UNITED STATES SMALL BUSINESS ADMINISTRATION
v.
CITIBANK, N.A.
No. 94 Civ 4259 (PKL)
United States District Court, S.D. New York
February 4, 1997

Callaghan & Company's Headnote and Classification

¶ 1103.1(7), ¶ 1103.7(4), ¶ 3419.5(1)
Preclusion of common law negligence action against bank.
S.D.N.Y. Feb. 4, 1997
Plaintiff SBA, acting on behalf of X (a corporation it licensed), could not bring a common law negligence cause of action against several banks alleging that they allowed 17 checks payable to X to be cashed by a crooked employee. While Hechter v. New York Life Ins. Co., 25 UCC Rep Serv 537, 46 NY2d 34, 412 NYS2d 812 (1978) arguably suggests that all common law actions remained viable even after New York's adoption of § 3-419, Subsection (3) of § 3-419 creates a safe harbor for banks that acted in good faith and according to reason able commercial standards in cashing an improperly indorsed check. Subsection (3)'s failure to also mention that a bank would be permitted to raise comparative negligence as a defense to a negligence action arising out of its cashing of such a check leads to the conclusion that at least common law negligence claims related to a bank's allegedly improper check payment are precluded by § 3- 419.
UNITED STATES SMALL BUSINESS ADMINISTRATION v. CITIBANK, N.A. (SD NY 1997). 1997 WL 45514 (S.D.N.Y.), 31 UCC Rep.Serv.2d 795

Callaghan & Company's Headnote and Classification

¶ 3204.5, ¶ 3205, ¶ 3206.3, ¶ 3206.4
Restrictive deposit not violated.
S.D.N.Y. Feb. 4, 1997
Where 15 checks payable to a company called 'Diamond Capital Corp.' ('DCC ') were indorsed with some variation of 'for deposit only/Diamond Capital/620200855,' depositary bank did not violate the restriction imposed by those indorsements when it deposited them into an account numbered '620200855' even though that account had been opened by 'International Diamond Capital Corp.' ('IDCC'), not DCC. For those checks (eight of them) indorsed 'for deposit only/Diamond Capital/620200855,' the payee's signature (i.e., 'Diamond Capital') functioned both as a special indorsement to IDCC and as a restrictive indorsement requiring deposit to the specified account. The same result followed for two checks indorsed 'for deposit only/620200855/Diamond Capital' since the only difference was the word order. Finally, the deposit to that account of those checks (five of them) indorsed merely 'for deposit only/620200855' did not violate the restriction, either.
UNITED STATES SMALL BUSINESS ADMINISTRATION v. CITIBANK, N.A. (SD NY 1997). 1997 WL 45514 (S.D.N.Y.), 31 UCC Rep.Serv.2d 795

Callaghan & Company's Headnote and Classification

¶ 1103.6, ¶ 4104.5(9), ¶ 4205.1
Supplying of indorsement by bank.
S.D.N.Y. Feb. 4, 1997
Where a check payable to a company called 'Diamond Capital Corp.' ('DCC') was accepted for deposit to an account in the name 'ABR Management, Inc. A/A/F Diamond Capital Corp.' over an indorsement supplied by the depositary bank, a question of fact as to the propriety of bank's action was raised precluding summary judgment

dismissal of action by plaintiff SBA, acting on behalf of DCC (a corporation it licensed). While 'A/A/F' commonly stands for 'as agent for,' plaintiff raised questions as to the validity of ABR's purported agency status by pointing out inconsistencies in one witness' testimony and in certain documents.
UNITED STATES SMALL BUSINESS ADMINISTRATION v. CITIBANK, N.A. (SD NY 1997). 1997 WL 45514 (S.D.N.Y.), 31 UCC Rep.Serv.2d 795

Callaghan & Company's Headnote and Classification

¶ 3206.4
Following terms of restrictive indorsement.
S.D.N.Y. Feb. 4, 1997
Any action arising from the deposit to an account in the name 'ABR Managemen t, Inc. A/A/F Diamond Capital Corp.' of a check payable to a company called 'Diamond Capital Corp.' ('DCC') was subject to dismissal since that check was indorsed (and not by bank): 'Diamond Capital Corp./Deposit Only/35377334 [the number of ABR's account].' The word order suggested that DCC had signed the check and then added the 'where it should be deposited' instruction.
UNITED STATES SMALL BUSINESS ADMINISTRATION v. CITIBANK, N.A. (SD NY 1997). 1997 WL 45514 (S.D.N.Y.), 31 UCC Rep.Serv.2d 795

Callaghan & Company's Headnote and Classification

¶ 1201.43, ¶ 3401.3, ¶ 3404.3, ¶ 3419.4(3)
Signature by purported agent.
S.D.N.Y. Feb. 4, 1997
While SBA regulations forbid its licensees from empowering agents to act on their behalf, such an agreement made by a certain licensee, Diamond Capital Corp. ('DCC'), and an individual never approved by SBA was not necessarily void under state law. In any event, SBA would not be permitted to use the alleged invalidity of that agreement to hold depositary banks liable for having accepted for deposit checks payable to DCC over indorsements, in DCC's name, supplied by that agent. Notwithstanding SBA's position, DCC cloaked its agent with the apparent authority to conduct banking business on its behalf.
UNITED STATES SMALL BUSINESS ADMINISTRATION v. CITIBANK, N.A. (SD NY 1997). 1997 WL 45514 (S.D.N.Y.), 31 UCC Rep.Serv.2d 795

