

# Commercial Financial Services Brief: Secured Creditor Loses Security Interest In Cash By Delivering The Cash To A Bankruptcy Trustee

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The March 2013 Commercial Financial Services Brief included a cautionary tale about a secured party's inadvertent loss of its security interest in its borrower's bankruptcy case as a result of the secured party having mistakenly filed a UCC termination statement. This article describes another situation in which a secured party experienced a similar haunting outcome.

In *In re WEB2B Payment Solutions, Inc.*, the debtor was in the business of providing payment processing services for third parties. The debtor deposited payment items received from third parties in its deposit accounts at its bank, for which the bank provided immediate credit. When a payment item was subsequently dishonored, the bank recovered the amount of the dishonored item from the funds remaining in the debtor's deposit accounts. To secure the debtor's obligation to reimburse it for the amounts of the dishonored items, the bank held a contractual security interest in the debtor's deposit accounts. The bank's security interest was perfected by "control" of the deposit accounts under UCC Article 9 because the deposit accounts were maintained with the bank itself.

After the debtor filed bankruptcy, its bankruptcy trustee made a demand on the bank to turnover approximately \$933,000 in funds on deposit in the debtor's deposit accounts. The bank unilaterally determined that it would retain \$50,000 to cover reimbursement for any future dishonored items, and paid the balance to the trustee. Unfortunately for the bank, payment items in excess of \$512,000 that previously had been deposited by the debtor subsequently were dishonored. As a result, the bank commenced a lawsuit against the trustee asserting that it retained a perfected security interest in the debtor's funds that it had paid to the trustee and demanded that the trustee return those funds in order to reimburse it for the dishonored items.

The Eighth Circuit Bankruptcy Appellate Panel held that the bank had voluntarily relinquished its perfected security interest in the funds in the debtor's deposit accounts when those funds were paid to the trustee. As a result, the bank was not entitled to the return of any of those funds to cover the reimbursement amounts due it. The Court observed that the bank should have requested an order of the bankruptcy court providing "adequate protection" of its security interest in the funds in the debtor's deposit accounts before it paid the



funds to the trustee. An adequate protection order could have allowed it to maintain its security interest in the deposited funds even after those funds were paid to the trustee.

The lesson for secured parties in this tale is that, when the collateral is cash or other property for which a security interest is perfected by control or possession, that security interest will be lost if the collateral is delivered to the borrower's bankruptcy trustee unless the secured party first obtains an adequate protection order from the bankruptcy court.

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