

Ohio Banking Brief: All The Notable Legal Updates In Q4

By **Alex Durst** (January 13, 2025)

In this Expert Analysis series, attorneys provide quarterly recaps discussing the biggest developments in Ohio banking regulation and policymaking.

Ohio's banking and financial services sector saw several significant developments in the fourth quarter of 2024, including a landmark ruling in a Uniform Commercial Code Article 9 case, adjustments to the state's Homebuyer Plus Program, a pause in beneficial ownership reporting requirements, and the launch of the state's first women-led bank.



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First Appellate District Rules in Intercreditor Dispute

The Ohio Court of Appeals, First District, recently decided the case of *First Financial Bank v. Tailored Fund Cap LLC*, an intercreditor dispute with significant implications for secured lenders.[1]

The case arose from the fallout following the collapse of Harold Sosna's nursing home empire. Sosna engaged in an extensive check-kiting scheme that resulted in massive losses to several involved banks and led to his conviction on federal criminal charges.

Before the check kite came to light, First Financial Bank, or FFB, issued loans to three Sosna entities: Shining Knight Realty LLC, Wexford Care Center Inc. and Wexford Place Inc. FFB alleged that the series of loan and security agreements it entered into with these debtors granted it a first-priority security interest in their future accounts receivable.

Tailored Fund Cap, or TFC, is a so-called merchant cash advance company that provides lump-sum cash advances to businesses, i.e., merchants, in exchange for a set amount of future accounts receivable.

TFC entered into two of these merchant cash advance transactions with Shining Knight and the Wexford companies, whereby TFC paid \$3 million for the right to receive approximately \$4.2 million of their future receivables.

Merchant cash advance transactions are not loans — rather, they represent a sale of the right to collect a business's future revenue. Typically, the merchant authorizes the merchant cash advance company to transfer a set payment via automated clearinghouse transfers on a daily or weekly basis.

Under their agreement with TFC, Shining Knight and the Wexford companies were required to deposit 20% of their daily receipts into a deposit account held at FFB.

From this deposit account, TFC was paid approximately \$3.6 million via automated clearinghouse transfers. When FFB learned about these transactions in the aftermath of the collapse several months later, FFB sued TFC for conversion of its collateral.

Under Ohio law, conversion is defined as the "wrongful exercise of dominion or control over

property in exclusion of the owner's right, or the withholding of property from the owner's possession under a claim inconsistent with the owner's rights," per *Alexander v. Motorists Mutual Insurance Co.* in the First Appellate District in 2012.

According to *Gurry v. C.P.*, decided in 2012 in the Ohio Court of Appeals, Eighth District, the elements of conversion are: (1) the plaintiff's ownership or interest in the property, (2) the plaintiff's actual or constructive possession or immediate right to possession of the property at the time of conversion, (3) the defendant's wrongful interference with the plaintiff's property rights, and (4) damages.

FFB's theory of conversion was that it had a perfected, first-priority security interest in the receivables TFC purchased from Shining Knight and the Wexford Companies; that TFC therefore wrongfully interfered with FFB's security interest by purchasing those receivables; and that FFB suffered damages by virtue of TFC being paid \$3.6 million of its collateral while the loan balance of Shining Knight and the Wexford Companies went unpaid.

After extensive trial court proceedings, the Hamilton County Common Pleas Court found TFC liable for conversion and awarded FFB \$1,187,886.29 in damages, representing the unpaid principal loan balance of Shining Knight and Wexford. TFC appealed.

On appeal, TFC argued that Revised Code 1309.332(B), Ohio's analogue to Section 9-332(b) of the Uniform Commercial Code, precluded FFB's conversion claim. Revised Code 1309.332(B) provides: "A transferee of funds from a deposit account takes the funds free of a security interest in the deposit account unless the transferee acts in collusion with the debtor in violating the rights of the secured party."

Official comments to Section 9-332(b) explain the policies underlying the statute: finality of payments and the free flow of funds. Section 9-332(b) was enacted in response to the increasing prevalence of electronic payments, and was adopted by Ohio in 2001.

If not for this statute, a bank with a security interest could potentially sue to claw back any payment made by a debtor in default — payroll, Netflix, college tuition — any payment whatsoever. Imagine the chaos this would cause.

Protecting the rights of secured creditors remains a priority; however, the statutory collusion exception protects the secured party where the transferee is not innocent.

TFC argued that, because all payments it received were transmitted directly from a deposit account, and because FFB did not allege collusion, Revised Code 1309.332(B) plainly operated to strip any security interest the bank had, precluding a claim for conversion.

TFC urged the court to follow the decision of the Ohio Court of Appeals, Eleventh District, in *Cortland Savings & Banking Co. v. Platinum Rapid Funding Group Ltd.*, another bank-versus-merchant-cash-advance case.