Callaghan & Company's Headnote and Classification

¶ 1103.6, ¶ 4104.5(9), ¶ 4205.1
Supplying of indorsement by bank.
S.D.N.Y. Feb. 4, 1997
Where a check payable to a company called 'Diamond Capital Corp.' ('DCC') was accepted for deposit to an account in the name 'ABR Management, Inc. A/A/F Diamond Capital Corp.' over a 'PEG' indorsement supplied by the depositary bank, a question of fact was raised precluding summary judgment dismissal of action by plaintiff SBA, acting on behalf of DCC (a corporation it licensed). While a bank is entitled to supply such an indorsement on behalf of its 'customer,' it was not clear that the ABR account was maintained for DCC's benefit to the extent that DCC would qualify for that status.
UNITED STATES SMALL BUSINESS ADMINISTRATION v. CITIBANK, N.A. (SD NY 1997). 1997 WL 45514 (S.D.N.Y.), 31 UCC Rep.Serv.2d 795

Callaghan & Company's Headnote and Classification

¶ 3206.3, ¶ 3419.4(2), ¶ 3419.5(2)
Deposit in third party's account.

S.D.N.Y. Feb. 4, 1997

Checks payable to a corporation and indorsed 'for deposit' to various bank accounts in the name of other corporations but lacking any indorsements by the payee or any 'PEG' indorsement by bank on payee's behalf were improperly accepted for deposit by depositary banks. Thus, plaintiff SBA, acting on behalf of payee corporation as its licensor was entitled to summary judgment on its violation of § 3-419(1)(c) claim.

UNITED STATES SMALL BUSINESS ADMINISTRATION v. CITIBANK, N.A. (SD NY 1997). 1997 WL 45514 (S.D.N.Y.), 31 UCC Rep.Serv.2d 795

UCC Sections Cited: § 1-103, § 1-201(43), § 3-201, § 3 -202, § 3-204(1), (2), § 3-205, § 3-206(1), (3), § 3-401, § 3-404, § 3-41 9(1)(c), § 4-104, § 4-205(1).

EDITORS' NOTE

As of February 1997, New York had still not adopted Revised Articles 3 &am p; 4.

Leslie Trager of Morley & Trager, New York City, for plaintiff.

Joseph L. Buckley and Adam J. Kaiser, both of Sills Cummis Zuckerman Radin Tischman Epstein & Gross, P.A., New York City, for defendant Citibank, N.A.

Andrew S. O'Connor, New York City, for defendant Republic Nat. Bank of New York.

George F. Hirtz and Mark J. Schirmer, both of Davis, Scott, Weber & Ed wards, P.C., New York City, for defendant Bank of Tokyo Trust Co.

LEISURE, District Judge.

The above-captioned action is a case under Ne w York's Uniform Commercial Code (the 'NYUCC' or the 'Code') and common law principles of commercially reasonable prac tice. Plaintiff United States Small Business Administration ('SBA') alleges that these checks were honored and deposited-B ank of Tokyo Trust Company ('BOTT'), Republic National Bank of New York ('RNB'), and Citibank, N.A. ('Citibank')-i n contravention of the endorsement instructions by defendant banks. Before the court are defendants' motions to dismiss plaintiff's common law claim for payment of an instrument on a forged endorsement; defendants' motions for summary judgment, un der Rule 56(b) of the Federal Rules for Civil Procedure, as to the other claims; plaintiff's cross-motion for summary judgment, under Rul e 56(a); and defendants Citibank's and BOTT's motions to strike all or portions of the affidavits submitted by counsel for plaintiff in connection with the herein motions, or in the alternative to impose discovery sanctions. For the reasons stated below, the motion to dismiss is granted, all of the motions for summary judgment are granted in part and denied in part, and the mot ions to strike are granted in part and denied in part.

BACKGROUND

The relevant, undisputed facts are as follows. Diamond Capital Corporation (' DCC') was a Small Business Investment Corporation ('SBIC') licensed by the SBA. In early 1991, Charles Starace bought shares of DCC from a number of individuals, including some of the officers of the corporation. At around the same time, Mr. Starace en

tered into a consulting agreement (the 'Agreement '), signed by DCC's officers and principals, purporting to confer on M r. Starace the power to run the day to day operations of DCC, including control of cash-flow and the authority to endorse checks made payable to DCC.

Also in early 1991, a bank account was opened at BOTT under the name International Diamond Capital Corporation ('IDCC'), [FN1] and another account was opened at Citibank under the name ABR Management, Inc. ('ABR'). [FN2] Between March and December of 1991, Mr. Starace or his representatives deposited seventeen checks-fifteen at BOTT and two at Citibank-each made payable to the order of DCC, in these accounts. [FN3] All of the checks but one were endorsed to the IDCC or ABR account by Mr. Starace or under his authority, [FN4] and the proceeds of each check were credited to the account named in the endorsement on the back of the check rather than to the payee named on the front, DCC. One of the checks was not endorsed by Mr. Starace, but was presented to Citibank and was endorsed by it on his behalf.

FN1 Plaintiff alleged in its complaint that the account was opened under the name Internationa l Diamond Capital Corporation, but now in its briefs refers to 'International Diamond Corporation.' See, e.g., Pl.'s Mem. Opp. Mot. & Supp. Pl.'s Cross-Mot. at 7. The Court must assume that this inconsistency is the result of plaintiff's oversight.

FN2 There is dispute as to the exact name of the account. The account name appearing on the signature card prepared when the account was established lists 'ABR Management, Inc. A/A/F Diamond Capital Corp.' See Trager Reply Aff. S upp. Cross-Mot. Ex. B. Plaintiff contends that the name was only 'ABR Management, Inc.,' and pre sents three other documents relating to the establishment of the account, on which the words 'A/A/F Diamond Capital Corp.' are absent. See id.

FN3 The checks were made by payors and drawn on banks not parties to this litigation.

