

BANKING ALERT

September 2014

[Bank and Customer May Agree To Shorten UCC Section 4-406\(4\) One-Year Statutory Period by Agreement](#)

In *Clemente Brothers Contracting Corporation v. Hafner-Milazzo*, 23 N.Y.3d 277 (2014), the Court of Appeals for New York considered whether a bank and its customer may, by agreement, shorten the statutory time period under Section 4-406(4) of the Uniform Commercial Code (the “UCC”) for reporting improper transactions from one year to fourteen days.

In *Clemente*, the plaintiff, a contracting business, opened three corporate operating accounts and a loan and a line of credit, both of which were backed by a promissory note, with the defendant bank, in April 2007. To drawdown on the line of credit, the plaintiff was required to send a signed drawdown request to the bank.

In connection with opening this line of credit, the bank required the plaintiff to pass a corporate resolution providing that the plaintiff’s principal was the only authorized signatory on the account and the only person authorized to execute drawdown requests on the line of credit. Critically, the corporate resolution further provided that “unless [the plaintiff] shall notify the [b]ank in writing within fourteen calendar days of the delivery or mailing of any statement of account and cancelled check, draft or other instrument for the payment of money....of any claimed errors in such statement, or that [plaintiff’s] signature was forged, or that any such [i]nstrument was made or drawn without the authority of [the plaintiff]...said statement of account shall be considered correct for all purposes and [the bank] shall not be liable for any payments made and charged to the account of [the plaintiff].” Each month, the bank sent three separate statements of account for the operating accounts to the plaintiff’s business address.

Over the course of a two-year period commencing in January 2008, the plaintiff’s secretary and bookkeeper forged the principal’s signature on drawdown requests on the line of credit and checks paid from one of the three accounts. In total, the employee embezzled approximately \$380,000. The plaintiff did not notify the bank of any of these unauthorized transactions until February 2010. After the bank demanded

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repayment on the entire amount of the line of credit due and owing, the plaintiff filed suit against the employee and the bank.

After the Appellate Division affirmed the Supreme Court's granting of summary judgment in the bank's favor, the Court of Appeals granted the plaintiff's leave to appeal to decide, among other things, whether the agreement between the bank and the plaintiff to shorten the one-year statutory period to report improper transactions was valid and enforceable. Recognizing that the UCC "imposes strict liability upon a bank that charges against its customer's account any 'item' that is not 'properly payable,'" the Court of Appeals analyzed a bank customer's obligation under Section UCC 4-406(1) to timely and promptly review its statements for improper transactions or irregularities, noting that a bank customer's failure to exercise diligence "may preclude a customer's suit against the bank." In particular, Section 4-406(4) of the UCC precludes a customer from seeking recovery from the bank for an improperly charged item that is not reported within one year of receiving a statement identifying the item, regardless of whether the bank acted with due care.

The Court of Appeals observed, however, that the parties, by way of the corporate resolution executed by the plaintiff and required by the bank, shortened the one-year period contained in Section 4-406(4). The Court of Appeals noted that while the UCC permits a bank and its customer to vary the terms of the UCC by agreement, pursuant to Section 4-103, a bank cannot disclaim its responsibility to act in good faith or exercise ordinary care.

Nonetheless, the Court of Appeals rejected the primary argument advanced by the plaintiff that by shortening the one-year statutory period to fourteen days, the bank effectively disclaimed its obligation to act in good faith or with due care: "While shortening the period certainly affected [the bank's] liability for improperly paid items, whether paid in good faith or not, it did not exclude all liability for negligence. Nor did the modification affect the measure of damages; it merely limited the time within which plaintiffs must provide notices of the improper charge." Indeed, the Court of Appeals noted that, given the nature of the plaintiff's business -- *i.e.*, one with numerous employees and thousands of dollars under its management -- it was not unreasonable to expect the plaintiff to dutifully monitor its statements within fourteen days. Thus, the Court of Appeals held, once the bank provided the plaintiff with the account statements identifying the improperly paid items, the plaintiff was under an obligation to report these transactions to the bank within fourteen days as provided for in the corporate resolution.

