Commerce Bank's successor), and Susquehanna Bank (collectively, "Defendants") for conversion.

The trial court granted Defendants' motion to dismiss Plaintiffs' complaint, and denied Plaintiffs' motion for leave to amend their complaint to include a claim for presentment warranties under New Jersey's Uniform Commercial Code (the "UCC"). Plaintiffs appealed and the Appellate division found that by the time Plaintiffs filed suit in 2013, the three-year statute of limitations for a claim of conversion under the UCC had run and, thus, Plaintiffs were barred from bringing a cause of action for conversion arising from Defendants acceptance of a check without Plaintiffs' endorsement. The Court further found that the discovery rule does not apply to conversion of negotiable instruments and, therefore, Plaintiffs' ignorance regarding the wrongful taking of their settlement funds did not toll the statute of limitations.

With respect to their claim for breach of the presentment warranties under the UCC, Plaintiffs argued that because they were the parties who actually incurred the loss as a result of the breach of the warranty, the warranty should work to their benefit. Under the UCC, the depository bank has the primary responsibility for checking endorsements and then warrants to each subsequent bank in the collection chain that the

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endorsements are valid. See N.J.S.A. 12A:3-417(a). In this instance, Commerce Bank was the depository bank and Susquehanna Bank was the drawee bank. The Court found that because Commerce Bank took the settlement check without all three endorsements it breached the presentment warranty to Susquehanna Bank. Plaintiffs argued that Susquehanna Bank has an interest in recovering the money paid on the check and holding it in trust for Plaintiffs and further argued that barring their claim for breach of the presentment warranties would contravene public policy and allow collusion between banks. However, as the Court noted, Plaintiffs did not allege any collusive behavior by the Defendants in this instance.

The Court found that "Plaintiffs cannot assert Susquehanna [Bank's] rights under the presentment warranties, nor could Susquehanna [Bank] assert Plaintiffs' rights in an attempt to recover under the warranties." According to the UCC, the presentment warranties only run between the presenter and the drawee and the purpose is not to insulate payees from loss, but rather to protect drawee banks from the damages that flow from a breach of the warranties. The Court noted that its holding that a payee may not assert a claim for breach of the presentment warranties is consistent with other jurisdictions. Ultimately, the Court affirmed the lower court's denial of Plaintiffs' motion to amend and found that essentially Plaintiffs had no recourse against Defendants.

While depository banks should be mindful of the presentment warranties, this decision confirms that a payee cannot bring a claim for a breach. A drawee bank, however, can bring a claim against the depository bank in an instance where the drawee bank is harmed.

Lending Industry Prepares As Biggest Regulatory Change To Home Mortgage Disclosures In Twenty Years Set To Go Into Effect

The lending industry is working to meet an August 1, 2015 deadline for the implementation of the Consumer Financial Protection Bureau's new, simplified home mortgage disclosure requirements under Dodd-Frank. The nearly 1,900-page rule created by the Bureau seeks to make mortgage terms simpler for home buyers to read and understand. Accordingly, beginning August 1st, borrowers will receive one disclosure, the Loan Estimate, setting forth the terms and anticipated closing costs shortly after applying and a Closing Disclosure just before committing to a loan.

Commonly referred to as the TILA-RESPA rule, the new forms under the rule will streamline four different mortgage disclosures currently required under the Truth in Lending Act ("TILA") and Real Estate Settlement Procedures Act ("RESPA"). In addition to integrating and simplifying the disclosure forms, the TILA-RESPA rule will change the timing and method of the disclosure process and the conditions required for disclosure. In particular, consumers must be given the Loan Estimate no more than three days after submitting a loan application and a Closing Disclosure at least three days before the execution of the loan documents. In order to electronically satisfy the timing and form of the new disclosure requirements, banks, mortgage servicers, title companies and others in the lending industry are spending the next several months introducing and adapting to new technology and software applications designed for the rule changes.

Appellate Division Vacates Foreclosure Judgment Due To Bank's Failure To Comply With Fair Foreclosure Act

In City National Bank of New Jersey v. Hodge, A-1483-13T4 (N.J. App. Div. Apr. 15, 2015), the New Jersey Appellate Division vacated a judgment of foreclosure where the foreclosing bank failed to comply with the notice requirements of New Jersey's Fair Foreclosure Act (the "FFA").

Defendant, Minerva Hodge, was the owner of commercial property ("Lombardy Property") and residential property where she and her family lived ("Lake Property"). Sometime in 2007, Ms. Hodge entered into a refinance mortgage with the plaintiff, City National Bank of New Jersey ("Bank"), for the Lombardy Property in the amount of $500,000. Ms. Hodge subsequently purchased a third property ("Ballantine Property"), which she planned to make her residence with her daughter. To go forward with the purchase, Ms. Hodge entered into another agreement with the Bank to borrow $425,000, which was secured by a second mortgage lien on the Lombardy Property and first mortgage liens on the Lake and Ballantine Properties. After closing, she and her daughter moved out of the Lake Property into the Ballantine Property. Ms. Hodge's son continued to make the Lake Property his residence.

Ms. Hodge defaulted on her loan payments in July 2009. The Bank filed a commercial foreclosure action seeking to foreclose on the first and second mortgages on the Lombardy Property. When Ms. Hodge failed to file an Answer, the Bank obtained a final judgment of foreclosure by default. The Bank also filed an action in the Law Division for damages based on Ms. Hodge's failure to pay the $425,000 promissory note. Like the foreclosure action, Ms. Hodge defaulted, and the Bank obtained a judgment in the Law Division action in January 2014.

In 2012, the Bank also filed an action to foreclose on the first mortgage on the Lake Property. Again, Ms. Hodge failed to file an answer and a default judgment was entered. On a motion to vacate the default judgment, Ms. Hodge argued that the Bank failed to comply with its obligations under the FFA when seeking to foreclose on the Lake Property, which at the time was being used as a residence by Ms. Hodge's son. The Bank successfully argued otherwise, stating that the Lake Property was intended for commercial purposes and, as a result, the Bank was not required to comply with the FFA. The lower court upheld the default judgment and denied Ms. Hodge's motion.

On appeal, the Appellate Division held that the Bank was required to comply with the FFA when foreclosing on the Lake Property. The Appellate Division noted that the FFA defines a residential mortgage as one secured by a property "such as a house….which is occupied, or is to be occupied, by the debtor…or a member of the debtor's immediate family, as that person's residence." Given that Ms. Hodge's son continued to live at the Lake Property when Ms. Hodge and her daughter moved out, the Lake Property remained a residence for the purposes of the FFA, which required the Bank to serve a written notice of intention to foreclose prior to the initiation of the foreclosure proceeding. The business reason for the second loan, the Appellate Division stated, did not obviate the need for the Bank to comply with the FFA. Because the Bank failed to comply with the FFA, the Appellate Division vacated the judgment of foreclosure and remanded the matter to the lower court.

The decision in Hodge serves as a cautionary reminder that the underlying purpose of a loan transaction does not obviate a lender's obligation to strictly comply with the FFA's requirements where the property securing the loan remains a "residence" within the meaning of the statute.

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