FN4 Defendants' Rule 3(g) statements asserted that it was undisputed that the checks 'were endorsed b y or under the authority of Mr. Starace.' Def. BOTT's Rule 3(g) Statement ¶ 2; Def. Citibank's Rule 3(g) Statement ¶ 2 . Plaintiff responds: 'Denied. See answer 1. above.' See Pl.'s Resp. to Def. BOTT's 3(g) Statement &pg ;2; Pl.'s Resp. to Def. Citibank's 3(g) Statement ¶ 2. The paragraph referred to relates to plaintiff's position regar ding Mr. Starace's actual authority to operate DCC, including his authority to endorse checks for 'unlawful' deposit. It is apparent from plaintiff's arguments that it does not dispute that the endorsements were added by Mr. Starace or under his authority (to the extent that he had any authority). Thus, plaintiff's statement can only sensibly be read in context as disputing not that Mr. Starace in fact endorsed the checks, but his authority to do so.

In early 1992, an account was opened at RNB, also under the name Internationa l Diamond Corporation. Between February and November of 1992, six checks, payable to the order of DCC and endorsed on the ba ck with RNB's IDCC account number, were deposited by Starace or his representatives. The proceeds of the checks were credited to R NB's IDCC account. Some time in July of 1992, a second account, under the name Starace Equities ('Starace') was opened a t RNB. In August of 1992, one check, made payable to DCC and endorsed on the back with the Starace account number, was deposited, and the proceeds were credited to the Starace account.

Plaintiff asserts three claims against each bank. First, it claims that the b anks failed to act in a commercially reasonable manner when they credited the proceeds of the checks into accounts ot her than an account belonging to the payee, DCC, named on the front of the checks. Second, plaintiff claims that the banks violated § 3 -206(3) of the NYUCC by failing to deposit the funds in a manner consistent with restrictive endorsements on the ba cks of the checks. Third, plaintiff claims that the banks converted the checks in violation of § 3-419(1)(c) of the NYUCC by p aying the checks on a forged endorsement.

DISCUSSION

. . . . . .

II. Common Law Claim and Displacement Under the NYUCC

The NYUCC displaces certain common law causes of action. However, '[u]n less displaced by the particular provisions of this Act, the principles of law and equity . . . . shall supplement its provisio ns.' N.Y. U.C.C. § 1-103 (McKinney 1993). Further, general principles of statutory construction indicate that specific, cl ear legislative intent is required in order to displace existing common law. See, e.g., Hechter v. New York Life Ins. Co., 4 6 N.Y.2d 34, 39, 412 N.Y.S.2d 812, 815, 385 N.E.2d 551, 554 [25 UCC Rep Serv 537] (1978). Here, plaintiff states a common law cause of action on the basis of the same underlying facts as those alleged in support of its claims under Code § 3- 419(1)(c), which holds a bank liable for payment of an instrument on a forged endorsement. Plaintiff's common law cause of action so unds in negligence, alleging that defendants acted in a commercially unreasonable manner in negotiating the checks because th ey were endorsed by one lacking authority to endorse on the payee's behalf.

Thus, the issue is whether plaintiff's common law negligence claims are displ aced by § 3-419 of the NYUCC. The New York Court of Appeals held in Hechter that a common law cause of action sounding in contract was not displaced by the statute. See id. In so holding, the court stated that the language in § 3- 419(3), which states that a representative 'is not liable in conversion or otherwise' under certain circumstances, 'suggests that all pre-code actions regardless of form are to continue.' Id. (emphasis added). Thus, Hechter arguably stands for the proposition that any common law cause of action, not just a contract cause of action, can still be validly asserted for a depositary bank's payment on a forged endorsement.

With regard to the specific question of the survival of a cause of action sou nding in negligence, however, the holding in Hechter does not readily apply. The Code section itself states an exception to l iability for 'a representative, including a depositary or collecting bank' who acts 'in good faith and in accordance with th e reasonable commercial standards applicable to the business of such representative.' N.Y. U.C.C. § 3-419(3) (McKinney 1991). It appears that the legislature, in enacting the Code, intended that a bank's only defense, once a forged endorsemen t is proved, be proof of good faith and commercial reasonability. The statute does not contemplate a defense of comparat ive negligence, which typically would apply against a common law claim. Thus, plaintiff's claim that defendants failed to act in a com mercially reasonable manner appears to be displaced by or subsumed in § 3-419. See Hartford Fire Ins. Co. v. Cavallo , No. 125640/94-001, slip op. at 3 [27 UCC Rep Serv 2d 35] (N.Y. Sup. Ct. June 28, 1995); accord, e.g., Equitable Life Assur ance Soc'y v. Okey, 812 F.2d 906, 910 [3 UCC Rep Serv 2d 1035] (4th Cir. 1987). Therefore, plaintiff cannot state an i ndependent common law claim for commercially unreasonable practice as to the allegedly forged endorsement.

III. Claims for Violation of Restrictive Endorsements

An endorsement on an instrument like a check is a writing, appearing usually on the back of the instrument, whereby the instrument is negotiated to another party. See N.Y. U.C.C. § § 3-201, 3- 202 (McKinney 1991). An endorsement can be in blank, special, or restrictive. An endorsement in blank is simply the signature of the transferor, and an instrument so endorsed becomes a bearer instrument, payable upon delivery unless further endor sed. See id. § 3-204(2). A special endorsement is one negotiating an instrument to the transferee named in the endorsement; a r estrictive endorsement is one that includes words directing that the instrument be dealt with only in a specific manner, one of the most common examples being 'for deposit only.' See id. § § 3-204(1), 3-205 (defining, respectively, special and restrictive endorsements). A restrictive endorsement does not prevent further transfer of the instrument, but one that in cludes the words 'for deposit' (as do the endorsements involved in this case) has the effect of requiring a further transf eree, such as the depositary banks named as defendants here, to pay or apply the value of the instrument 'consistently with the indorsement.' Id. § 3-206(1), (3). A depositary bank can be held liable under section 3-206(3) for failing to appl y funds in a manner consistent with a restrictive

endorsement.