Cortland held that the merchant cash advance company took the transferred funds free of the bank's security interest in the merchant's receivables, unless the bank could prove collusion.

Cortland rejected the holding in 2016's *In re: Tusa-Expo Holdings Inc. v. Knoll Inc.* in the U.S. Bankruptcy Court for the Northern District of Texas, concluding that it was decided based on the incorrect premise that a deposit account "contains funds," as opposed to simply representing a "right to payment from a bank of the money that was deposited by

the customer."

FFB countered that under the plain language of Revised Code 1309.332(B), the only security interest that was extinguished when the funds were transferred to TFC was that in the deposit account itself — not its security interest in "the funds that were in the deposit account as proceeds of accounts receivable." In support of this position, FFB cited Tusa.

Ultimately, the First Appellate District followed Cortland and reversed the trial court's judgment: "We therefore adopt the majority approach and hold that R.C. §1309.332(B) bars recovery for conversion when funds secured by a first-priority security interest transfer through a deposit account to a noncolluding third party. ... Accordingly, FFB cannot recover in conversion from TFC absent collusion, which it has not alleged."

Judge Jennifer Kinsley authored the court's unanimous decision and recounted in great detail the legislative histories of Uniform Commercial Code Section 9-332 and Ohio Revised Code 1309.332(B), and noted that when Section 9-332 was adopted, it codified a widely accepted rule that transferees of funds take free of security interests in the absence of collusion.

The court noted that "[v]irtually every court to consider the question — and every Ohio court to do so in a published decision — has concluded that TFC's reading controls."

Addressing to Tusa, the court explained that

key factual differences separate Tusa ... Tusa dealt with a subordination agreement between the first-priority secured party and the ultimate transferee, and Tusa's reading of the statute was inextricably linked with the parties' contractual agreement. ... The first-priority secured party in Tusa also retained a security interest in specific accounts receivable identified by contract, rather than undefined accounts receivable as a generic asset.

Noting that "there are strong public policy arguments on both sides," the First Appellate District reasoned that

R.C. 1309.332(B) represents the General Assembly's reasoned judgment that funds transferred out of a deposit account should not be the subject of conversion lawsuits absent some evidence that the account holder colluded with the funds' recipient. In the end, this means that security interests in deposit accounts are simply less secure than other forms of collateral.

State Treasurer Modifies Homebuyer Plus Program

In November, the Ohio Treasurer's Office announced significant modifications to previously proposed changes in the Homebuyer Plus Program's interest rate formula.

The Homebuyer Plus Program is a new tax-advantaged savings initiative designed to promote homeownership in Ohio through a linked-deposit model. Initially proposed by Gov. Mike DeWine in his 2023 "State of the State" address and later incorporated into the state operating budget, the program offers Ohio residents access to above-market interest rates at participating financial institutions for saving toward a home purchase.

The revisions announced will substantially reduce the burden on participating banks compared to the original proposal announced in August.

Under the modified framework, the interest rate changes for excess funding accounts will be phased in more gradually than originally planned, with rates capped at 50% of the benchmark rate by the fourth quarter of 2025 rather than 100% as initially proposed.

The Treasurer's Office also committed to further stakeholder discussions in summer 2025 before additional changes are implemented.

Federal Court Halts Beneficial Ownership Reporting

U.S. District Judge Amos Mazzant issued a preliminary injunction in early December in the case of Texas Top Cop Shop v. Garland in the U.S. District Court for the Eastern District of Texas, temporarily halting enforcement of the Financial Crimes Enforcement Network's beneficial ownership information reporting requirements nationwide.

The ruling stayed the compliance obligation for approximately 33 million small businesses that would otherwise have been required to report their beneficial owners.

The National Federation of Independent Business filed the suit challenging the Corporate Transparency Act's constitutionality under the commerce clause and First and Fourth Amendments.

While the injunction provided temporary relief from reporting obligations, banks must continue collecting beneficial ownership information under separate customer due diligence requirements.

Financial institutions should advise business clients that although beneficial ownership information reporting is paused, they should remain prepared for possible reinstatement of the rule pending further updates in this litigation. The banking industry had supported the legislation to shift the collection burden from banks to FinCEN.

First Women-Led Bank Opens in Grandview, Ohio

In a milestone for Ohio's banking sector, Fortuna Bank opened in Grandview in December as the state's first women-run bank. Led by co-founders Lisa Berger and Ilaria Rawlins, the bank aims to close the financial literacy gender gap by creating an approachable environment for women to learn about finances.

The opening represents a significant development in an industry where less than 1% of U.S. banks are led by women.[2]

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Disclosure: The author represented Tailored Fund Cap LLC in the First Financial Bank case.

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[1] First Financial Bank v. Tailored Fund Cap, LLC, 1st Dist. Hamilton No. C-230626, 2024-Ohio-4982.

[2] <https://www.investopedia.com/women-owned-banks-by-state-5115603>.