While the Court in *Clemente* limited the scope of its ruling to the particular facts, *Clemente* provides persuasive authority to support an argument that a bank's deposit agreement shortening the one-year statutory period (there to a time period of fourteen days) is enforceable and binding on the customer. The Court of Appeals' analysis also reinforces the basic principle that the bank customer stands in the best position to monitor its own accounts and promptly report irregularities.

[Condemning Authority Has No Duty to Negotiate With Mortgage Holders](#)

In *Borough of Merchantville v. Malik & Son, LLC*, 95 A.3d 709 (N.J. 2014), the New Jersey Supreme Court considered whether a condemning authority has an obligation to negotiate with a mortgage holder prior to bringing a condemnation action.

In *Borough of Merchantville*, LB-RPR REO Holdings LLC (“LB”), a redeveloper of distressed properties and holder of a mortgage on a 54-unit apartment building in Merchantville, New Jersey, challenged the borough’s declaration of taking arguing that the borough had a duty to engage in *bona fide* negotiations with LB prior to instituting eminent domain litigation because LB was the “real party in interest.”

LB had advised the borough that it obtained a final judgment of foreclosure and that a sheriff’s sale of the property was scheduled for December 7, 2011. LB further expressed its desire to meet with the borough to discuss reasonable compensation for the property. In addition, LB had a receiver appointed for the property and made substantial repairs to the building.

The borough had been pursuing plans to redevelop the property since 2010. Following the adoption of a redevelopment plan in September 2011, the borough engaged an appraiser who assigned the property a fair market value of \$270,000. The borough offered Malik & Son, LLC (“Malik”), the record title owner, \$270,000 for the property. Malik formally rejected the offer because the amount offered would have been insufficient to satisfy the liens on the property, but invited further discussion about “more reasonable compensation.”

On December 5, 2011 – just two days before the scheduled sheriff’s sale of the property – the borough filed a declaration of taking and verified complaint in condemnation. LB moved to dismiss the complaint.

In its motion, LB argued that the borough had failed to engage in *bona fide* negotiations with Malik and LB. The trial court denied the motion, concluding that the borough had no obligation to negotiate with LB and that the borough discharged its obligation to engage in *bona fide* negotiations with Malik prior to initiating condemnation proceedings.

After the Appellate Division affirmed the trial court’s dismissal of LB’s motion, the New Jersey Supreme Court granted LB’s petition for certification to decide, among other things, whether the borough had an obligation to negotiate with LB prior to initiating condemnation proceedings and whether the borough discharged its obligation to engage in *bona fide* negotiations with Malik.

In determining whether the borough had an obligation to negotiate with LB, the Supreme Court examined the nature of a mortgage holder’s interest in property after it obtains a final judgment of foreclosure. The Supreme Court noted that a final judgment of foreclosure does not extinguish a mortgagor’s “right of redemption.” As such, Malik, the mortgagor, remained the party “holding the title of record” until its right of redemption is extinguished by the issuance of a sheriff’s deed.

The Supreme Court held that the plain language of the Eminent Domain Act, specifically N.J.S.A. 20:3-6, requires a condemning authority to negotiate with the “condemnee who holds title of record to the property.” Since Malik still retained “title of record” at the time the condemnation proceedings were initiated, it was the only party that the borough had an obligation to negotiate with. The Supreme Court noted that the rationale for this limitation is that it “avoids the difficult requirement of negotiating with each condemnee having an interest in the property. The rights of all other condemnees with a compensable interest are better protected by allowing them to participate later during the Commissioner’s hearing, where value is determined . . . and during the still subsequent proceeding when

the compensation is allocated.”

Although the Supreme Court concluded that LB lacked standing “to challenge the bona fides of the negotiation process between the borough and Malik,” it nonetheless held that the borough properly discharged its duty to engage in bona fide negotiations with Malik. The Supreme Court noted that the borough offered to purchase the property from Malik for fair market value and supplied Malik with an appraisal identifying the valuation methodology used. The Court held that the borough was not obligated to engage in any further discussions with Malik after it rejected the borough’s offer because Malik offered no “concrete and credible” evidence of the property’s value.

The Supreme Court’s holding in *Borough of Merchantville* should serve to remind mortgage holders that a final judgment of foreclosure does not vest a mortgagee with an indefeasible interest in a property and that they should make an effort to inform themselves about municipal actions which could affect properties in which they hold an interest.

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