A. Checks Deposited at BOTT

Between July and December of 1991, thirteen checks payable to the order of DC C, for a total of $443,832.36, were deposited into the BOTT account numbered 620200855. This account had been opened under the name 'International Diamond Capital Corp.' Plaintiff claims that BOTT is liable under § 3-206(3) of the NYUCC because it deposited the checks, in violation of restrictive endorsements on each check, into the IDCC account. Plaintiff also cl aims that BOTT failed to act in a commercially reasonable manner in doing so.

The checks can be grouped into three categories according to the endorsements placed on each. The eight checks comprising the first group, totaling $256,076.25, were endorsed as follows: 'for deposit on ly/620200855/Diamond Capital.' See Trager Aff. Supp. Cross-Mot. & Opp. Defs.' Mots. Ex. D. The two checks in the second gro up, totaling $113,420.31, were endorsed as follows: 'for deposit only/Diamond Capital/620200855.' See Trager Aff. Supp. Cro ss-Mot. & Opp. Defs.' Mots. Ex. A. The five checks in the third group, totaling $74,335.80, were endorsed substantially as follows: 'for deposit only/620200855.' [FN6] See Trager Aff. Supp. Cross-Mot. & Opp. Defs.' Mots. Ex. C. The entirety of each endorsement on each check is written in the same handwriting.

> FN6 Three of the five checks bore the following endorsement: 'for deposit only/620200855/International Diamond Capital.' However, all five checks can be analyzed as a group in that al l lack an endorsement in the name of the payee, Diamond Capital Corporation.

Plaintiff cannot prevail on its claim that defendant failed to comply with th e restrictive endorsements given on the checks in the first group. The endorsement directs the depositary bank to deposi t the funds only in the account numbered 62020085 (that belonging to IDCC), and is signed in the name of the payee named on the front of the check. [FN7] The single endorsement functions both as a special endorsement transferring the check to IDCC and as a restrictive endorsement making the check good only for deposit to that account. See Spielman v. Manufacturers Hanover Trust Co., 60 N.Y.2d 221, 226-27, 469 N.Y.S.2d 69, 71-72, 456 N.E.2d 1192, 1194-95 [37 UCC Rep Serv 1] (1983). BOTT followed the payee's (DCC's) unambiguous instructions by depositing the funds into IDCC's acc ount. Accordingly, no finder of fact could rationally conclude that there was a violation of Code § 3-206 or that BOTT acted in a commercially unreasonable manner. See Federal Ins. Co. v. Manufacturers Hanover Trust Co., 157 A.D.2d 460, 460, 549 N. Y.S.2d 385, 386 (1990) ('Having followed the express language of the endorsements, defendant cannot be held liable, and this is so ev en though the endorsements directed that the money be deposited into an account held by someone other than the endorsing part y.' (citing Spielman)).

> FN7 The fact that the transferee, IDCC, is only identified by its account number does not change this analysis, because, as the New York Court of Appeals has observed, '[t]hat the account number was used rather than the name of the owner of the account does not alter the designation when the account is in existence and identifiable as belonging to a specific person.' Spielman v. Manufacturers Hanover Trust Co., 60 N.Y.2d 221, 227, 469 N. Y.S.2d 69, 72, 456 N.E.2d 1192, 1195 [37 UCC Rep Serv 1] (1983); cf. N.Y. U.C.C. § 3- 401(2) (McKinney 1991) (including i n the definition of signature 'any word or mark used in lieu of a written signature.').

The endorsements on the checks in the second group are analytically similar, only differing in the order of the words. Plaintiff urges a strained construction of this endorsement, interpreting the fi rst two lines as directing that the funds be deposited only in DCC's account, and reads the last line as surplusage. Plaintif f would carry the burden of proof at trial, and thus must point evidence to show that such an interpretation is possible. Se e Goenaga v. March of Dimes Birth Defects Found., 51 F.3d 14, 18 (2d Cir. 1995) ('In moving for summary judgment against a party w ho will bear the ultimate burden of proof at trial, the movant's burden will be satisfied if he can point to an absence of ev idence to support an essential element of the nonmoving party's claim.'). Here, plaintiff puts forward no

evidence to show tha t the endorsement was not written by a single person and in a single writing. Indeed, the fact that on each check all t hree lines of the endorsement are written in the same handwriting supports this interpretation. Thus, the endorsement can only rationa lly be read as a single endorsement, directing that the check be accepted for deposit, signed in the name of the paye e named on the front of the check (DCC), and directing the deposit into the IDCC account. As it did with the checks in the first group, BOTT deposited the funds as directed, and summary judgment for defendant is therefore appropriate.

The checks in the third group, in contrast, bore endorsements that did not co ntain the name of the payee indicated on the front of the check, DCC. Thus, although it is undisputed that the checks were pr esented and endorsed by Mr. Starace or under his authority, neither he nor anyone else actually signed the checks on DCC's behalf. As to these checks, defendant did not violate Code § 3- 206(3) because it followed the letter of the restrictive endorsement o n the checks by depositing the funds in the named account. The only legal question presented by these facts is whether BOTT should have allowed IDCC to negotiate the checks by depositing them into it s account, absent an endorsement from DCC negotiating the checks to IDCC. [FN8] Accordingly, defendant's motion for summary judgment is also granted as to plaintiff's claims that BOTT failed to follow a restrictive endorsement on the checks in this third category.

