

COMMON LAW DEFENSE TO A CHARGEBACK—WHETHER THE UCC RIGHT TO A CHARGEBACK CAN BE COUNTERED BY THE COMMON LAW RIGHT TO AN OFFSET WHEN A BANK IS BOUND BY A WIRE TRANSFER AGREEMENT

By Tyler Allen*

Cadence Bank v. Elizondo, 606 S.W.3d 802 (Tex. App.—Houston [1st Dist.] 2020, pet. filed).

Background

In *Cadence Bank v. Elizondo*, the defendant, Elizondo, is an attorney who became the target of a check-fraud scam involving an international client.¹ The client solicited Elizondo for representation in a collection action against an alleged debtor.² Shortly after, the client informed Elizondo that the debtor had agreed to a settlement, and the debtor would mail Elizondo a cashier's check containing the settlement amount.³ The client also asked that Elizondo promptly wire part of the amount contained in the check to a third-party account in Japan, as the client did business with the owner of the Japanese bank account and the debtor dispute had interrupted cash-flow.⁴ On Friday, September 19, Elizondo received the cashier's check, payable to him in the amount of \$496,850 which he deposited into his IOLTA account with Cadence Bank on Monday, September 22.⁵ The bank added provisional credit in the amount of the check to Elizondo's account on the same day.⁶

On Tuesday, September 23, Elizondo contacted the plaintiff, Cadence Bank (“Cadence”), to facilitate the wire transfer from the IOLTA account to the Japanese bank account.⁷ Elizondo emailed a Cadence employee and provided the pertinent information, including the amount to be wired—\$398,980.⁸ The employee sent Elizondo a wire transfer form for him to fill out and sign.⁹ The form contained a place for Elizondo to sign acknowledging the terms of the wire transfer and a \$55 wire transfer fee.¹⁰ It also contained several blank fields to be filled in by Cadence, including a field for the “collected balance” from which the wire transfer amount would be drawn as well as a field for the name of the Cadence employee “who verified [the] collected balance.”¹¹ The term “collected balance” was not defined.¹²

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¹ *Cadence Bank v. Elizondo*, 606 S.W.3d 802, 806 (Tex. App.—Houston [1st Dist.] 2020, pet. filed).

² *Id.*

³ *Id.*

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

⁹ *Id.* at 807.

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

After Elizondo signed and returned the form, Cadence employees filled out the remaining fields.¹³ One employee signed and indicated that the transfer would be made from a “collected balance” of \$497,643.89, but the employee did not verify whether payment had actually been received for Elizondo’s cashier’s check and did not make a distinction between a provisional credit in the account and funds actually received.¹⁴ Another Cadence employee wrote in the margins of the form that Elizondo’s “available balance” was \$497,643.89.¹⁵ The Deposit Agreement defined “available balance” as the amount “available for immediate withdrawal.”¹⁶ On Wednesday, September 24, Cadence wire transferred \$398,980 to the Japanese bank account using the provisional funds previously credited to Elizondo’s account.¹⁷

On Thursday, September 24, the check was dishonored by the drawee bank.¹⁸ Cadence charged back the funds that were provisionally credited to Elizondo’s account, resulting in a negative balance and overdrawn funds of \$398,980.¹⁹ When Elizondo refused to repay the overdrawn amount, Cadence filed suit, asserting claims for breach of contract under the parties’ Deposit Agreement and breach of warranty under Section 4.207 of the Texas UCC (“UCC”).²⁰ Elizondo asserted the affirmative defense of the right to an offset and counterclaimed for breach of contract under the wire transfer form, alleging that Cadence had failed to transfer the funds from a “verified collected balance.”²¹ Cadence moved for summary judgment on the basis of its breach of contract claim and breach of warranty claim, arguing that Elizondo breached his warranties that “all signatures” on the check were “authentic and authorized” and “the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item is drawn” under the UCC.²² Elizondo moved for summary judgment on his breach of contract claim, alleging that the wire transfer form was a contract that required Cadence to draw the funds from a “verified collected balance.”²³ Elizondo argued that this language prohibited Cadence from transferring funds from provisional credit because “collected balance” encompassed only funds which were actually received.²⁴ Cadence responded that as it defined “collected balance” it could include provisional funds from unpaid checks.²⁵ The trial court granted Elizondo’s motion for summary judgment and rendered a take-nothing judgment in his favor.²⁶ Cadence appealed.²⁷

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.* at 807-808.

²² *Id.* at 808.

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.* at 809.

