SHERMAN WELLS
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BANKING ALERT

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New Jersey Supreme Court Rules That The Uniform Fiduciaries Law Does Not Permit An Affirmative Claim Against A Bank

In *Lembo v. Marchese, et al.*, Case No. 082930 (N.J. June 17, 2020), the New Jersey Supreme Court reversed the Appellate Division's decision permitting plaintiffs to assert a claim against defendant TD Bank (the "Bank") under New Jersey's Uniform Fiduciaries Law ("UFL") and reinstated the trial court's decision dismissing the case against the Bank.

Plaintiffs, a dental practice and dentist, brought an action against the Bank, among others, alleging that plaintiffs' employees unlawfully took possession of numerous checks and forged plaintiffs' indorsement and deposited the checks into their own accounts at the Bank. Plaintiffs did not bring a claim against the Bank under New Jersey's Uniform Commercial Code ("UCC") within the three-year limitations period. The Bank moved to dismiss the complaint for failure to state a claim. The trial court dismissed the claims against the Bank, finding that the UCC governed the parties' relationship and absent a "special relationship" between the Bank and plaintiffs, which was not pled, plaintiffs could not assert a common law claim against the Bank. The trial court also rejected plaintiffs' argument that they could bring a claim under the UFL.

The Appellate Division affirmed in part, vacated in part, and remanded. The Appellate Division found that the complaint on its face only alleged common law claims against the Bank, which were barred absent a "special relationship." The Appellate Division found no facts supporting a special relationship and, thus, affirmed the trial court's dismissal of a common law negligence claim. The Appellate Division then conceded that the complaint did not reference the UFL or allege that the employees were acting as fiduciaries, but found plaintiffs should be permitted to amend their complaint to bring a UFL claim because the complaint "suggested" a cause of action under the UFL. The Appellate Division remanded to the trial court to permit plaintiffs to amend the complaint and plead a UFL claim.

The New Jersey Supreme Court reversed the Appellate Division, holding that the UFL does not provide an affirmative cause of action against a

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bank. The Supreme Court, in reviewing the legislative history, found that the UFL was enacted to protect banks from the obligation of having to monitor fiduciary accounts and provides immunity to banks for failing to detect a breach of a fiduciary's obligation when the bank acts in good faith and without actual knowledge. The Supreme Court found that allowing an affirmative UFL claim would potentially undermine the UCC's comprehensive framework for allocating and apportioning the risks of handling checks, and permitting an affirmative claim here would revive a claim otherwise barred by the UCC's three-year statute of limitations. The Supreme Court additionally found that there were no facts to support a "special relationship" to permit a claim outside the UCC. The Supreme Court, therefore, reversed the Appellate Division and reinstated the trial court's decision dismissing the action against the Bank in its entirety.

Sherman Wells attorneys Anthony J. Sylvester and Caitlin T. Shadek represented TD Bank in this action.

New Restrictions in Foreclosure Proceedings in New York

On June 23, 2020, New York Chief Administrative Judge Lawrence K. Marks entered an Order which established certain protocols for the handling of residential and commercial foreclosure proceedings. Specifically, the Order requires any party commencing a foreclosure action to submit (1) a form affirmation indicating that the plaintiff's attorney has reviewed state and federal restrictions on foreclosure proceedings and that the filing is in compliance with those restrictions; and (2) a form notice to defendants-tenants informing them of their eligibility to obtain an extension of time to respond due to the COVID-19 pandemic.

The Order further stays proceedings in pending foreclosure matters until the gubernatorial Executive Orders suspending statutory timetables for the prosecution of certain matters, specifically Executive Order 202.38, expires. Finally, the Order precludes both the filing and adjudication of virtually all motions, except those seeking to discontinue a pending case.

New Jersey Appellate Division Refuses to Vacate Default in Promissory Note Action Seeking to Enjoin Sale of Property

In *Patel v. American Exchange Loans, LLC*, A-3789-18T3 (N.J. App. Div. Jun. 5, 2020), the Appellate Division affirmed a trial court's determination that the defendants could not have default judgment vacated in an action arising out of defaults under a series of promissory notes.