FN8 This question is addressed below in Part IV.B.

B. Checks Deposited at Citibank

In March and April of 1991, two checks payable to the order of DCC, for a tot al of $162,684.93, were deposited into the Citibank account numbered 35377334, the ABR account. The first check, for $80,00 0, was not endorsed in writing but had an endorsement added by Citibank. The second check, for $82,684.93 was endorsed as follows: Diamond Capital Corp./Deposit Only/35377334. The first line of the endorsement appears next to an 'x' apparent ly imprinted on the back of the check. Plaintiff asserts that depositing checks endorsed in this manner into an account not belon ging to the payee named on the front was inconsistent with a restrictive endorsement and thus constituted a violation of § 3-206(3) and a failure to act in a commercially reasonable manner.

The first check was only endorsed by Citibank with the words 'Credit to the A ccount/of the Within Named Payee/Absence of Endorsement Guaranteed/CITIBANK, N.A./[branch address]/A/C # 35377334.' Th e funds were deposited into the account indicated by the number, the ABR account. Such an endorsement, commonly known as a 'PEG' e ndorsement, can be supplied by a bank on behalf of its customer. See N.Y. U.C.C. § 4-205(1). The party whose endors ement is supplied need not hold an account at the bank, given that the statute speaks [sic] uses the term 'customer,' which includes 'any person . . . . for whom a bank has agreed to collect items.' N.Y. U.C.C. § 4-104. Once a bank has supplie d such an endorsement, it is bound by its own restrictive endorsement on the customer's behalf. See Marine Midland Bank, N.A. v. Price, Miller, Evans & Flowers, 57 N.Y.2d 220, 227, 455 N.Y.S.2d 565, 569, 441 N.E.2d 1083, 1087 [34 UCC Rep Ser v 1207] (1982) ('[The] contention that subdivision (3) of section 3-206 does not apply to a depositary bank which ha s supplied a restrictive indorsement on its customer's behalf pursuant to subdivision (1) of section 4-205, finds no supp ort in either statute.').

As to both the question whether DCC was Citibank's customer and the question whether the funds can be deemed to have been deposited in an account for DCC, factual issues remain, precluding summary judgm ent in either party's favor. Mr. Starace, in deposition testimony, stated that the ABR account was maintained for DCC's benef it. The arrangement was necessary, according to Mr. Starace, because other banks would not accept DCC's checks due to the hig h volume of checks returned for insufficiency of funds. Dep. Tr. at 40-43, 46, In re Diamond Capital Corporation (Bankr. S.D.N.Y. Jan. 22, 1993), attached as Kaiser Aff. Ex. J. Indeed, the title of the account appearing on the signature card is 'ABR Management, Inc. A/A/F Diamond Capital Corp.' [FN9] See Trager Reply Aff. Supp. Cross-Mot. Ex. B. Thus, defendant contends, DCC was Citibank's customer in that Citibank, by opening the account, in effect agreed to collect items on behalf of DCC. See N.Y. U.C.C. § 4-104. Furthermore, Citibank contends, depositing the funds in an account maintained by the agent of DCC for DCC's benefit satisfied the restrictive endorsement that the funds were credited to the named payee's (DCC's) account.

FN9 'A/A/F' commonly stands for 'as agent for.'

Plaintiff, however, raises sufficient questions about the validity of ABR's a gency status to defeat defendant's motion for summary judgment as to the first check. First, plaintiff points to apparent inconsistencies in Mr. Starace's deposition testimony, suggesting that his testimony that the ABR account was maintained for the benefit of DCC might not be reliable. Second, plaintiff presents documents relating to the opening of the account, on which the name 'ABR Management, Inc.' alone appears. Thus, plaintiff at least raises an issue of credibility, which preclude s summary judgment in favor of either party. See, e.g., Lendino v. Trans Union Credit Info. Co., 970 F.2d 1110, 1113 (2d Cir. 1992).

The endorsement appearing on the second check is a much simpler matter, as it is analytically similar to the endorsements on the first and second groups of checks, discussed above, that were deposited a t BOTT. Only the order of the items is rearranged, with DCC's signature appearing on the first line and the instruction and transferee appearing on the second and third lines respectively. Plaintiff again urges that the first two lines should be read together as a restrictive endorsement directing deposit only in an account belonging to DCC, and the last line as surp lusage. As with the second group of checks deposited at BOTT, the absence of evidence supporting such a reading and the fac t that the handwriting is the same in all three lines of the writing militate against such a construction. Moreover, in this cas e, the 'x' on the first line, which usually indicates where the signature should appear, supports the more logical interpret ation: the payee named on the front of the check, DCC, signed where indicated by the 'x' and added below that its instructions tha t the check be accepted for deposit into the ABR account.

C. Checks Deposited at RNB

The endorsements on the checks deposited at RNB are analytically identical to those deposited at BOTT. The one check in the first category, for $1,000.00, was endorsed: 'for deposit only/310263719/Dia mond Capital.' See Trager Aff. Supp. Cross-Mot. & Opp. Defs.' Mots. Ex. I. The two checks in the second group, totaling $5839.98, were endorsed as follows: 'for deposit only/Diamond Capital/310263719.' See Trager Aff. Supp. Cross-Mot. & Opp. Defs.' Mots. Ex. H. [FN10] The four checks in the third group, totaling $46,359.97, were endorsed in three forms, similar for analytical purposes in that none of the endorsements contained a signature in DCC's name. [FN11] See Trager Aff. Supp. Cross-Mot. & Opp. Defs.' Mots. Ex. G. [FN12]

FN10 The check in Exhibit H that is dated February 27, 1992 matches the description in Complaint ¶ 58, which lists a check deposited in March of 1992, dated February 27, 1992, and for the sum of $2,919.99. However, t he Complaint's description of the endorsement does not match the exhibit; apparently, this description was ina dvertently switched with the description of the endorsement on the check listed in Complaint ¶ 64. Because the copies of t he checks are before the Court, the Court will assume that the Complaint simply reflects a typographical error.

