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SECURED TRANSACTIONS

Cash Collateral—An Illusion or a Reality?

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In *JNET Commc'ns, LLC v. Caldwell* (*In re Servicom, LLC*, 677 B.R. 1 (Bankr. D. Conn., Nov. 2025)) (JNET), the U.S. Bankruptcy Court for the District of Connecticut (the court) confronted a secured creditor's years-long effort to convince the court—and the debtor's estate—that $1.4 million in cash collateral still existed, when in fact it had been spent down to barely $82,000, and that the creditor was entitled to enforce the underlying promissory note despite having relinquished possession of it.

The decision offers a stark reminder that control of cash collateral is not a mere formality under Article 9 of the Uniform Commercial Code; it is the crucial element of perfection itself.

Once spent, cash collateral cannot simply be "replenished" from other sources as if it was always there—and that having an ability to obtain cash is not the same as having control of it. The decision also underscores that possession of a negotiable instrument remains a threshold requirement for enforcement under the UCC, regardless of a party's equitable claim to the underlying debt.

Case Background

JNET Communications, LLC (JNET), Servicom LLC and Vitel Communications, LLC (collectively,

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the Debtors) operated telecommunications businesses. In 2011, the Debtors entered into a Factoring Agreement with Coral Capital Solutions LLC (Coral) pursuant to which accounts receivable were sold to Coral. The arrangement was amended twelve times before the Debtors filed for bankruptcy on Oct. 19, 2018 (the Petition Date).

In 2017, in order to address their increasing liquidity issues, the Debtors and their principals, David Jefferson and Eugene Caldwell (the Guarantors), entered into a Secured Term Note with Coral initially in the principal amount of $750,000 but that later grew through amendments to $1.4 million (the Note).

The Guarantors each personally guaranteed the Note and, over time, provided $1.4 million of cash that was then pledged to Coral as collateral (the Side Collateral). Article 7 of the Note purported to grant Coral "a first priority lien on and security interest in… the Side Collateral." Between November 2017 and June 2018, Coral disbursed the full $1.4 million to JNET under the Note.

Coral had a loan facility with Wells Fargo Bank, N.A. That facility was secured by an all-assets lien on the property of Coral, including the Note, physical possession of which was transferred to Wells Fargo prior to the Petition Date.

Per the terms of the Note, each time the Guarantors wired an installment of the Side Collateral, the funds were initially applied to Coral's "Loan Account"—a revolving secured working-capital facility ledger (not a deposit account) at Wells Fargo, and were then moved to a Wells Fargo "Collateral Account."

Coral did not own or control either the Loan Account or the Collateral Account. Each time money was credited to the Loan Account there was an increase in the amount of money Coral could borrow from Wells Fargo, and each time that credit was transferred to the Collateral Account, there was a decrease in such availability.

On Dec. 11, 2018, Wells Fargo transferred the $1.4 million from the Collateral Account back to Coral's Loan Account per Coral's instruction, thereby increasing Coral's loan availability by $1.4 million, which it then borrowed from Wells Fargo.

Coral then requested return from Wells Fargo of the original Debtors' Note. According to Coral, however, Wells Fargo refused to return the instrument because the $1.4 million had not been credited to the Note and, accordingly, the Note remained unpaid. Coral then borrowed approximately $1.7 million from Wells Fargo and transferred that money to its owned and controlled Operating Account at Wells Fargo.

From there it transferred approximately $1.5 million to its account at another bank and applied roughly $1.5 million to payment of costs of its business operations. Evidence showed that by December 24, 2018, Coral's aggregate cash across all its deposit accounts was no more than $82,181.42.

At least according to the court, over nearly six years of litigation, Coral's representatives and counsel had given inconsistent statements about the location and status of the $1.4 million. In 2019, counsel told the court it was in a "segregated account… not accruing interest." In 2021, counsel admitted it had been commingled and had "completely lost its identity."

By 2024, Coral still could not identify a specific account holding the full amount. The court would go on to characterize Coral's actions surrounding its accounts, and its claims that it consistently held the Side Collateral as cash collateral, as "an illusion."

Analysis/Discussion

The court first tackled Coral's standing to enforce the Note, finding that Coral in fact lacked standing to do so. Under N.Y. UCC §3-301, the right to enforce a negotiable instrument is generally limited to the "holder—defined in N.Y. UCC §1-201(b)(21) as a person in possession of a negotiable instrument that is payable either to the bearer or to an identified person who is the person in possession. In either instance, physical possession is required.