The underlying facts were not in dispute. Defendant American Exchange Loans, LLC ("AEL") executed a series of promissory notes with plaintiffs in exchange for loans that AEL represented it was using to offer car loans to consumers. The total amount borrowed was approximately $295,000. Ultimately, AEL breached its obligations under the promissory notes for failing to make timely payments of monthly principal and interest and, contrary to its representations to plaintiffs, utilized the proceeds of the loans to pay for personal expenses and acquire property in Perth Amboy which was subsequently transferred to AEL's principal, defendant Eugene Shnayderman, for one dollar. Accordingly, plaintiffs filed a verified complaint based on breach of the promissory notes, as well as a notice of *lis pendens* to prevent Shnayderman from transferring the Perth Amboy property. Plaintiffs also sought an order requiring Shnayderman to escrow any sales proceeds pending resolution of the litigation. Defendants failed to timely answer. After a request for default was filed, defendants filed an order to show cause to set aside the *lis pendens*, with plaintiffs filing their own order to show cause to enjoin the sale of the Perth Amboy property. Ultimately, after the motions were filed, counsel for the parties agreed to withdraw the pending motions based on defendants' counsel's representation that defendants would file an answer by a date certain. An order, which was reviewed on the record with the trial court, was entered memorializing the terms of this arrangement. However, defendants failed to file an answer by the deadline agreed to by the parties and, four days later, default was requested and entered by the clerk. Defendants subsequently moved to vacate the default and plaintiff cross-moved for entry of final judgment. The trial court entered final judgment and denied defendants' request to vacate default, finding that defendants' basis for seeking relief from the default – *i.e.*, defendants' counsel's representation that Shnayderman had not had time to review the proposed answer – was insufficient. The trial court also found that defendants lacked any meritorious defense.

On appeal, the Appellate Division affirmed the decision, noting that appellate review of a denial to vacate a default is premised on the abuse of discretion standard. The Appellate Division found that the four month delay in filing an answer was never adequately explained by defendants and the fact that one of the defendants purportedly failed to review the draft answer could not meet the "good cause" standard.

New Jersey Appellate Division Declines to Bar Foreclosure Action Based on Entire Controversy Doctrine

In *Carrington Mortg. Servs., LLC v. Moore*, No. A-4084-18T3 (App. Div. June 10, 2020), David and Elizabeth Moore purchased a home with a mortgage loan, which was assigned to Bank of America and, in turn, assigned to Carrington Mortgage Services (the plaintiff in this case). In October 2012, the Moores' home was severely damaged by flooding during Hurricane Sandy, and, in February 2015, the Moores defaulted on their mortgage payments.

After the Moores' efforts to recover from both their flood insurer and their homeowners' insurer failed, the Moores filed a lawsuit in the United States District Court for the District of New Jersey against the two insurers, naming Bank of America as a co-defendant. The federal complaint claimed that Banking of America should be precluded from collecting mortgage payments and should only recover from whatever insurance proceeds were payable. The District Court granted the bank's motion to dismiss and granted the insurers' motions for summary judgment.

In April 2018, Carrington filed a foreclosure action. The Moores did not respond to the foreclosure complaint, and the trial court entered final judgment. After a sheriff's sale was conducted, the Moores filed a motion to vacate the default judgment, arguing that the entire controversy doctrine precluded Carrington's foreclosure case in state court because Bank of America (as Carrington's predecessor) was obligated to file a counterclaim against them in the federal case to protect its rights but did not do so. The trial court denied the motion.

The Appellate Division agreed with the trial court, calling the Moores' invocation of the entire controversy doctrine "critically flawed." Briefly stated, the entire controversy doctrine requires parties to an action to bring all transactionally-related claims that they may have in that action. But the doctrine has a more limited scope in the foreclosure setting. Rule 4:64-5 provides that foreclosure claims should not be joined with non-germane claims against the borrower, and the borrower can only assert germane counterclaims, such as claims on the instrument evidencing the mortgage debt.

The Appellate Division questioned whether the federal court would have had jurisdiction over a foreclosure claim if Bank of America had chosen to plead it as a counterclaim. Even assuming jurisdiction, however, the panel did not see a basis to hold that the foreclosure claims had a sufficient transactional relationship to the insurance dispute to require them to be brought in the federal action. The mortgage contract, the panel explained, "demonstrates that there is no transactional relationship because the insurance clauses in the contract do not affect the Moores' obligation to pay the debt." Although the mortgage had a clause requiring the Moores to purchase insurance, the panel stated that an insurance payout and the underlying mortgage are not related: "insurance payouts do not affect a mortgagor's monthly obligations to make insurance payments, and are not tied to their obligation to make payments toward the underlying debt." The payment obligation was independent of the result of the insurance claim. The panel closed by stating that a "further requirement that a mortgage holder preemptively bring a foreclosure action whenever homeowners sought to recover insurance proceeds on their property would greatly add to the burdens of mortgagors in an already stressful situation."

If you have any questions about this Alert:

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