FN11 The checks were endorsed as follows: (1) two checks with a rubber stamp reading 'Pay to the orde r of/Republic National Bank/for deposit only/International Diamond/Capital Corp./310263719; (2) one check in handwriting , 'for deposit only/310263719/International Diamond'; and (3) one check in handwriting, 'for deposit only/Starace Equities/310263689.

FN12 The check included in Exhibit G that is dated October 27, 1992 is described in Complaint ¶ 64 with the exception that the Complaint incorrectly describes the endorsement. As noted previously, the court will assume that the Complaint is in error.

The result as to each group of checks is identical to the results stated abov e as to the three categories of checks deposited at BOTT, for the reasons stated above with respect to BOTT's conduct. In each case, RNB deposited the funds in accordance with the restrictive endorsement. Accordingly, summary judgment in RNB's favor i s appropriate as to the claims alleging violation of a restrictive endorsement.

IV. Statutory Claims for Payment on a Forged Endorsement

An endorser can use any name, fictitious name, or mark in making a signature, but, in order to be effective, the endorsement must include an authorized signature. See N.Y. U.C.C. § § 3-401 , 3-404 (McKinney 1991). An 'unauthorized' signature under the Code includes both forged signatures and signatures made by an agent o r representative acting outside of his actual or apparent authority. See N.Y. U.C.C. § 1-201(43) (McKinney 1993).

A. Authority to Endorse on DCC's Behalf

Plaintiff claims that defendant banks violated § 3-419(1)(c) of the Cod e when they negotiated the checks based on endorsements by Mr. Starace because, plaintiff asserts, Mr. Starace lacked actua l authority to endorse checks on DCC's behalf. Plaintiff does not dispute the existence of the Agreement-signed by Mr. Stara ce, Steven Kravitz (President of DCC), Diana Ortado (Executive Vice President and Corporate Secretary of DCC), and Martin Lev ine (Vice Chairman and Vice President of DCC)-which purports to confer on Mr. Starace control of the day-to-day operation of DCC. [FN13] Rather, plaintiff argues that the Agreement is without legal effect because Mr. Starace was never approved by the SBA, as required by federal regulation. See 13 C.F.R. § 107.106(c) (1995) ('W ithout prior written approval of SBA, ... no officer, director, employee or other Person acting on the Licensee's behalf shal l . . . . [p]ermit the proposed new owner to . . . . participate in any manner in the conduct of Licensee's affairs.').

> FN13 In fact, plaintiff stipulates to the fact that DCC's officers and/or directors authorized Mr. Starace to endorse its checks. Hritz Aff. Ex. J; Buckley Aff. J.

Thus, the SBA's regulations prohibit its licensees from entering, without pri or written approval, agreements like that purportedly made by DCC and Mr. Starace. However, the New York Court of Appeals has held that an agreement made in violation of an SBA regulation is not necessarily void. See Lloyd Capital Corp. v. Pat Henchar, Inc., 80 N.Y.2d 124, 128, 589 N.Y.S.2d 396, 398, 603 N.E.2d 246, 248 (1992), aff'g 152 A.D.2d 725, 727, 544 N.Y.S.2d 178, 18 0 (1989); see also United States v. Fidelity Capital Corp., 920 F.2d 827, 831, 838 n.39 (11th Cir. 1991) (citing Talco Capita l Corp. v. Canaveral Int'l Corp., 225 F. Supp. 1007, 1013-14 (S.D. Fla. 1964), aff'd, 344 F.2d 962 (5th Cir. 1965)); G eneral Venture Capital Corp. v. Wilder Transp., 26 A.D.2d 173, 178, 271 N.Y.S.2d 805, 811 (1966). Nothing in the regulations or sta tutes governing SBICs indicates that a violation of 13 C.F.R. § 107.106(c) renders a contract void and unenforceable . Rather, a violation of the regulation can lead to revocation of the SBIC's license or other actions by the SBA against the SBIC or its officers. Although '[i]llegal contracts are, as a general rule, unenforceable,' agreements violating regulatio ns that 'are merely malum prohibitum' have been excepted from the general rule. Lloyd Capital Corp., 80 N.Y.2d at 127, 589 N.Y.S .2d at 397, 603 N.E.2d at 247 (quoting John E. Rosasco Creameries, Inc. v. Cohen, 276 N.Y. 274, 278, 11 N.E.2d 908, 909 (193 7)) (internal quotation marks omitted).

To determine whether a given statute renders void any contract made in violat ion of it, New York courts have generally looked first to whether the statute was enacted to protect public health and saf ety, and whether the party seeking to assert the defense of illegality is part of the class of persons intended to be protected. See Richards Conditioning Corp. v. Oleet, 21 N.Y.2d 895, 896, 289 N.Y.S.2d 411, 412, 236 N.E.2d 639, 640 (1968); John E. Rosa sco Creameries, 276 N.Y. at 280, 11 N.E. at 910 (holding that, where violation of a licensing statute did not

endanger the publi c health, and where the statute was intended to protect milk producers and the consuming public, defendant milk dealers could not avoid their contracts with an unlicensed dealer based on its failure to obtain a license). Furthermore, '[a]llowing parties to avoid their contractual obligation is especially inappropriate where there are regulatory sanctions and statutory penalties in place to redress violations of the law.' Lloyd Capital Corp., 80 N.Y.2d at 128, 589 N.Y.S.2d at 398, 603 N.E.2d at 248. Finally, the New York Court of Appeals has recognized the principle that 'forfeitures by operation of law are disfavore d, particularly where a defaulting party seeks to raise illegality as 'a sword for personal gain rather than a shield for the publ ic good.' ' Id. (quoting Charlebois v. Weller Assocs., 72 N.Y.2d 587, 595, 535 N.Y.S.2d 356, 360, 531 N.E.2d 1288, 1292 (1988)).