²⁶ *Id.*

²⁷ *Id.*

Analysis

On appeal, Cadence argued that the evidence showed as a matter of law that Elizondo was liable for breach of warranty under the UCC and breach of the Deposit Agreement previously entered by the two parties.²⁸ Elizondo did not dispute that he breached the warranties under the UCC or that Cadence was entitled to charge back the provisional funds credited to the account after the cashier's check was dishonored, per the Deposit Agreement and the UCC.²⁹ However, Elizondo argued that he entered into another contract with Cadence after he breached his warranties—a contract reflected by the wire transfer form in which Cadence agreed to transfer funds from a “verified collected balance” to the Japanese account.³⁰ Under Elizondo’s theory, Cadence breached that contract when it used provisional funds to complete the wire transfer and was thus responsible for its own damages.³¹ Elizondo maintained that he was entitled to offset the chargeback by the amount of the overdraft due to Cadence’s breach.³²

Cadence asserted that Elizondo’s affirmative defense of the right to an offset failed because the UCC preempts such a defense.³³ The common law “supplements, but does not supplant” the UCC.³⁴ If a common law defense conflicts with the UCC’s purpose or text, the defense is preempted by the UCC.³⁵ While the UCC has preempted common law defenses to a bank’s right to charge back settlement funds, such as defenses based in fraud or negligence,³⁶ common law defenses to a bank’s recovery of an overdraft when it is caused by a statutory chargeback are not necessarily preempted.³⁷ The UCC provides a bank’s right to a chargeback and regulates a bank’s check processing procedures, but is silent as to a bank’s communications to an account holder with regard to those procedures.³⁸ Because this area is not addressed by the UCC, it is covered by supplementing common law principles.³⁹ Because Elizondo asserted a common law defense to Cadence’s representations in the wire transfer agreement and not in response to Cadence’s actual right to a chargeback, the affirmative defense of the right to an offset was not preempted in this instance.⁴⁰

The Court found all elements of a contract in the wire transfer form.⁴¹ The offer—for Elizondo to pay a \$55 wire transfer fee for Cadence to transfer “verified collected funds” from the IOLTA account to the Japanese account—was accepted when Cadence signed and completed the

²⁸ *Id.* at 812.

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

³² *Id.* at 813.

³³ *Id.*

³⁴ *Id.*; citing TEX. BUS. & COM. CODE § 1.103.

³⁵ TEX. BUS. & COM. CODE § 1.103, cmt. 2.

³⁶ *Cadence Bank*, 606 S.W.3d at 813.

³⁷ *Id.*

³⁸ *Id.* at 814.

³⁹ *Id.*

⁴⁰ *Id.* at 814-15.

⁴¹ *Id.* at 815-16.

form.⁴² Elizondo's promise to pay the \$55 wire transfer fee constituted consideration.⁴³ The parties' subsequent actions reflected consent to the terms, a meeting of the minds, and execution—creating a binding contract.⁴⁴

The issue of liability hinged on the meaning and materiality of the term "verified collected balance."⁴⁵ Elizondo offered deposition testimony of a registered investor advisor and former chairman of four banks, who testified that a "collected balance" means a "balance minus deposited checks in the process of collection, i.e., minus checks that have not been actually paid by the paying bank."⁴⁶ Cadence offered deposition testimony of its own corporate representative and branch administration manager, who testified that Cadence had an internal definition for "collected balance" which can encompass provisional credit for uncollected checks.⁴⁷ Cadence argued that every bank has its own definition of the term "collected balance," and it is based on the bank's own calculations and assumptions.⁴⁸

The Court found Elizondo's construction to be the only one consistent with the terms of both the wire transfer agreement and Deposit Agreement—thus reflecting the true intent of the parties.⁴⁹ The Deposit Agreement defined "available balance" as the customer's ledger balance, less any debits, plus any credit not subject to holds.⁵⁰ The Court reasoned that "collected balance," as a material term of the wire transfer agreement, must have a different meaning than the clearly defined "available balance."⁵¹ However, Cadence's proposed construction tended to give "collected balance" the same meaning as "available balance" by noting that either can include credits not subject to holds.⁵² The Court observed that Cadence's failure to disclose its internal definition of "collected balance" to Elizondo further reinforced the notion that Elizondo had no reason to construe the term in that way.⁵³

The Court concluded that Cadence breached the wire transfer agreement by using provisional credit funds and failing to transfer funds from a "collected balance," using Elizondo's construction of the term.⁵⁴ Therefore, the breach entitled Elizondo to offset Cadence's chargeback by the amount of overdrawn funds as a matter of law.⁵⁵

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.* at 816.

⁴⁶ *Id.* at 817.

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.* at 817-18.

⁵⁰ *Id.* at 818.

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.* at 819.

⁵⁴ *Id.*

⁵⁵ *Id.* at 820.