In this case, Chief Judge Nevins applied §3-301 straightforwardly: since Coral had transferred the original Note to Wells Fargo pre-petition and never regained possession, Coral was never in possession of the Note at any relevant time. Citing *Bank of Am., N.A. v. Sebrow,* 180 A.D.3d 982, 985 (2d Dep't. 2020) and *U.S. Bank v. Cadeumag*, 81 Misc. 3d 660, 667 (Sup. Ct. Kings Cnty, 2023), the court held that physical possession is a critical element to enforcement under New York law.

Though N.Y. UCC §3-804 (renumbered as UCC §3-309 under the 1990 amendments to the Official Uniform Code (which have not yet been adopted in New York)), provides an exception that allows enforcement of a lost, destroyed or stolen negotiable instrument even if a person is not in possession of such instrument, the court ruled that the exception does not apply because the Note was not "lost"—Coral knew exactly where it was.

It simply could not get it back. The court further determined that Coral failed to present any evidence that it was authorized by Wells Fargo to enforce the Note while it was in the possession of the bank.

The court then went on to hold that, even assuming its ruling on enforcement of the Note was in error, Coral did not have a perfected security interest in the Side Collateral because it had "used or applied" the $1.4 million of cash delivered to Wells Fargo.

Citing what it referred to as "sloppy transfers" that "prioritized convenience over compliance," the court held that Coral was "mistaken" in believing that "the ability to obtain cash it does not hold, when and if needed, is the same as holding cash as collateral." Instead, the court held with respect to the $1.4 million at issue that "Coral needed to present evidence it *continuously* [emphasis added] held at least that amount in bank accounts it owned or controlled."

Here, each installment of Side Collateral was routed through Coral's Loan Account—not a depository account, then moved to a Collateral Account that Coral never owned or controlled, and then disbursed for various purposes. So even if Coral had control of the cash constituting the Side Collateral, it could not have had control as of Dec. 24, 2018, since it had only $82,181.42 on such date across all its accounts, meaning that it must have "used" the cash.

Next, the court applied the Lowest Intermediate Balance Test and found Coral had used most of the Side Collateral, again reaching the conclusion that Coral must be deemed to have applied the money to the Debtors' obligations.

Once funds are commingled in a general account and the balance drops below the amount claimed as collateral, later deposits cannot replenish the depleted pool. Coral had also argued that having access to cash equal to the collateral amount is functionally equivalent to holding cash collateral, which the court rejected. Once the cash was spent, it ceased to constitute “identifiable proceeds” pursuant to UCC Section 9-315(a)(2).

The court held that since Coral’s aggregate cash balance fell to $82,181.42 by Dec. 24, 2018, the remaining $1,317,818.58 had been used and, under the Note’s own terms, must be deemed applied to the Debtors’ obligations. The $1.4 million in cash collateral had simply ceased to exist, whether or not Coral’s security interest had ever been perfected.

Accordingly, the court completely disallowed Coral’s claim, holding that Coral lacked standing to enforce the Note, and in any event it “never perfected a security interest in the $1.4 million of cash, never held the cash as collateral, was required to pay the $1.4 million of cash to the Debtors’ obligations if Coral no longer held the cash as collateral, and therefore was not owed anything on the Note on the Petition Date.”

It further held both that the ability to borrow money on demand is not “equivalent to holding cash as collateral” and that “the law is clear that later received funds cannot be used to refill or replenish a deposit of cash being held as collateral.”

Conclusion

The *JNET* decision serves as a wake-up call for any secured creditor on two fronts. First, any creditor who has itself pledged a promissory note or other instrument to a third party as collateral should negotiate the right to either re-possess the Note or require the pledgee to enforce the same.

Second, cash collateral must be retained in the minimum amount required for the relevant obligation with an ability to track identifiable proceeds. Importantly, the decision reinforces that perfection of a security interest in cash collateral held in a deposit account requires creditor control and an effort to avoid or at least monitor commingling.

And while from a business perspective having an ability to obtain cash, whether from a transfer from another account or drawing on a line of credit, may be viewed as being as good as having that cash in a deposit account, the UCC would beg to differ, at least insofar as it affects perfection of security interests in that cash (or lack thereof).