Application of these principles in the instant case is somewhat novel, becaus e the case is unlike the situation presented in the typical cases, where a defendant asserts the illegality of a contract in order to excuse its default. Nevertheless, nothing in the cited cases indicates that the principles outlined should not be applied to a party seeking to avoid, based on illegality, the effects of its own contract insofar as the contract affects t hird parties. First, the regulation in question was not enacted to protect public health or safety. As a general matter, the purpose of the Federal Small Business Investment Act ('SBIA') is to 'aid, counsel, assist, and protect, insofar as is possible, t he interests of small-business concerns in order to preserve free competitive enterprise,' and the SBIA 'is concerned not with publi c health or safety, but with carrying out Federal small business policy.' Id. (quoting 15 U.S.C. § 631(a)) (internal qu otation marks omitted). The specific SBA regulation asserted by plaintiff is evidently intended to protect the public from fraud by ensuring that the overseeing agency approves those controlling SBICs as properly qualified to run such institutions. See 13 C .F.R. 107.101-.103 (detailing the required qualifications). Second, plaintiff, which sues in its capacity as DCC's receiver , is not part of the class of persons intended to be protected-quite to the contrary, DCC is a member of the class of entities sought to be regulated.

In terms of regulatory sanctions imposed by the SBIA for enforcement of the r egulations, the SBA is empowered to forfeit the SBIC's rights, privileges, and franchises under the SBIA or to dissolve the SBIC; to issue cease and desist orders or to revoke or suspend the SBIC's license; to enjoin the offending conduct, or to imp ose fines on corporate officers for violation of SBA's regulations. See 15 U.S.C. § § 637(d), 637a, 637c, 637g (19 94). Furthermore, the SBA can sue the responsible director or officer for damages to the SBIC resulting from conduct in violation of the re gulations. See, e.g., Small Bus. Admin. v. Segal, 383 F. Supp. 198 (D. Conn. 1974). Thus, DCC itself, or Ms. Ortado and Mes srs. Levine and Kravitz, could be sanctioned for entering into the Agreement. The regulatory sanctions make it clear that avoidan ce of an SBIC's contract for violation of a regulation is not indicated. In the context of this regulatory scheme, allowing plaintiff to void the contract as it affects these defendants would be inappropriate.

Indeed, to allow plaintiff to assert the regulation in order to avoid the eff ect of DCC's own irresponsible actions in granting operational control to Mr. Starace would lead to a particularly pervers e result in this case. DCC, the licensee which violated the regulation by entering into the Agreement in the first place would, if its illegality argument were accepted, be allowed to shift liability to defendants, who had no hand in the formation of the contract. Plaintiff should not be able to wield the regulation as a sword for private gain. DCC cloaked Mr. Starace with a t least the apparent authority to act on its behalf, and gave him operational control of the corporation such that, on a prac tical level, he controlled the corporation's cash-flow and had access to the checks in question. If DCC acted unlawfully in doing so, it should not now be able to complain of its own misconduct in order to avoid consequences it alleges to have resulted from its own delegation of authority. [FN14] This court therefore finds that for the purposes of the payee's claim under Code § 3-419(1)(c), the Agreement was sufficient as a matter of law to vest in Mr. Starace the authority to endors e checks on DCC's behalf. Accordingly, summary judgment must be granted in defendants' favor on plaintiff's § 3-419(1)(c) claims with respect to the checks endorsed in DCC's name.

FN14 The fact that the SBA is the named plaintiff asserting the illegality of DCC's conduct does not change the result. The SBA sues in its capacity as receiver and thus stands in DCC's shoes. See, e.g., Armstrong v. McAlpin, 699 F.2d 79, 89 (2d Cir. 1983) ('A receiver stands in the shoes of the person for whom he has been a ppointed and can assert only those claims which that person could have asserted.'). Thus, because DCC could not assert the illegality of its own contract in order to place liability on defendant banks, plaintiff cannot avoid the effect of the contract.

B. Checks Lacking Endorsement on DCC's Behalf

In addition to the checks bearing Mr. Starace's endorsements for DCC, however , there are at issue a number of checks that were not endorsed on DCC's behalf at all. These are the checks referred to in Pa rt III above as the third group of checks deposited at BOTT and at RNB, and the first check deposited at Citibank. Because no signature in the name of the payee (DCC) appears in the endorsements, the checks on their face appear never to have been negotiated to the owners of the accounts into which the funds were deposited. Payment of an instrument lacking an endorsement constitutes conversion, and normally there would be no remaining issues of fact under such circumstances. See, e.g., Home I ns. Co. v. Manufacturers Hanover Trust Co., 20 U.C.C. Rep. Serv. 2d (CBC) 220 (Sup. Ct. 1993), aff'd 203 A.D.2d 125, 610 N.Y.S. 2d 508 [23 UCC Rep Serv 2d 816] (1994); Costello v. Oneida Nat'l Bank & Trust Co., 109 A.D.2d 1085, 1086, 48 7 N.Y.S.2d 238, 239 [40 UCC Rep Serv 1301], aff'd 66 N.Y.2d 619, 495 N.Y.S.2d 32, 485 N.E.2d 239 (1985). However, in this case, ma terial issues of disputed fact remain as to the check deposited at Citibank.

The first check deposited at Citibank was not endorsed by DCC, but rather by Citibank with a 'PEG' endorsement under Code § 4-205. Such an endorsement, if made on behalf of a customer, is not a fo rgery. See Marine Midland Bank, 57 N.Y.2d at 227, 455 N.Y.S.2d at 569, 441 N.E.2d at 1087. However, as noted above in Part III.B, a material issue of disputed fact remains as to whether the ABR account was maintained for DCC's benefit such that DCC can be deemed to be Citibank's customer. Accordingly, summary judgment cannot be granted in either party favor as to the § 3-419 (1)(c) claim on this check.

With regard to the checks without DCC's endorsement that were deposited at BO TT and RNB, no issues of fact remain. No signature in DCC's name appears on any of the checks, and neither bank attempted to supply a missing endorsement on DCC's behalf, as Citibank did, with a 'PEG' endorsement. Defendant BOTT urges that Code § 3&n1 ;401 allows any name or mark to be used as a signature. However, this argument involves a strained reading of both the statut e and the endorsements. The endorsements contain only (1) words indicating a restriction ('for deposit'); and (2) words identifyi ng IDCC, whether by its account number alone or also by the words 'International Diamond Capital.' The restrictive words sure ly cannot be read as having been intended or accepted as a mark on DCC's behalf. Similarly, the words identifying IDCC cannot be so construed. As to the checks including only the account number, if the number were accepted as a mark on DCC's behalf, then BOTT should not have deposited the funds in an account other than one belonging to DCC. As to the checks with both the accou nt number and the name, it is scarcely credible to interpret the one as a mark on DCC's behalf while interpreting the o ther as naming a transferee, since BOTT's account record would show that the number and the words identify the same entity-IDCC, not DCC. [FN15] Therefore, as to the checks lacking endorsement in DCC's name and deposited at BOTT and RNB, p laintiff's motion for summary judgment is granted.

FN15 Defendant's argument, based on Latallo Establissement v. Morgan Guaranty Trust Co., 155 A.D.2d 214, 218-19, 553 N.Y.S.2d 686, 689 (1990), is also unconvincing. In that case, a mother and son w ere both authorized signatories for an account, each being empowered to sign singly. The son, for reasons of his own, endorsed i nstructions to the defendant bank not in his own name, but in his mother's name. The court held that 'whatever name son Guill ermo signed on the written instructions, it is clear that he was empowered to direct the transfers of money,' and the bank ther efore was not negligent. Id. at 218. This language, when quoted out of context, appears to mean that Mr. Starace, who had at least apparent authority to endorse on DCC's behalf, could sign using 'whatever name.' However, in the context of the facts o f the case, it appears that the son's endorsement was held effective because he had authority to sign and he signed th e name of an authorized endorser. The case is inapposite here, because no signature in DCC's name appears at all.

V. Summary of Holdings

The motion to strike plaintiff's affidavits is granted in part with respect t o the first and third affidavits, and denied with respect to the second affidavit. Accordingly, the affidavit statements that remain are the exhibits attached to the first affidavit, the entirety of the second affidavit, and the first five sentences of the fifth paragraph of the third affidavit, along with the exhibits attached to the third affidavit.

The motion dismiss the common law claim for commercially unreasonable practic e in paying an instrument on a forged endorsement is granted as to all defendants.

BOTT's motion for summary judgment on the claims for applying funds inconsistently with restrictive endorsements, in violation of § 3-206(3) of the NYUCC and as contrary to commercially reasonable practice, is granted with respect of the checks deposited at BOTT (enumerated in Complaint ¶ ¶ 19, 21, 23, 25, 27, 29, 31, 33, 35, 37, 39, 41, 43, and 45). Citibank's motion for summary judgment on the same claims is granted with respect to the check dat ed March 28, 1991, in the amount of $82,684.93 (enumerated in Complaint ¶ 84); the motion is denied with respect to the other check (enumerated in Complaint ¶ 82). RNB's motion for summary judgment on the same claims is granted with respect to all of the checks deposited at RNB (enumerated in Complaint ¶ ¶ 54, 56, 58, 60, 62, and 64).

Defendants' motions for summary judgment on the claims for payment of an inst rument on a forged endorsement, in violation of § 3-419(1)(c), are granted to each defendant respectively, with respect to the following checks:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

Plaintiff's cross-motion for summary judgment on its claim of payment of an i nstrument on a forged endorsement in violation of § 3-419(1)(c) is denied with respect to the check dated March 22, 1991, in the amount of $80,000.00, and deposited at Citibank (enumerated in Complaint ¶ 82).

Plaintiff's cross-motion for summary judgment on the same claim is granted wi th respect to the following checks:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

Accordingly, the issues that remain in the case are: (1) the claim for violat ion of § 3-206(3) or commercially unreasonable practice in applying funds inconsistently with the restrictive endo rsement on the check, dated March 22, 1991, in the amount of $80,000.00, and deposited at Citibank (enumerated in Complaint ¶ 82) ; and (2) the claim for violation of § 3-419(1)(c) with respect to the same check.

CONCLUSION

For the reasons stated above, the motions to strike plaintiff's affidavits ar e hereby granted in part. The motion to dismiss the common law claim for payment on a forged endorsement is hereby grant ed. Defendants' motions for summary judgment are hereby granted in part, and plaintiff's cross-motion for summary judgment is her eby granted in part.

The parties are directed to appear for a pre-trial conference at 500 Pearl Street in Courtroom 18B, at 11:30 February 28, 1997.

So ordered.

END OF DOCUMENT